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Host Country Legislation: A Necessary Condition?

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Abstract

The subject of this Essay is the adoption of a "legislative guide" on privately financed infrastructure ("PFI") by the United Nations Commission for International Trade Law ("UNCITRAL"), at its plenary session in July 2000 in New York. The guide deals with subjects a host country legislature should consider in deciding whether legislation is needed to attract investment and enable the country to proceed with PFI, such as constitutional and legislative authority; a competitive procurement regime; questions of the exclusivity and duration of concessions; construction, operations, and regulation; and settlement of disputes. UNCITRAL also decided at its plenary session that more work might be needed on this subject: namely the preparation of a model law or at least some model provisions for those countries desiring the same

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The United Nations Commission for International Trade Law ("UNCITRAL"), adopted a "legislative guide" on privately financed infrastructure ("PFI"), at its plenary session in July 2000 in New York. The guide deals with subjects a host country legislature should consider in deciding whether legislation is needed to attract investment and enable the country to proceed with PFI, such as constitutional and legislative authority; a competitive procurement regime; questions of the exclusivity and duration of concessions; construction, operations, and regulation; and settlement of disputes. UNCITRAL also decided at its plenary session that more work might be needed on this subject: namely the preparation of a model law or at least some model provisions for those countries desiring the same. This will be the subject and theme of this Essay, but first some background.

Other essays in this volume make clear that there are now many countries, including emerging and developing ones, privatizing sectors previously within the state structure, inviting private capital both domestic and foreign to build infrastructure and provide services previously public, and negotiating sophisticated financial and operational arrangements to do the same. At the same time many countries, across an enormous range of economic condition, are unsure how to proceed, indeed whether to proceed; their governmental structures are incomplete, their ability to effectively negotiate limited. Much has been written about this: the project finance technique, the required allocation of risks among the several parties, the matrix of contracts involved in a typical project, and the resultant transactional complexity and costs. Pierre Guislain[1] has written about other, interrelated and important, legal and policy aspects: the

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1. LES PRIVATISIONS: UN DEFI STRATEGIQUE JURIDIQUE ET INSTITUTIONNEL (1995) [Privatizations: A Legal and Institutional Challenge].

need for policy for the structure of the sector involved, regulatory policy, and competition policy. As Guislain has said, we do not wish to replace public monopolies with private ones.

This Essay looks at the matter somewhat differently: namely the function of law in a society with respect to something as important to those societies as the provision of public services by private parties or involving private parties and capital. We have to recognize that this shift to the private sector, although it is proceeding, remains controversial in many countries.

Americans writing about the importance of law are often accused of seeking to export American models,[2] although this is less the case in an area such as this where we, like other common law countries, do not—whether at the federal, state, or local level—typically have a coherent legislative structure in place. Nor would I wish to expatiate at length about the "rule of law" as such and how it is implicated in the successful realization of privately financed infrastructure projects. It is true that in many countries the modernization—indeed the creation—of the legal framework, and the many related laws, needed to handle PFI projects (usually called BOT, BOOT, BOO, etc.), does entail law reform, institutional change, and much greater "transparency" and accountability—all the hallmarks of the effort to install or vindicate the rule of law.[3]

What I want to do, rather, is get down to cases, or maybe more precisely the case of what law can and does do within the host country for the PFI phenomenon and specific PFI projects. In essence a proper law, or laws, provides a variety of internal instructions within the country. Most crucially it provides instructions to the relevant parts of the government administration and their "bureaucrats." Moreover, it should ideally do so in an open way, that is to say the policies, obligatory and optional

2. Jacques deLisle, *Lex Americana?: United States Legal Assistance, American Legal Models, and Legal Changes in the Post-Communist World and Beyond*, 20 U. PA. J. INT'L ECON. L. 179 (1999).

3. UNCITRAL often deals with the harmonization of existing law, viz the United Nations Sales Convention, work on arbitration, and work on procurement, but often in recent years we have been closer to creation or development of proposed law, viz the Model Law on Electronic Commerce. The work on PFI tends towards that—when we began our work there were virtually no useful national examples; as time goes on, of course, more effective national laws have emerged and UNCITRAL becomes more able to harmonize the best among them, or at least consolidate the best national practices they have given rise to.

terms for the BOT, BOOT, BOO, etc. arrangements and techniques, should be dictated and communicated in such a way that the private sector knows them. One should avoid to the greatest extent what in China is called *neibu*, i.e., internal government regulations or instructions known only to the bureaucracy and not to the citizenry or private sector to whom they also apply and with whom they deal. But there is, in my view, a far more important and larger recipient for the instructions of a good law, and that is the people, their government and their legislators. Indeed, most crucial ultimately is the *formulation* of the instructions by government and legislatures by such procedures and in such a way that they themselves and the public comes to understand and accept the utility and legitimacy of PFI. This is not always—indeed may rarely be—easy, and governments may prefer to move to such policies by indirection and in increments. Histories of foreign exploitation or domestic distaste for capitalism may complicate the politics of privatization and PFI, and in addition there will be competition and other economic policy arguments pro and con. Each country must fight its own battles. The formulation and enactment of sound law, if possible and if effectively done, should strengthen support for PFI projects and in turn constitute a kind of instruction to the society about them.

To be sure there may be many who, in my view mistakenly, do not think a sound law necessary, and paradoxically others who believe the subject of infrastructure and the attendant public services too important to be limited by such sound law. First, to those who may not think laws necessary or at least believe them inconvenient. Unfortunately, and shortsightedly, this may include some of the key players, the parties to the BOT/PFI matrix of contracts. To be sure they will wish their contracts to be enforceable. But private commercial lenders and their lawyers, often talk as if the general legal framework (a law dealing with core BOT or PFI issues) within the host project country is a matter of some indifference to them; to be sure they want to be secured (and a specific law dealing with security interests might therefore be desirable) and/or guaranteed. Possibly the export credit agencies and other public sector lenders may have a different view.

The investors/sponsors, and their lawyers, also tend to minimize the importance of laws. More precisely, they will be hostile to laws that interfere with their ability to freely bargain the terms

of project agreements/concessions with governments. Of course I share their desire to be able to do so, but proper laws may need to be in place to enable them to do so, laws that eliminate the obstacles that exist in many countries or the uncertainties that exist in others. Additionally, both lenders and investors may underestimate the anxieties of governments, especially over the level, continuity, and cost of the public services to be provided. Governments may also underestimate the value of sound laws. Thus contracting agencies may not properly appreciate the need for legal provisions for a sound competitive method for selection of the concessionaire; rather they may just want to contract with sponsors offering the lowest price, say for a cubic meter of water or a highway toll rate—but to so limit the selection criteria may be shortsighted indeed.

Conversely, there are those who think PFI too important for mere laws. These may include the "custodians" of the public services, the ministries, agencies, cities, and others responsible for the provision of the same. To begin, they may be hostile to surrendering the provision of services to the private sector; but if this must be done, they will wish to preserve great control over the projects. This tendency is very much in evidence in the legal structure of those civil law countries that have a special body of administrative law, and administrative tribunals to go with them, to govern contracts with government. The ability of governments to unilaterally vary the parameters of a project may well render them unbankable. So too the multilateral lending agencies, having the clout to protect their rights, may sometimes be too indifferent to the necessity to have sound laws in place to protect the rights of, and provide remedies to, lenders and investors. And even those who see the necessity of industry structure, competition law and laws creating regulatory regimes may not always focus sufficiently on the needs of private sector investors and lenders.

Stepping back from all these specifics, we see an underlying theme, a dialectic at this particular point in time: two inexorable forces, the interventionist imperative that many governments respond to, versus the needs of business and capital to bargain freely with those governments for maximum flexibility, efficiency, and security.

So what is to be done? As I have already suggested at the beginning of this Essay, UNCITRAL remains seized of this mat-

ter. More precisely, the Commission decided in July 2000 at its plenary to determine whether to proceed with a model law or provisions. This determination will be assisted by a colloquium to be held in Vienna from July 2 to 4, 2001, to be jointly sponsored by UNCITRAL and the World Bank.

I believe strongly that UNCITRAL should, and can, proceed to prepare either a model law dealing with the core PFI issues or, in the alternative, a checklist of such issues and individual model provisions. The Commission has indicated as much on several occasions. The law or checklist would be limited to the core issues; important matters, such as a law for the foreign direct investment regime, and even security interests law would not be included in the core. Whether procurement/selection of the concessionaire should be included is problematic. Probably it would not; rather there would be a reference to the UNCITRAL Model Procurement Law and possibly a short provision adapting that law to PFI projects (in a particular country, the adaptation and reference would be to that country's actual procurement law, assuming it to be otherwise adequate). A similar approach would be taken to other areas of law, e.g., security interests law, where it would be assumed that a country has such a law suitable for PFI projects, or would separately prepare one, and the PFI core law would again merely adapt and refer to it.

The law "reform" (creation of new law and/or review and modification of existing law) urged in this Essay is what many countries are engaged in, in many areas of commercial law, whether public or private. Work in UNCITRAL and other international bodies engaged in such law making and harmonization[4] increasingly seeks to respond to practical and market imperatives, rather than debating the doctrinal niceties of the common and civil law, or other bodies of law, or their national variations. This is especially the case in an area such as PFI and the attendant need for practical reconciliation of the imperatives already mentioned: how to create a legal climate, a framework to attract

4. These include UNIDROIT, currently working, inter alia, on security interests in mobile equipment, the Hague Conference on Private International Law working on a judgments convention and on security interests intermediaries, and the periodic OAS conferences on private international law ("CIDIPs")—the current one is working on loan financings and security interests; incidentally an about to be completed UNCITRAL project deals with the very practical and market driven subject of accounts receivables financing.

private capital for the construction and operation of infrastructure and public services, on terms deemed satisfactory by governments.

UNCITRAL, and its method of successive studies and drafts by the Secretariat (with or without the benefit of outside expert advice), combined with thorough review and discussion by the Commission and its working groups, is suited to determine, codify, and refine the best practice of the market and legislation, into the requisite model legal provisions. It is my submission that this is necessary for many countries to be able to begin to realistically put their houses in order, so as to attract private capital and enterprise into the infrastructure sectors, which they wish to develop, and to be able to negotiate effectively with them. Of course it is not the sufficient condition (which also entails government and policy making organization, and the acquisition of further expertise and experience), but in many cases it is the necessary condition.