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A Standard Contract for PPPs the World Over: Recommended PPP Contractual Provisions Submitted to the G20

An essay by Steven Shrybman and Scott Sinclair

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CONTENTS

Executive Summary 7

A one-sided approach to dealing with risk under the PPP contract 8

Dispute resolution proposals similarly privilege the private party 9

1. A global template for PPP schemes 10

2. Default/termination under a PPP contract 11

Force majeure 12

Material adverse government action, and change in law 12

Termination payments 17

Failing to account for contracting authority losses when the private partner defaults 18

Dispute resolution 20

Conclusions 26

EXECUTIVE SUMMARY

At the request of the G20, staff at the World Bank has prepared a report recommending model language for public-private partnership (PPP) contracts.[1] Those proposals to standardize PPP contract language were presented by the World Bank Group and the Public-Private Infrastructure Advisory Facility PPIAF to the September 2015 meeting of the G20 Meeting of Finance Ministers and Central Bank Governors (the "Report").[2]

The G20 consists of the major shareholders of most existing and new Development Finance Institutions (DFIs). As a result, the G20 is a conduit — through the DFIs, such as the World Bank Group — to the PPP and investment promotion units in governments around the world.

The WBG/PPIAF proposals are part of an international effort to accelerate and replicate PPPs worldwide by standardizing many aspects of PPP regimes– from feasibility studies, to contracts, and procurement. Such standardization is being promoted in an effort to reduce the time for concluding PPP arrangements from roughly seven to three years.

In standardizing contracts, it is important to treat public and private interests in an even by-handed way, particularly because many governments lack the readiness and capacity negotiate and implement PPPs. For instance, the Economist Intelligent Unit, in collaboration with several banks, measures the readiness and capacity of governments with regard to their legislative/regulatory frameworks; institutional capacity; operational maturity; investment climate; financing facilities; and subnational capacity. In its evaluation of 15 countries in Africa, it found that with the exception of South Africa, 14 countries had low or very low abilities to implement infrastructure PPPs. In the evaluation of 17 developing countries in the Asia-Pacific region, only India and the Philippines had "good" ratings; the others had low or very low ratings.[3]

Even-handedness is also crucial because even determined proponents of the PPP model admit that it "has become tarnished by its waste, inflexibility and lack of transparency,"[4] and are now proposing reforms they claim will ameliorate these problems.[5]

Unfortunately, for the reasons set out below, the WBG/PPIAF proposals fail to grapple with several of the problems that have plagued many PPP schemes, or contribute in a constructive way to finding solutions to them. The failure is largely the consequence

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1 The critique of the Dispute Provisions of the WBG/PPIAF proposals was provided by Mr. Sinclair.

2 World Bank Group, PPIAF; *Report of Recommended PPP Contract Provisions*, 2015 Edition.

3 The 2014 Infrascope: Evaluating the environment for public-private partnerships in Latin America Complete the registration form opposite to download the 2014 Infrascope Index and Report. http://www.eiu.com/public/topical_report.aspx?campaignid=Infrascope2014

4 H M Treasury, *A new approach to public private partnerships*; December 2012, p. 3.

5 Idem.

of the authors' preoccupation with the interests of private investors that is evident throughout their report in proposals which are often skewed to favour private interests to the prejudice of the public entities that are ostensibly the beneficiaries of the projects and services being contracted for.

That preoccupation is most apparent in the Report's focus on the various triggers that allow the Private Partner to such a scheme to terminate a PPP contract while ameliorating the financial consequences of that failure for private investors, as well as in proposals for the resolution of disputes under the PPP contract.

A one-sided approach to dealing with risk under the PPP contract

Under the headings *Material Adverse Government Action (MAGA)*, and *Change in Law,* WGB/PPIAF proposals would impose the risks and PPP costs arising from shifts in public policy and law — as well as from events such as labour protests, over which the Contracting Authority may have no control — entirely on the Contracting Authority. While this allocation of risk in cases such as outright expropriation is understandable, imposing the same burden in cases where the Contracting Authority has no control, or in cases of good faith and non-discriminatory regulation established to achieve valid public purposes such as greenhouse gas emission reductions or public health protection, is not.

As the WBG/PPIAF admits, assigning these risks to the Contracting Authority privileges PPP investors relative to those in non-PPP enterprises that are similarly impacted but which have no right to compensation. Such unequal treatment might well discourage domestic capital formation and investment, and lead to calls from all sectors for similar compensation — a result that would very likely impose a chill on the development of needed reforms to policy and law.

By equating the concepts of *MAGA* and *Change In Law* with default or voluntary termination by the Contracting Authority, the WBG/PPIAF proposes a compensation regime that entitles the Private Partner to terminate the PPP contract in such cases, and to be fully compensated for any consequential damages, including the loss of future profits. In doing so, WBG/PPIAF proposals not only create unnecessary triggers for terminating PPP contracts, but fall at the extreme end of contemporary PPP contract norms for allocating risk as between the public and private parties to such contracts.

By requiring the Contracting Authority to pay compensation even in the event of Private Partner default, WBG/PPIAF proposals also depart from conventional norms. These ensure that when PPP projects fail because the Private Partner has not met its obligations under the contract, then the Contracting Authority is protected from having to pay the Private Partner more than the value of the infrastructure it may acquire once projects are underway or complete. WBG/PPIAF proposals also entirely ignore the circumstances of PPP services contracts where compensation is often paid to the Contracting Authority in the event of default by its Private Partner.

Dispute resolution proposals similarly privilege the private party

There is no doubt that PPP contracts must provide recourse to fair and transparent dispute resolution processes. However, relying on the globally controversial system of investor–state dispute settlement (ISDS), as the WBG/PPIAF proposals do, ignores the mounting evidence that ISDS favours investors at the expense of public policy and democratic governance, leading many countries to look for other solutions. State and public interests generally suffer when concession contracts become entangled in the ISDS system.

When efforts to resolve a dispute amicably or through alternative dispute settlement procedures fail, recourse to the domestic courts is essential to building capacity and strengthening local institutions, particularly in developing countries. The recommended proposals take the opposite approach, allowing PPP investors to bypass domestic courts entirely, while expanding the power of international investment arbitration tribunals to adjudicate not only breaches of investment treaties, but also disputes regarding the concession agreement itself.

A fairer and more independent international dispute resolution process would establish a permanent international body to adjudicate disputes related to public contracts, including PPPs. The WBG/PPIAF dispute resolution proposals, in contrast, rely on ISDS as the ultimate means to settle disputes. Like too many of the Report's other proposals, this unfairly privileges Private Partners and financiers at the expense of governments, citizens and taxpayers.

1. A global template for PPP schemes

The WBG/PPIAF Report recognizes that much of the legal framework for a PPP must be negotiated to reflect the particular project involved and the legal system within which it will be situated. The proposals for contract terms are therefore limited to a handful of key and "typically encountered provisions" of a PPP contract. Nevertheless, with some adaptations, its proposed model is meant to be disseminated worldwide — to developed and developing countries alike.

Model contract terms[6] are set out under eight headings: *Force Majeure*; *Material Adverse Government Action*; *Change in Law*; *Termination Payments*; *Refinancing*; *Lenders' Step-in Rights*; *Confidentiality and Transparency*; and *Dispute Resolution*. As noted, in proposing model contract language for only certain aspects of a PPP scheme the principal focus of the Report is on the various ways in which such schemes may fail and on the consequences for private investors when they do.

In several respects the WBG/PPIAF proposals cover ground that has been addressed more thoroughly in other works that have also presented model PPP contract terms.[7] In some respects these proposals accord fairly closely to common practice in drafting such contracts. However, in other instances the proposals stray from the conventions, and it is these departures that are the focus of the following analysis.[8]

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6 The purpose of the Report is to present and discuss 'recommended' language in respect of a selection of these typically encountered provisions. The 'recommendations' contained in the Report are not meant to be prescriptive — specifically, they are not mandatory clauses for use in all PPP transactions which the World Bank Group financially supports.

7 See for example fns. 4, 15 and 23 and also see Private Partner in Infrastructure Resource Center for Contracts, Laws and Regulations (PPPIRC) Reviewed: Robert Phillips, LEGPS http://www.worldbank.org/pppFebruary 2007

8 This analysis adopts the nomenclature of the WBG/PPIAF Report in describing the public and private entities involved in a PPP contract. These define the public partner as the "Contracting Authority", and "Private Partner" to mean the private company that enters into the PPP Contract with the Contracting Authority. The Private Partner often takes the form of a special purpose company.

2. Default/termination under a PPP contract

The first three aspects of a PPP contract addressed by the WBG/PPIAF proposals concern the triggers for default and/or termination of the PPP contract: "*Force Majeure*"; "*Material Adverse Government Action*"; and "*Change in Law*".

It is generally the case under most commercial contracts that if either party fails to meet one of its material obligations, the 'damaged' party has the right to terminate the contract. Under a PPP contract, this means that both parties should have the right to terminate if the other defaults on one of its key obligations.

The first thing to note, therefore, about the WBG/PPIAF Proposals is that they almost exclusively concern the actions and conduct of the Contracting Authority that may justify termination of the PPP contract by the Private Partner, with very little consideration being given to the circumstances of default by Private Partner. [9]

The same focus on the interests of the Private Partner is evident in how the Report's approach to the question of *Termination Payments* is addressed. Thus little attention is paid to the non-financial consequences of PPP project failures when necessary infrastructure projects are delayed or abandoned, or when the provision of important public services is interrupted. The seriousness of such consequences explains why French PPP contracts do not usually recognize the right of a Private Partner to terminate the contract following default by the Contracting Authority. In the event of a breach or default by the Contracting Authority, the Private Partner is expected to seek an amicable settlement. If this fails, they are expected to resort to the relevant administrative court.

Unfortunately, the importance of preserving the viability of the PPP projects is virtually absent from WBG/PPIAF Report, which is far more concerned with the goal of ensuring that the Private Partner is compensated when they fail.

9 PPP contracts will often include an itemised default list of Private Partner Default events that include:

- insolvency/bankruptcy of the Private Partner;
- failure of the Private Partner to reach certain construction milestones or project completion;
- failure of the Private Partner to deliver the services according to the agreed specifications;
- penalty points (awarded for intermittent failures to deliver services) that exceed specified thresholds;
- change of ownership of the Private Partner without the consent of the Authority; and
- failure to insure the PPP project assets/business as required.

Force majeure

All PPP contracts deal with the question of *Force Majeure* — circumstances which are beyond the control of the contracting parties and make it impossible for one or both to fulfill their respective obligations under the PPP contract.

PPP contracts typically adopt one of two approaches to defining *Force Majeure* events, either giving the term a broad definition to include any event that is unforeseeable, beyond the control of the parties and that makes it impossible for either party to perform its obligations under the contract; or by providing an itemized list of such events.

The WBG/PPIAF proposals adopt the latter approach and include the typical array of natural as well as political events such as war, acts of terrorism, nuclear explosions, natural disasters (e.g. earthquakes, landslides, floods), strikes and protests. Where the Report departs from conventional norms is to include in the definition of *Force Majeure* events:

> general labor disturbance such as boycotts, strikes and lock-out, go-slow, occupation of factories and premises, excluding similar events which are unique to the PPP Project and specific to the Private Partner or to its subcontractors, <u>and occurring outside the Country</u> (emphasis added).

The intent of the provision is unclear and could be clarified. An interruption, or failure of the PPP project caused by a strike or boycott directed at the Private Partner which occurs outside the country, should be considered default by the Private Partner not a *Force Majeure* event. However the same is not necessarily true when the focus of the protest is the PPP project itself rather than one party to it. The treatment of similar events occurring within the contracting country is addressed under the heading *Material Adverse Government Action,* and is considered below.

Material adverse government action, and change in law

Proposed contract terms presented under these two headings would allocate the risks arising from shifts in public policy and law, but also from events, such as labour protests, over which the government may have little control — to the Contracting Authority. In such cases the Private Partner is entitled to compensation for costs and losses arising from such changes or events.

In certain instances, such as outright expropriation, the proposed allocation of risk is understandable. In others, such as good faith and non-discriminatory regulation to reduce greenhouse gas emissions or protect public health, the justification for compensating PPP investors for the costs such reforms may impose is far from obvious. Moreover, as the WBG/PPIAF admits, such an arrangement would privilege PPP investors relative to those in non-PPP enterprises that are similarly impacted.[10] Such structural

10 Report p. 19

inequity might well discourage domestic capital formation and investment in emerging markets, or lead to calls from all sectors for similar compensation. Such a result would be very likely to impose a chill on the development of needed reforms to policy and law.

Material Adverse Government Action

The WBG/PPIAF proposals use the concept of *Material Adverse Government Action* (or *MAGA*), or "political force Majeure" as the phenomenon is also described, as the means for allocating certain types of "political" risk to the Contracting Authority. *MAGA* is defined to mean:

> any act or omission by the Contracting Authority or any relevant public authority, which occurs during the term of this PPP Contract and which (i) renders the Private Partner unable to comply with all or a material part of its obligations under the PPP Contract and/or (ii) has a material adverse effect on the cost or the profits arising from such performance. [11]

> Where a *MAGA* event occurs,

> the Private Partner (i) shall be excused from the performance of its obligations under the PPP Contract to the extent that it is prevented, hindered or delayed in the performance of such obligations by reason of the Material Adverse Government Action and (ii) shall be entitled to compensation under this PPP Contract, in each case subject to and in accordance with the provisions of this clause.[12]

While the Report proposes that both parties would have the right to terminate the PPP Contract in the event of a *MAGA* lasting longer than a certain period of time (generally between 6 to 12 months), the occurrence of a *MAGA* is treated as default by the Contracting Authority. This allocates the costs and losses that may be the consequence of such an event entirely to the Contracting Authority, whereas in the case of *Force Majeure*, the financial costs are to be shared.

As noted, that assignment of risk is arguably justified in the case of certain forms of government action, such as expropriation of project assets or the discriminatory application of existing laws, but the net cast by the Report's proposals is far more expansive and includes various acts or alleged omissions by governments over which the Contracting Authority may have little if any control. Thus while acknowledging the overlap with *Force Majeure*, the Report nevertheless includes the following occurrences under the *MAGA* heading:

11 Report 2.2 (1)
12 Report 2.2 (3)

. . .

b) any act of war (whether declared or undeclared), invasion, armed conflict or act of foreign enemy, blockade, embargo or revolution, [occurring inside the Country];

c) radioactive contamination or ionising radiation, [originating from a source in the Country];

d) any riot, insurrection, civil commotion, act or campaign of terrorism, [occurring inside the Country];

e) any strike, work-to-rule, or go-slow which is not primarily motivated by a desire to influence the actions of the Affected Party so as to preserve or improve conditions of employment, [occurring inside the Country];

Clearly such events may interfere with or even destroy a PPP project, but there seems to be little justification for imposing the costs resulting from such events entirely on the Contracting Authority. As is true in the case of *Force Majeure* events, such unforeseen events call for a more equitable sharing of the costs that may result. Nevertheless, where *MAGA* events interfere with the way in which the Private Partner may operate, or the profits it would make under the PPP scheme, it is the Contracting Authority that must entirely bear the costs.

Change in Law

The skewed concern for the interests of the Private Partner is even more evident in the *Change in Law* provisions of the WBG/PPIAF Report, which apply to the following events:

(i) the enactment of any new Applicable Law;
(ii) the repeal, modification or re-enactment of any existing Applicable Law;
(iii) a change in the interpretation or application of any Applicable Law;
(iv) the imposition by any government entity of any material condition in connection with the issuance, renewal or modification, or the revocation or non-renewal (other than in accordance with the existing Applicable Law) of any Approval; and/or
(v) the imposition or levying of any taxes on the Private Partner or the increase or decrease in the tax rate of any taxes, which was not foreseeable at the date on which the successful bidder submitted its bid,

which

(a) has a material adverse effect on (i) the ability of a Party to comply with its material obligations under the PPP Contract or (ii) the shareholder profits arising from such performance; and

(b) was not published as a draft law [in the Government Gazette] at the date on which the successful bidder submitted its bid.

In setting out the consequences that follow from such events, the Report offers two alternative approaches.

The first, which is presented as the 'traditional' approach, requires the Private Partner to be compensated for any previously undisclosed change in law, without regard to whether that change in law is discriminatory in respect of the Private Partner or the PPP project. The other, which has been recommended as part of the UK's efforts to make PPPs more palatable,[13] provides a more balanced approach to risk allocation, which would entitle the Private Partner to compensation only where it is seriously impacted by a) discriminatory change in law, i.e., change in law applying to the PPP Project or Partner, and not to other projects or operators; or b) general changes in law which would require the Private Partner to incur capital expenditures during the operations period (and not during the construction period).

As the WBG/PPIAF Report acknowledges, the 'reformed' approach is generally more beneficial to the Contracting Authority, but warns that it may not be "bankable" if lenders balk at such terms.

However, even the reform model for *Change in Law* risk allocation is problematic. Take, for example, changes in law established to meet greenhouse gas emission reduction targets mandated under international law — such as a carbon tax or a cap on emissions. Both might compel or provide a strong incentive for emitters to invest in efficiency or abatement technology. Given that the duration of PPP contracts will often span decades, it is likely that many will have to contend with such measures to reduce GHG emissions.

Under the 'UK' reform scheme, Private Partners would be entitled to recover the costs of such capital investments (above specified thresholds and if occurring within the operations phase) from the Contracting Authority. While there might be an accounting for the savings in energy use brought about by such measures (which entails its own costs), the Private Partner will enjoy a privileged position in relation to all other similarly impacted private sector parties in that jurisdiction. Providing such preferential treatment, often to the benefit of foreign investors, will obviously put other non-PPP companies and investors at a competitive disadvantage. Moreover, the inequity of such an approach may itself operate to discourage public support for needed environmental reforms.

In addition, the right to compensation for such capital expenditures may blunt the incentive for a Private Partner to find the most efficient and cost effective means for achieving the desired reduction in GHG emissions. There is also the risk that a Private Partner, unwilling to incur the costs of compliance, even though these are recoverable, may seize on a *Change in Law* event to invoke its right to terminate the PPP contract on

13 See fn. 4.

terms that entitle it to full compensation, including for future profits.[14] For nothing in the WBG/PPIAF proposals require the Private Partner to make its best, or for that matter any, effort to comply with a *Change in Law*.

Furthermore, even the less onerous requirements of the 'reform' approach are at odds with current trends in the United States PPP Market[15] which entitle Private Partners to compensation only when adversely impacted by discriminatory changes in the law, and only then, when the Contracting Authority is itself the author of the change. The application of these principles to state highway projects is described by the U.S. Department of Transportation[16] this way:

(1) The Developer generally bears any negative financial impact associated with any unforeseen change in Federal law on the basis that (unlike with respect to other transportation sectors (e.g., aviation)) regulation of highways is largely devolved down to State government, the private business community is as well (if not better) placed as any Department to address any pending Change in Law, and (subject to the terms of the toll rate schedule) an increase in toll rates may afford some level of "hedge" against any negative impact of such a Change in Law.
(2) With respect to any unforeseen change in a non-Federal law, the Department only bears any negative financial impact associated with such Change in Law to the extent that it is a "Discriminatory Change in Law" (see Section 6.5 below for a discussion of the definition of Discriminatory Change in Law).
(3) The negative financial impact associated with any "Nondiscriminatory Change in Law" are generally borne by the Developer, except that with respect to changes in sales tax rates or exemptions (whether of general application to suppliers or not), protection is often afforded to the Developer (see Section 6.6 below).[17]

Thus, in stark contrast to the WBG/PPIAF approach, the Contracting Authority is to bear the *Change In Law* risk only where it is the author of discriminatory reforms. In such a case the Private Partner is to be compensated to leave it in no better and no worse position than it would have been in had such a change in law not arisen. With respect to any other unforeseeable change in law, the Private Partner may be afforded performance relief in order to bring itself into to compliance, but it must bear the costs of doing so.

In sum: WBG/PPIAF proposals under the heading *Material Adverse Government Action*, and *Change in Law* decidedly favour the interests of the Private Partner and may significantly discourage public authorities from implementing progressive policy and

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14 Under the proposed contract language *Option 1: Protection Against All Changes in Law*, section 5: *Termination due to Change in Law*, both parties are entitled to terminate the PPP contract where non-compliance with new requirements persist. The same rights exist under the proposed *Option 2: Protection Against Discriminatory or Specific Changes in Law.*

15 U.S. Department of Transportation Federal Highway Administration: Model Public Private Partnerships Core Toll Concessions Contract Guide — Sept 2014. p. 42. http://www.fhwa.dot.gov/ipd/p3/resources/p3_core_toll_concession_contract_guide.aspx

16 Idem.

17 Idem.

law reforms, even where these are mandated under international law. Moreover, the proposed contract terms would impose significant obligations on Contracting Authority to compensate the Private Partner for impacts arising from events over which it may have no control, a problem that is considered further under the next heading.

Termination payments

The lack of balance in addressing the interests of the public and private partners can also be seen in the contract terms proposed for *Termination Payments*, which are correctly described as a "key element of the risk allocation in the PPP contract."

In the case of voluntary termination by the Contracting Authority (for public policy purposes), or termination for Contracting Authority default, WGB/PPIAF proposals are in keeping with conventional norms. In such cases, the Private Partner is generally allowed to terminate the PPP contract where the Contracting Authority acts in a way which either (a) renders the parties' contractual relationship untenable or, (b) completely frustrates the Private Partner's ability to meet its obligations under the PPP contract.[18] Where this occurs, the Contracting Authority is to pay the Private Partner sufficient compensation to ensure that the Private Partner is left in no better or no worse economic position than it would have been had the early termination not occurred and the PPP continued until the last day of its term.

In other circumstances, however, WGB/PPIAF proposals represent a significant departure from contemporary practices that recognize the need to provide for an equitable sharing of the risks presented by the PPP. This is particularly true of the proposals for *Termination Payments* to be made because of i) *MAGA* or *Change in Law* events; or ii) Private Partner default.

Expanding the scope and quantum of compensation to the private partner

As described above, WBG/Proposals conflate the concepts of Contracting Authority default and voluntary termination with *MAGA* and *Change in Law* events. Thus the Report proposes:

> If the PPP Contract is terminated upon Contracting Authority default, prolonged MAGA, Change in Law or termination by the Contracting Authority for public policy reasons, the Private Partner should obtain repayment of the sums used to finance the Project (equity and debt), as well as expected returns for a determined number of years to be negotiated between the Parties and not exceeding the contractual term of the PPP Contract. In order to be left in in the same position as if the PPP Contract had not been terminated, the Private

18 Even in this case, the Contracting Authority would generally have the benefit of a cure period to allow it an opportunity to cure the relevant default and avoid the early termination of the PPP for its default.

Partner will also expect to be compensated for any redundancy payments incurred, as well as for costs payable as a result of the early termination of its subcontracts.

The PPP convention of assigning the risks of voluntary termination or Contracting Authority default entirely to the Contracting Authority is grounded in the control it has over those events. Yet as noted, WBG/PPIAF proposals define *MAGA* to include events over which the Contracting Authority would have little if any control. Such events are similar and in some cases identical to those considered *Force Majeure*. Because *Force Majeure* events are the fault of neither party, the normative PPP practice is to have the public and private parties share the financial impacts that may arise from them, it is not to assign these costs entirely to the Contracting Authority.

Equally problematic is the proposal to save the Private Partner harmless in the event of project fails because of a *Change in Law* event. To begin with, and as noted, under the normative approach in the U.S., a Private Partner is entitled to compensation when the law changes, but only when the change is discriminatory. Moreover, while those norms contemplate allowing the Private Partner to suspend performance under the PPP until it can bring itself into compliance with new and unforeseen legal requirements, it is not entitled to terminate the PPP on account of those legal reforms. If discriminatory legal changes actually made performance of the contract impossible, they should arguably be considered indirect expropriation and dealt with as such.

In short, by conflating the concepts of *MAGA* and *Change In Law* with default or voluntary termination by the Contracting Authority, the WBG/PPIAF proposes a compensation regime that favours the interests of Private Partners to an extent that falls at the far end of contemporary norms adopted by leading authorities on PPP arrangements.[19]

Failing to account for contracting authority losses when the private partner defaults

The one-sided nature of WBG/PPIAF contract terms are also apparent in the proposal to compensate a Private Partner in the event of its own default. While devoting considerable attention to the various ways in which default can arise because of the actions or inaction of the Contracting Authority, as noted, the Report makes no effort to describe circumstances of Private Partner default even though they as readily lend themselves to expression as model contract terms.

Rather, the only effort to address the issue of Private Partner default is set out in a perfunctory provision for ensuring that the Private Partner and its lenders are compensated in the event of such default. Thus proposed provision 4.3-2 provides:

Termination upon Private Partner Default

If the Contracting Authority terminates this PPP Contract in the event of a

19 See for example fn. 15 pp. 41-43.

[Private Partner Event of Default], the Contracting Authority shall pay to the Private Partner a compensation amount equal to [80 to 85]% of the Outstanding Senior Debt.

The rationale for such payments is to avoid a situation in which "the Contracting Authority could otherwise benefit from the default of the Private Partner (by, for instance, retaining the asset while paying no compensation) and would thus be incentivized for terminating the PPP Contract."

However the WBG/PPIAF recognizes that if entitled to the entirety of their investment in the PPP project, whatever the failures of the Private Partner, lenders will have limited interest in ensuring that the Project performs, and become less involved in monitoring and restructuring the Project.[20] As a result, the proposal is that lenders take a "haircut" and be compensated only to 80-85% of their outstanding debt entitlement.

While it is common for the Private Partner to be compensated in the event of its own default in the case of infrastructure projects, entirely overlooked by the WBG/PPIAF proposals is that under PPP service contracts, it is often the case that the Private Partner, not the Contracting Authority, makes a payment on termination.[21]

The other problem with the blanket compensation the WBG/PPIAF proposes is that it may unfairly burden the Contracting Authority when the costs of compensating the lenders, having regard to the costs necessary to complete or repair the project, exceeds the value of the infrastructure. The authors recognize the problem and refer to the UK PF2 standards that propose, as the fairest approach, the market value approach to calculating the compensation that may be payable to the Private Partner. This is ensure that the Contracting Authority will not have pay the Private Partner more than the value of the infrastructure it contracted for. [22]

The PF2 approach is not, however, included in the recommended contract terms, even as an option, based on the concern that lenders may be reluctant to participate in PPP projects on such terms, at least in emerging markets. No authority is cited for that assessment, and as noted, WBG/PPIAF proposals are advocated as a global standard, not simply one to be adopted for PPP projects in emerging markets.

In fact, a survey conducted for a leading European authority on PPPs[23] indicates that of the countries surveyed, only Turkey has adopted debt-based compensation of the type recommended by the WBG/PPIAF as the general approach to PPP contracts. Most nations surveyed favour some form of market, or book-value assessment — the two approaches rejected by the WBG/PPIAF. [24]

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20 Report p. 30 and also see for example fn. 15 p. 54.

21 See fn. 15, p. 53.

22 Report p. 31.

23 European PPP Expertise Centre: *Termination and Force Majeure Provisions in PPP Contracts*. The European PPP Expertise Centre (EPEC) is an initiative involving the European Investment Bank, the European Commission and European Union Member States and Candidate Countries. EPEC's mandate is to "strengthen the capacity of its public sector members to enter into Public Private Partnership (PPP) transactions." http://www.eib.org/epec/resources/Termination_Report_public_version.pdf

24 Idem, p. 39.

Arguably, a rational allocation of the costs of Private Partner default would at a minimum adjust *Termination Payments* to the Private Partner to reflect the cost of completing or curing any deficiencies of the PPP project. If the construction of the Project is not complete, then the termination compensation will generally be calculated by reference to the value of the work performed to date (taking into account the anticipated cost to the Contracting Authority of completing the remaining work) and having regard to the amount owed to the Private Partner lenders.

Thus deductions from payments to the Private Partner on account of any outstanding debt would include the cost to complete or repair the PPP project including:

(i) the costs of carrying out any process to request tenders from any parties interested in completing the project entering into a contract;
(ii) the costs of negotiation and execution of relevant contracts which are often very considerable;
(iii) the costs that the Private Partner reasonably and properly projects that it will incur in achieving [Substantial Completion]; and
(iv) any other losses the Private Partner would, but for the termination of PPO (sic.) not have incurred prior to completion of the PPP.

This calculation provides Private Party lenders with some comfort that they will receive compensation in the event of a termination, but also provides the Contracting Authority with the opportunity to ensure that it does not pay any more than is necessary to receive the project it originally contracted for.

As the EPEC survey states: “The market value approach is in principle the fairest, as the Authority is required to pay compensation equivalent to what the impaired contract is effectively worth. As a result, there is a much reduced risk of unjust enrichment or overpayment”.

Where a project is substantially complete when default occurs, the WGB/PPIAF proposal may provide for an equitable allocation of the consequences of such default. In other cases, it would not.

Dispute resolution

WBG/PPIAF proposals for the resolution of PPP disputes are just as problematic as the recommendations for substantive provisions discussed in detail above. There is no doubt that PPP contracts, which are extremely complex and span several decades, need to provide recourse to fair and transparent *Dispute Resolution* processes. While some of the procedures proposed by the WBG/PPIAF are reasonable, their reliance on the globally controversial system of investor–state arbitration is a fatal flaw.[25]

25 “The arbitration game: governments are souring on treaties to protect foreign investors.” *The Economist*. Oct. 11, 2014. http://www.economist.com/news/finance-and-economics/21623756-governments-are-souring-treaties-protect-foreign-investors-arbitration.

The world is waking up to the fact that investor–state dispute settlement (ISDS) is neither fair nor independent. On the contrary, it exhibits a systemic bias in favour of investors at the expense of public policy and democratic governance, leading many developing countries to limit their exposure to ISDS.

Brazil, for example, has never ratified a treaty that included ISDS, and Argentina, which still faces millions of dollars in unresolved claims from its 2001 financial crisis, has been a vocal critic. South Africa intends to end the use of ISDS in its trade and investment treaties. Indonesia has also indicated it will let its existing treaties that include ISDS expire. Ecuador, Bolivia and Venezuela have withdrawn from the Convention on the Settlement of Investment Disputes between States and Nationals of Other States administered by the World Bank and are terminating their bilateral investment treaties.

Even in Europe, where ISDS was conceived in the post-colonial era, there are rumblings. In response to intense public pressure, the European Commission (EC) recently proposed reforms to replace traditional ISDS processes in its internal and external trade and investment treaties with an international investment court.[26]

Recommended reliance on ISDS

The importance given to ISDS by the WBG/PPIAF drafters is fully consistent with the rest of the Report's content. The general privileging of the rights of private partners and financiers while overlooking or neglecting the rights of governments, citizens and taxpayers fails to pass the crucial test of balance.

The Report proposes the following stepped process for *Dispute Resolution*:

- A mutual commitment to try to resolve disagreements promptly and amicably.
- Agreement that technical disputes can be referred to an expert to recommend resolution.
- More intractable issues can be brought before a dispute board comprised of representatives of both parties, which may be empowered to reach a binding resolution by consensus.

The Report notes that, given "the time and the cost of international arbitration, serious consideration should be given to the use of mandatory alternative dispute resolution mechanisms (such as dispute boards)." Yet if such a board fails to resolve the dispute within a mere 30 days, "the Dispute shall be referred to and finally settled by international arbitration."[27] Clearly, under such rules, most disputes would proceed to investor–state dispute settlement.

26 European Commission. "Investment in TTIP and beyond — the path for reform." May 2015. http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153408.PDF.

27 "Proposed Dispute Settlement Provision." Section 8.2, Article 23, p. 52.

Sidelining the domestic courts of developing countries

State and public interests, particularly those of developing countries, have generally been given short shrift when concession contracts become entangled in the ISDS system. Indeed, one of the first investor–state disputes to attract global notoriety and international concern — *Aguas del Tunari v. Bolivia* — involved a failed water services concession operated by the U.S. multinational corporation Bechtel in Cochabamba, Bolivia. When price hikes triggered public protests against this privatization, the national government stepped in and terminated the concession. Bechtel and its French partner subsequently sued under a Bolivia–Netherlands investment treaty.[28]

One of the Bolivian government's key legal defences in that case was that the concession agreement provided for disputes between the public authorities and the concessionaire to be resolved "in Bolivian courts in accordance with Bolivian laws."[29] The tribunal rejected Bolivia's argument on the grounds that the "forum selection clause" in the concession agreement was unclear and instead asserted its own jurisdiction over the claim. Ultimately, domestic and global public pressure on Bechtel resulted in the company settling its claim for a token amount.[30]

Unfortunately, it is not uncommon for international investment arbitrators to sidestep clauses in concession contracts that designate a specific dispute settlement forum, such as the domestic courts. For example, in 2012, Argentina was hit with a $200-million investor–state damages ruling in a dispute over a failed electricity concession operated by three French multinationals.[31] This dispute was one of dozens of investor–state claims stemming from Argentina's 2001 financial crisis, when the government was compelled, after a steep devaluation of the peso, to renegotiate concession agreements with tariffs calculated in U.S. dollars. The tribunal dismissed Argentina's arguments that the terms of the concession agreement clearly stipulated that any disputes be heard in local courts. Such rulings are part of a broader pattern of arbitrators failing "to show restraint in light of the role of another adjudicator."[32]

On the issue of the appropriate venue to adjudicate disputes, the WBG/PPIAF proposals clearly take the side of private investors and financiers, recommending that the parties to a PPP avoid an "overly long dispute resolution clause" and instead "submit

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28 "It emerged during the arbitration that, prior to bringing its claim and as public opposition was developing, the foreign investor 'migrated' corporate ownership of the privatized assets from the Cayman Islands to the Netherlands in order to have access to the Netherlands-Bolivia BIT." International Investment Arbitration and Public Policy. *Aguas del Tunari v Bolivia* (Netherlands-Bolivia BIT). Case summary accessible at: www.iiapp.org.

29 *Aguas del Tunari, S.A., Claimant/Investor v. Republic of Bolivia,* ICSID Case No. ARB/02/3 Respondent/ Contracting Party. "Decision on Respondent›s Objections to Jurisdiction." Washington, D.C., October 21, 2005, p. 21.

30 International Investment Arbitration and Public Policy. *Aguas del Tunari v Bolivia* (Netherlands-Bolivia BIT). Case summary. Accessible at: www.iiapp.org.

31 Luke Eric Peterson. "Another ICSID loss for Argentina, as arbitrators award 136 Million to jilted investors in electricity concession; with interest, award exceeds 202 Million." *Investment Arbitration Reporter*. July 17, 2012.

32 Gus van Harten. *Investment Treaty Arbitration and Public Law. (Oxford University Press, 2007).* Chapter 5.

the PPP Contract to the rules of an independent international institution," such as the International Chamber of Commerce or UNCITRAL. The document specifically stresses the importance of investor–state arbitration for contracts in developing countries "where PPP projects will not be bankable if recourse to acceptable arbitration arrangements is not allowed."[33]

It is remarkable that a development institution would sanction completely bypassing a country's domestic courts in disputes related to PPP projects.[34] At the very least, a firm requirement to first exhaust local remedies would be essential to building capacity and strengthening local institutions in developing countries, including their courts. Indeed, in a situation where the domestic courts of a country are viewed by foreign investors or financiers to be so untrustworthy that they must be sidelined, complex instruments such as PPPs are likely inappropriate.

Expanding the scope of investor–state arbitration

Another contentious matter, which is closely related to the issue of how to determine the most appropriate venue for *Dispute Resolution*, is whether an investor–state tribunal should be limited to adjudicating breaches of the relevant investment treaty, or whether it should have additional authority to adjudicate disputes regarding the breach of the concession agreement itself. Predictably, the guidelines embrace the more expansive, investor-friendly option.

Where an investment protection treaty applies, a foreign investor in a PPP usually has the right to bring a claim alleging a breach of the relevant investment protections in the treaty, such as national treatment, fair and equitable treatment, expropriation and compensation, etc.[35] But it is still not the international norm for investment arbitrators to have full authority to adjudicate whether the terms of the concession agreement itself (as distinct from the terms of an investment treaty) have been respected.

Investment arbitrators have, however, frequently sought to expand their authority to enforce the terms of concession agreements and contracts. Some bilateral investment treaties include so-called umbrella clauses, which bring commitments made by the host state in connection with a foreign investment, such as investment authorisations and PPPs, under the protection of the treaty. But even where the relevant treaty does not contain such a clause, certain tribunals have employed controversial strategies to expand the scope of their authority.

For example, in the electricity concession case involving Argentina referred to above,

33 WBG/PPIAF proposals. "Rules of reputable (international) arbitration institutions." p. 47.

34 Generally (for example to pursue a human rights case), "a private party has to go to domestic courts, where they are reasonably available, before bringing an international claim." Gus van Harten. "A Parade of Reforms: The European Commission's latest proposal for ISDS." Osgoode Hall Law School. Legal Studies Research Paper Series. Vol. 11/ no. 5. 2015. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2603077.

35 An exception to this rule occurs where the investor explicitly waives that right in the concession agreement, although, as discussed above, arbitrators have a poor track record when it comes to respecting such waivers.

the tribunal ruled that despite the fact that the France–Argentina Bilateral Investment Treaty itself did not have an umbrella clause, its most-favoured nation treatment clause could be used to import umbrella clauses from other Argentine bilateral investment treaties. The tribunal then proceeded to rule that Argentina had violated these imported clauses by failing to honour the concession agreement.[36]

In further evidence of the report's partiality to investor interests, the WBG/PPIAF recommendations expressly designate the tribunals to hear disputes related to the concession agreement itself.[37] Consequently, foreign investors in PPPs would frequently have recourse to investor arbitration under both the relevant treaties and the concession agreement. Adopting the recommended approach would also appear to give wholly domestic partners in PPPs access to international arbitration under the concession agreement, including the option to bypass domestic courts.

In advocating this approach, the WBG/PPIAF proposals line up with recent efforts by developed countries, led by the U.S., to expand the scope of investor–state arbitration. The investment chapter of the recently finalized Trans-Pacific Partnership (TPP) agreement contains provisions that would allow foreign investors to submit an investor–state claim on the grounds that a government has breached not only the core TPP investment protection obligations, but also "investment authorisations" or "investment agreements."[38] These agreements are defined to include typical PPPs such as those between a central government and investor to "supply services on behalf of the Party for consumption by the general public for: power generation or distribution, water treatment or distribution, telecommunications, or other similar services supplied on behalf of the Party for consumption by the general public."[39]

It is regrettable that the WBG/PPIAF proposals for a purportedly universal, standardized approach to PPPs should align so one-sidedly with the interests of foreign investors, financiers and the most powerful developed countries.

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36 "*EDF International, et. al. v. Argentine Republic*." ISCSID Case No. ARB/03. Washington. June 11, 2012. "Specific Commitments: MFN Incorporation of Umbrella Clauses." Pp. 221-231.

37 "As noted above, the recommended provisions stipulate that, "if any Dispute which is not a Technical Dispute has not been resolved between the Parties through an amicable settlement or the Dispute Panel procedure within [*thirty (30) calendar*] days of the receipt of the notice provided in clause (2), which shall each be a condition precedent, the Parties agree that the Dispute shall be referred to and finally settled by international arbitration." Proposed Dispute Settlement Provision." Section 8.2, Article 23, p. 52.

38 Trans-Pacific Partnership. Chapter 9: Investment. Article 9.18: Submission of a Claim to Arbitration. Accessible at: https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text.

39 A footnote to the TPP definition of investment agreement explains that: "For the avoidance of doubt, this subparagraph does not cover correctional services, healthcare services, education services, childcare services, welfare services or other similar social services." Trans-Pacific Partnership. Chapter 9: Investment. Article 9.1. Definitions. P. 9-4. Accessible at: https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text.

Alternative approaches to dispute resolution

When sustained efforts to resolve a dispute amicably or through alternative dispute settlement procedures operating on the basis of consensus have failed, an obligation to pursue reasonably available remedies through the local courts is customary. This requirement to exhaust local remedies best respects and ultimately strengthens local institutions including the courts. Given the mounting evidence of pro-investor biases in the investor–state arbitration system, a public partner in a PPP should think long and hard before waiving this right of exhaustion as recommended by the WBG/PPIAF proposals.

Once local remedies have been exhausted, an alternative approach for ensuring a fairer and more independent international dispute resolution process would be to establish a permanent international body to adjudicate disputes related to public contracts, including PPPs, modelled after the EC proposal for an investment court.[40]

Such a body could include a permanent roster of arbitrators receiving a set salary. Cases would be assigned on an objective basis with a strict code of conduct prohibiting conflicts of interests. Unfortunately, conflicts of interest are rife within the ISDS system, where a lawyer may act as arbitrator in one case and counsel in another, or has a vested interest in the outcome of the disputes.[41] Qualifications could include not only training in international commercial law, but also expertise in other fields such as public international law and human rights. To create a truly impartial and independent system it is essential to take dispute resolution out of the hands of for-profit arbitrators.

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40 The EC proposal to establish an international investment court should be clearly distinguished from its negotiating proposals in the context of TTIP to establish a so-called International Court System, which has been rightly criticized for reproducing the "fatal flaws" of ISDS rather than replacing it with a true international court. See Seattle to Brussels Network. "Courting Foreign Investors." Oct. 6, 2015. Accessible at: http://www.s2bnetwork.org/isds-courting-foreign-investors/.

41 "The current system does not preclude the same individuals from acting as lawyers (e.g. preparing the investor's claims) in other ISDS cases. This situation can give rise to conflicts of interest — real or perceived — and thus concerns that these individuals are not acting with full impartiality when acting as arbitrators." European Commission. "Investment in TTIP and beyond — the path for reform." May 2015. p. 6.

CONCLUSIONS

In addition to the proposed PPP contractual provisions critiqued above, the WBG/PPIAF report includes recommended contract language for other common elements of a PPP contract, namely those concerning *Refinancing, Lenders' Step-In Rights, and Confidentiality and Transparency*. As noted, these comport more closely with common practice for drafting PPP contracts, and have for that reason not been reviewed in detail here.

In other respects, and as described above, WBG/PPIAF proposals reflect a one-sided concern with the interests of private companies and their lenders, often to the prejudice of their public partners. Given the resources available to the Private Partners to PPP schemes to protect their own interests, and the demonstrable challenges confronted by many public authorities to contend with the complexity of PPP contracts, it is unfortunate that the WBG/PPIAF presents such an imbalanced approach to the difficult problems PPP schemes engender.

It has not been our purpose here to comment on either the merits of the PPP approach, or the circumstances in which such schemes may be warranted. Rather this analysis has sought to assess the extent to which WBG/PPIAF proposals represent a justifiable balance of public and private interests which, unfortunately, and for the reasons set out above, they do not.

ECONOMY & SOCIAL ISSUES

A Standard Contract for PPPs the World Over: Recommended PPP Contractual Provisions Submitted to the G20

At the request of the G20, staff at the World Bank has prepared a report recommending model language for public-private partnership (PPP) contracts. Unfortunately, the proposals fail to grapple with several of the problems that have plagued many PPP schemes, or contribute in a constructive way to finding solutions to them. The failure is largely the consequence of the authors' preoccupation with the interests of private investors, often to the prejudice of their public partners. Many governments lack the readiness and capacity to negotiate and implement PPPs and even determined proponents of the PPP model admit that it "has become tarnished by its waste, inflexibility and lack of transparency."[1] The proposed PPP contractual provisions critiqued here include the one-sided approach to risk, dispute resolutions and termination procedures. This analysis seeks to assess the extent to which WBG/PPIAF proposals represent a justifiable balance of public and private interests and concludes, for the reasons set out here, they do not.

1 H M Treasury, *A new approach to public private partnerships*; December 2012, p. 3.

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