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**TOPIC**

***PUBLIC-PRIVATE PARTNERSHIPS AND THE DEVELOPMENT OF  
INFRASTRUCTURE IN KENYA: UNDERSTANDING AND RESOLVING  
DISPUTES.***

**BY**

**MADIALO LAWRENCE ODERO**

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## DEDICATION

To my late father: ***“Jaduong” Kamlus Oduor Madialo.***

You dedicated yourself and any little resource that came your way in your poverty stricken life to the education of your children. That indeed was your best gift to them for the Good Lord answered your prayers.

Now because of you my father, my dear mother Consolata Awino *“Nyaboro”* and my dear friend and Brother Sylvester Madialo, I am honoured and privileged to dedicate this dissertation to you.

## DECLARATION

I, LAWRENCE ODERO MADIALO, do hereby declare that this is my original work and has not been submitted for a degree in any other university

Signature:.....

**LAWRENCE ODERO MADIALO**

**Student**

I, KYALO MBOBU do hereby declare that this dissertation has been submitted for examination with my approval as university supervisor.

Signature:.....

**KYALO MBOBU**

**Lecturer**

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## ABBREVIATIONS

BBO	Buy –Build-Operate
BLOT	Build-Lease-Operate-Transfer
BOO	Build-Own-Operate
BOOT	Build-Own-Operate-Transfer
BOT	Build-Operate-Transfer
DB	Design-Build
DBFO	Design-Build-Finance-Operate
IPP	Independent Power Producer
O&M	Operation & Maintenance
PFI	Private Finance Initiative
PPP	Public-Private-Partnerships
PPIAF	Public-Private-Partnerships-Advisory Facility
UNCITRAL	UN Commission on International Trade Law



## **TABLE OF CASES**

- 1. Biwater Gauff (Tanzania) Limited (Claimant) v. United Republic of Tanzania (Respondent) (ICSID Case No. ARB/05/22),**
- 2. Consortium Groupement L.E.S.I.- DIPENTA v. Algeria, ICSID Case No. ARB/03/08**
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- 8. Tanzania Electric Supply Company Limited –v- Independent Power Tanzania Limited (ICSD Case No. ARB/98/8**
- 9. The Heart Research Institute Ltd (Plaintiff) v Psiron Ltd (Defendant) [2002], Supreme Court New South Wales, NSWSC 646**

## **ABSTRACT**

Disputes that arise under Public Private Partnerships (PPPs) and Private Finance Initiatives (PFIs) may often involve problems that do not frequently arise in connection with other types of contracts. This is attributable to the complexity of PPPs, PFIs, large infrastructure projects and the fact that they are to be performed over a long period of time, with a number of different and diverse enterprises participating in the financing, construction and in the operational phases. Furthermore, these projects usually involve governmental agencies and a high level of public interest. The role each party plays in the project will impact the method for resolving disputes which may ultimately arise amongst the parties. There is no steadfast answer as to which type of dispute resolution method will fit a particular situation but, the ability to adequately resolve disputes, which may arise at any point in the PPP hierarchy, is critical to ensuring the long-term viability and profitability of any PPP project.

Therefore, careful attention must be given to managing any disputes, real and potential to avoid as much as possible the escalation of disagreements between the parties and preserve their business relationship; to prevent the disruption of the works or the provision of the services; and to address the particular characteristics of the disputes that may arise.

# CHAPTER ONE

## INTRODUCTION

The Kenyan government has identified infrastructure as a challenge and a constraint to growth and to doing business in Kenya. Transport, Electricity, Water and Sanitation to Health Services demonstrate that there exists infrastructure deficit that affects Kenyans of all walks of life as evidenced by daily experiences from poor water and sanitation services to poor healthcare facilities, congested roads, congested ports, intermittent supply of electricity among other problems.<sup>1</sup>

Government strategies and plans recognise Kenya's lack of sufficient infrastructure. These strategies seek to solve this problem. Vision 2030, Kenya's long-term development strategy, seeks to transform Kenya into a Middle Income Country by the year 2030. This strategy sees infrastructure as a key pillar to obtain this goal.<sup>2</sup> The strategy has identified around US\$23 billion in infrastructure investment required through Financial Year 2013 and about Eighty Per cent of is expected to come from Public-Private Partnerships (PPPS).<sup>3</sup> While this target is seen to be extremely aggressive, and has not been achieved anywhere in the world, it emphasises the importance of PPPs for the Government.<sup>4</sup>

Kenya's First Medium Term Plan (2008-2012) for the implantation of Vision 2030, focuses on concrete activities, programs and projects to improve and modernise the country's infrastructure, which is conceived as key foundation for national

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<sup>1</sup> Kitolo, A.M. (2009). *The Experience of PPP in Kenya*. Nairobi: Ministry Of Transport

<sup>2</sup> Mascaro, Yira J. (2012). *Project Information Document (Appraisal Stage) - Kenya Infrastructure Finance/PPP project - P121019*. Washington, DC: World Bank. Retrieved August 20, 2012, <http://documents.worldbank.org/curated/en/2012/08/16592016/project-information-document-appraisal-stage-kenya-infrastructure-financeppp-project-p121019>

<sup>3</sup> David O. Ong'olo. (2006). Public Private Partnerships (PPP): Practice and Regulatory Policy in Kenya. *Paper prepared for The Institute of Economic Affairs (IEA)* on July 7<sup>th</sup> 2006, Kenya.

<sup>4</sup> Mascaro, Yira J. p 12.

transformation. The plan includes increased investment in the road network, water and sanitation, rail, sea and air transport, and energy supply services.<sup>5</sup> Further, the plan includes the legal framework to support PPPs and institutional reforms in transport. It also includes actions and policies in capital markets to create the enabling environment for long term finance by developing a more liquid long-term Government debt market, market architecture reforms and regulations that support long term instruments such as infrastructure bonds and asset backed securities. Reforms in the pension and insurance sectors designed to foster further growth in both sectors as well as a stronger involvement in long term finance are also under consideration.<sup>6</sup>

The Government on its part is cognisant of the need for to implement reforms to promote the development of a robust market for PPP financing to effect a substantively broader based growth in infrastructure and social investment across sectors in a manner that augments Value for Money (VfM) and enhances good governance.<sup>7</sup> The Government's first steps to strengthen the legal and institutional enabling environment were the Public Procurement and Disposal (Public Private Partnerships) Regulations, 2009 (PPP Regulations issued under the parent law being the Public Procurement and Disposal Act of 2005. It is notable however that the efficacy of these Regulations in achieving the intended objective of strengthening the legal and enabling environment for PPPs remain debatable.<sup>8</sup>

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<sup>5</sup> Stephen Cheruiyot. (2010). *PPP in the Health Sector in Kenya*. March 18, 2010

<sup>6</sup> World Bank. (2012). *Kenya - Adaptable Program Lending for Infrastructure Finance and Public-Private Partnership Project*. Washington D.C. - The Worldbank. Retrieved October 12, 2012 <http://documents.worldbank.org/curated/en/2012/10/16918931/kenya-adaptable-program-lending-infrastructure-finance-public-private-partnership-project>

<sup>7</sup> Mascaro, Yira J. p 14

<sup>8</sup> Mabizela, M. (2005). *Public-Private Partnerships: Organisational Conformity of Private Providers to Meet Market Demands*. Retrieved August 14<sup>th</sup>, 2012, [http://www.albany.edu/dept/eaps/propho/publication/ASHE05\\_presentation/ASHE2005\\_Mabizela.ppt](http://www.albany.edu/dept/eaps/propho/publication/ASHE05_presentation/ASHE2005_Mabizela.ppt).

The Government has since published a National PPP Policy. This Policy seeks to further strengthen the legal, institutional and operational framework to achieve the broad PPP market development objectives. To give a legislative effect to this framework, the Government has since published a PPP Bill ('PPP Bill 2012').<sup>9</sup>

The PPP Bill 2012 seeks to introduce three main reforms and initiatives. First is Institutional Governance; the PPP Regulations established a new PPP Committee (PPPC) and a PPP Unit (PPPU). These entities are tasked with driving a technical rigorous project development process and providing high level oversight of the Policy's implementation, respectively. The PPPC is a Permanent Secretary level body chaired by the Permanent Secretary (PS) of the Ministry of Finance and responsible for policy implementation and pipeline approval oversight. The PPPU on the other hand is considered as the technical body of the PPPC, headed by a PPP Director who reports to the PS of Finance as chair of the PPPC. The PPPU is supposed to be responsible for coordinating with the line ministries in the identification and development of PPP projects to financial close.<sup>10</sup>

The second reform initiative is Fiduciary Governance; The Government will, as part of the PPP Policy, implement significant reforms to the management of fiscal commitments and contingent liabilities associated with PPPs as well as develop new fiscal instruments- such as a Viability Gap Fund (VGF) for transparent financing and reporting on Government funding of PPPs.<sup>11</sup> Value for Money (VfM) is the third policy which places great importance on fostering PPP procurement through competitive processes, based on

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<sup>9</sup> Republic of Kenya. (2012). The Public Private Partnerships Bill, 2012. Nairobi: Government Printers.

<sup>10</sup> Republic of Kenya. (2012). Pp 1 – 14.

<sup>11</sup> Mascaro Yira

a high level of technical due diligence. It seeks to improve the ability of all government agencies to prepare, procure and implement quality PPPs more efficiently and consistently. This entails the development and training of specialised units (referred to as “Nodes” in the Policy and the PPP Bill 2012) within line ministries to undertake this responsibility.<sup>12</sup>

## **1.1 Dispute Resolution**

PPP disputes are considered in this thesis in the context of international trade and finance. In the wake of the spread of the internalisation of finance, commerce and political integration there is a form of conflict emerging between certain sectors of local populations and these forces of globalisation.<sup>13</sup>

Advocates of globalisation champion neo liberal ethos which are characterised by a reduced role of the state in the regulation and management of the economy in three main areas. First is trade liberalisation which leads countries to drop trade barriers by engaging in various forms of economic integration with other states. The second is financial liberalisation, which entails the freeing up of monetary policy either by pegging the currency or adopting a free floating currency mechanism. Another component of financial liberalisation is the relaxation of domestic and foreign investment policies to allow the free of portfolio and foreign direct investments.<sup>14</sup> This grants the investors more liberty to move their capital where and when they choose. The third component is the privatisation of state owned enterprises and the extensive deregulation of markets and

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<sup>12</sup> Republic of Kenya. (2012). Section 17.

<sup>13</sup> World Bank. (2012b). *Kenya - Infrastructure Finance Project : environmental and social management framework*. Washington D.C. - The Worldbank. Retrieved April 16, 2012, <http://documents.worldbank.org/curated/en/2012/04/16237821/kenya-infrastructure-finance-project-environmental-social-management-framework>

<sup>14</sup> World Bank. 2012. Pp9

specific industries and now the provision by private entities of services that were predominantly the preserve of the public sector (here called PPPs).<sup>15</sup>

Critics of globalisation argue that neoliberal economic reforms have variable results and have helped least developed countries to pull out of poverty. Instead, they argue that globalisation often reinforces the structural problem of inequality and the lack of political and economic agency by the disenfranchised further entrenching traditional power relations and inciting local conflict.<sup>16</sup>

James Mittelman argues that rather than promoting a homogenisation of better living conditions, globalisation has incited creative forms of local dissent and further constraining governments. He states

Globalization is not levelling civil societies around the world but, rather, is combining with local conditions in distinctive ways, accentuating differences, and spurring a variety of social movements seeking protection from the disrupting and polarizing effects of economic liberalism. Evidently, the state is constrained by a problem of supranationalism and subnationalism, facing pressures from below and above<sup>17</sup>.

As will be discussed further in this thesis, certain disputes relating to PPPs are associated with polarising effect of economic liberalism. A case in point is the bungled USD 140,000,000 project for the commissioning of a comprehensive programme of repairs to and the expansion of, the Dar-es-Salaam Water Supply and Sanitation Project (“the

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<sup>15</sup> World Bank. (2012b). Pp23

<sup>16</sup> Earl Conteh-Morgan, “International Intervention: Conflict, Economic Dislocation and the Hegemonic Role of Dominant Actors”, *International Journal of Peace Studies*, Vol.7, 2, (Autumn /Winter) pp33-35

<sup>17</sup> Mittelman pp25

Project”).<sup>18</sup> It is notable that as condition its funding the Government of Tanzania was required to appoint a private operator to manage and operate the water and sewerage system, and to carry out some of the works associated with the Project.<sup>19</sup>

Be that as it may, effective dispute resolution should form an integral part of any strategy to strengthen the PPP enabling environment framework. PPP dispute resolution has not received much emphasis as other aspects of governance as will be evidenced from the reading of the PPP Regulations, the PPP Bill 2012 as well as the PPP policy. Yet, if the primary goal of the Government is to develop a solid foundation to prepare and deliver PPPs and realise their benefits more effectively, a study of PPP disputes is necessary. First, to understand the nature of PPP disputes and second to come up with effective and efficient dispute resolution mechanism should be considered alongside legal, regulatory and institutional reforms that seek to help achieve the objective.<sup>20</sup>

Investors, contractors, and lenders will be encouraged to participate in projects in countries where they have the confidence that any dispute arising out of contracts forming part of the project will be resolved fairly and efficiently. As discussed above PPPs involve the public sector. The public sector is characterised by a political dimension together with issues about funding, accountability and authority from central government and departments responsible to institutions and local authorities. Therefore, on many occasions as will be seen later on in this research, the public sector disputes can often have specialist characteristics that require skills and innovative approaches to assist in

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<sup>18</sup> Jütting, J. (1999). Public –private-partnership and social protection in developing countries: the case of the health sector. Paper presented at the ILO workshop on the extension of social protection, Geneva, 13/14 December 1999.

<sup>19</sup> Biwater Gauff (Tanzania) Limited –v- United Republic of Tanzania (Award, 24 July 2008) ICSID Case No. ARB/05/22 published on [www.icsid.worldbank.org](http://www.icsid.worldbank.org) accessed on 7<sup>th</sup> September 2012

<sup>20</sup> Gordon Kingsley, G and Dara V. O’Neil (2004) “Performance Measurement in Public-Private Partnerships: Learning from Praxis, Constructing a Conceptual Model”. Paper presented at the American Society for Public Administration 65th. National Conference, Portland, Oregon, March 27-30, 2004.



finding appropriate solutions which are acceptable within specific parameters and on different levels.<sup>21</sup>

Many legal issues in PPPs will be new. For example, under concession contracts, it is common for lenders and governments to ask to be given “step-in-rights”. In the case of a lender, this right allows the lender to take over the project and if necessary bring in a substitute concessionaire in order to forestall a termination of the concession agreement following any consequences of default.<sup>22</sup> The main purpose of “step in right” is to avoid the collapse of the agreement of the concessionaire and the basis by which the lender is paid. Given this threat to its repayment the lender is likely to ensure that it or a substitute project company appointed by it, has an opportunity to cure the default. This in effect allows the private entity to injunct the government from exercising its rights to terminate the contract. This can be very controversial and can lead to several fronts of dispute. For example when can a lender step in? For what duration should a lender step in?<sup>23</sup>

PPPs are not traditional partnerships in the sense that the partners are co-owners and share in the profits and losses. In fact, many PPPs may create significantly increased financial risk for governments, developers, lenders and contractors, depending on the allocation of risk and the ultimate success of the project. PPPs may involve a combination of private financing, private contracting and private property interests.<sup>24</sup> A PPP agreement may confer upon a party private interest in public property in the form of

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<sup>21</sup> IPPR (2001), *Building Better Partnerships: the Final Report of the Commission on Public-Private Partnerships*, Institute of Public Policy Research, London,

<sup>22</sup> Zheng, J. Roehrich, J.K. and Lewis, M.A. (2008). The dynamics of contractual and relational governance: Evidence from long-term public-private procurement arrangements. *Journal of Purchasing and Supply Management*. 14(1): 43-54

<sup>23</sup> United Nations Economic Commission for Europe, *Guidebook on Promoting Good Governance in Public –Private Partnerships* (New York: United Nations, 2008) at page 32

<sup>24</sup> ACCA (2004), *Evaluating the Operation of PFI in Roads and Hospitals*, Research Report No. 84, The Association of Chartered Certified Accountants, London.

long-term possessory interest in the leasehold and a franchise right to collect tolls for example in toll roads.<sup>25</sup>

The US case of *South Bay Expressway v Otay River Constructors*<sup>26</sup> is a case in point. A franchise agreement was issued to a private developer to construct the SR125 toll road and a 35 year lease to collect tolls and operate the public road was granted. In turn, the developer entered into private contracts with a general contractor to design and build the improvements. After the general contractor completed the project, it recorded a mechanics lien on the toll road, which by their language did not seek to lien public property.<sup>27</sup> The general contractor then filed an action to foreclose liens. Meanwhile, the developer filed for bankruptcy and asserted the liens were invalid because they were placed on public property.<sup>28</sup>

The bankruptcy court found that the mechanics lien could attach to the private leasehold and franchise interests of the developer. In doing so, the court examined the enabling legislation and found that the toll road would be constructed by a private entity but owned by the state. After examining the franchise and lease agreements, the court found that the developer held “private” interest in public property in the form of a long term possessory interest in the leasehold and a franchise right to collect tolls. The contract granted the developer a right to privately develop and finance the construction of the toll road. Therefore, the court held that the toll road was a private work and the mechanic’s

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<sup>25</sup> Solomon Olusola Babatunde, Akintayo Opawole, Olusegun Emmanuel Akinsiku, (2012) "Critical success factors in public-private partnership (PPP) on infrastructure delivery in Nigeria", *Journal of Facilities Management*, Vol. 10 Iss: 3, pp.212 - 225

<sup>26</sup> United States Bankruptcy Court Southern District Of California (2012). Chapter 11, Case No. 10-04516-All Retrieved on August 5, 2012 [http://www.casb.uscourts.gov/pdf/opinions/10\\_90180.pdf](http://www.casb.uscourts.gov/pdf/opinions/10_90180.pdf)

<sup>27</sup> National Association of Credit Managers, *Manual of Credit and Commercial Laws*, 97<sup>th</sup> Edition January 2006).

<sup>28</sup> Roger C. Haerr. (2011). *Public Private Partnerships: Mechanic's Liens, Payment Bonds and Stop Notices*. McKenna Long & Aldridge Publication May 26, 2011

lien could attach to the developers distinct private property interests in the toll road, despite the fact that the toll road was owned in fee by a public authority.<sup>29</sup>

It will be observed at a later stage in this paper that, privately financed infrastructure projects typically require the establishment of a network of interrelated contracts and other legal relationships involving various parties. Whereas legislative provisions on the settlements of disputes arising in the context of these projects may take account of the diversity of relations, which may call for different dispute settlement methods depending on the type of dispute and the parties involved, where problems occur, it is essential that legal representatives for the parties and other players in the dispute resolution process have an in-depth understanding of the intricate and highly-specialized ways in which the contract documentation is created and the rights and obligations that result.<sup>30</sup>

## **1.2 Statement of the Problem**

Dispute is a state of accelerated conflict, which remains unsettled. Conflict requires the selection of a conflict resolution mechanism such as confronting, compromising, smoothing, forcing, or avoiding. Dispute resolution on the other hand involves the next step, that of resolving the unsettled conflict through the binding or nonbinding approach. Selection of an appropriate dispute resolution method is vital as every PPP project may have disagreements.<sup>31</sup>

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<sup>29</sup> Roger C. Haerr. (2011). Pp9

<sup>30</sup> Stanley K. Kamau. (2012). What are PPPs and can they work in Kenya? PPP Bill and The Status Of PPP Projects. *Meeting On Public Private Partnerships In Kenya*, Held On 28th March. 2012 At Serena Hotel, Nairobi.

<sup>31</sup> Esther Cheung, Albert P.C. Chan, & Stephen Kajewski, (2009). Enhancing value for money in public private partnership projects: Findings from a survey conducted in Hong Kong and Australia compared to findings from previous research in the UK. *Journal of Financial Management of Property and Construction*, 14(1), pp.7 - 20

The multiplicity of parties in privately financed projects makes conflict predictable. Yet despite its perceived negative impact, conflict within PPPs can lead to creative and constructive outcomes when it is well managed by encouraging open discussion that allows full exploration of the participants' needs, concerns, values, meanings, and interests – the essential ingredients of effective communication. This process can contribute significantly to the accountability and transparency that PPPs strive for, and serves itself as a mechanism for channelling constructive conflict towards positive outcomes.<sup>32</sup>

This study aims to develop an understanding of the nature and characteristics of PPP disputes with a view of proposing best practices and procedures in dispute resolution that can best contribute towards the PPP market development objectives.

### **1.3 Objectives of the Research**

The following were the objectives of the study:

- (i) To discuss PPPs and disputes likely to arise with a view to evaluating and understanding their slight uniqueness from other disputes and comparative approaches to their resolution,
- (ii) To identify some practices that may be adopted for dispute avoidance and resolution.

### **1.4 Research Questions**

The following were the research questions which the study sought to interrogate:

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<sup>32</sup> United Nations Economic Commission for Europe. (2004). *Governance in Public Private Partnerships for Infrastructure Development*. United Nations: Geneva.

- (i) What are PPPs and how do they establish a network of interrelated contracts?
- (ii) Which disputes are likely to occur in relation to PPPs and PPPs interrelated contracts?
- (iii) What are the dispute resolution options and procedures and practices that may be adopted to offer a more efficient and cost effective method of resolving disputes in PPPs?

### **1.5 Hypotheses**

The hypotheses which informed the study include:

- i. Public Private Partnerships require the establishment of a network of interrelated contractual and other legal relationships involving various parties.
- ii. Disputes that arise under PPPs may often involve problems that do not frequently arise in connection with other types of contracts.

### **1.6 Conceptual Framework**

**PPPs.** In this study, a Public Private Partnership (PPP) is defined as an enforceable binding contract between a public institution (such as a line ministry, local authority or public enterprise), and a private operator who becomes responsible for delivery of services that have traditionally been provided by the public sector.<sup>33</sup>

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<sup>33</sup> Janelle Plummer. (2002). Developing Inclusive Public-Private Partnerships: The role of small-scale independent providers in the delivery of water and sanitation services. *Presented at the Making Services Work for Poor People' World Development Report (WDR) 2003/04 Workshop* held at Eynsham Hall, Oxford 4-5 November 2002

## 1.7 Theoretical Perspective

This study is informed by the “Needs-based” or ‘Co-operation based’ theory of conflict resolution to the extent to which the theory can be modified and applied to PPP disputes. To briefly explain, the “Needs- based” or Co-operation-based” theory was developed as a discipline following World War II.<sup>34</sup> Conflict resolution as a discipline emerged from power-based conflict theory, which dominated and still dominates political science and international relations; and converged from psychology and sociology, which was interested in group dynamics, motivation and relationships between institutional structures. Normative political theory saw conflict as a comparative struggle to be won by one side.<sup>35</sup>

Galtung, Burton and many other scholars in the conflict resolution field portray deep affection by psycho-social analysis and the contribution of social scientists abound working on basic human needs.<sup>36</sup> Beginning with ground breaking work of Abraham Maslow in the early 1950s, the concept of human needs attempted to hierarchically schematise primal human necessities to live a fulfilling life. Maslow classified these basic human needs into five categories: physiological needs, safety needs, belonging and love needs, esteem needs, and needs for self actualisation.

Highlighting the role of needs theory in conflict relates directly to the long term legitimacy and stability of political and social systems. Rosati Carroll & Coate maintain

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<sup>34</sup> Jay Rothman, (1997). Resolving Identity-Based Conflict: In Nations, Organizations and Communities, San Francisco: Jossey-Bass Publishers, p. 61.

<sup>35</sup> Hasenclever, Andreas; Mayer, Peter; and Rittberger, Volker. (1997). *Theories of International Regimes*. Cambridge: Cambridge University Press; John F. Gaski (1984). The Theory of Power and Conflict in Channels of Distribution. *Journal of Marketing*, 48(3), pp. 9-29

<sup>36</sup> Louise Diamond and John McDonald, (1996), *Multi-Track Diplomacy: A Systems Approach to Peace* (3<sup>rd</sup> edit.), West Hartford, CT: Kumarian Press

that those systems, which fail to provide the basis for needs fulfilment, will inevitably grow unstable and undergo a process of systemic upheaval eventually leading to social change.<sup>37</sup>

In order to analyse PPPs and PPP disputes, it was necessary to understand the needs approach to conflict resolution and consider what underlying motivations draw individuals into social relationships that challenge policies and institutions as well as the processes through which this occurs.<sup>38</sup>

Rosenau argues that PPPs have the potential to create conflicting interests due to the varied pursuits and value systems of the two sectors involved in the contract. The private sector is predisposed to prioritizing shareholder return and taking measured risks whereas the public sector is influenced by regulations and authorities, political opinion and the achievement of societal goals.<sup>39</sup> Additional problems arise due to the fact that public taxpayers may not welcome the idea of PPPs due to a perceived lack of transparency in the private sector. Full disclosure may also be an issue for the private sector who has an interest in protecting proprietary information to ensure their competitiveness (Flinders, 2005).<sup>40</sup>

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<sup>37</sup> Jerel A. Rosati, David J. Carroll & Roger A. Coate, (1990), "A Critical Assessment of the Power of Human Needs in World Society", in John Wear Burton & Frank Dukes, (eds.), *Conflict: Readings in Management and Resolution*, New York: St. Martin's Press, pp. 174; John W. McDonald (1986). *Observations of a Diplomat*, in Edward E. Azar and John W. Burton (eds.)

*International Conflict Resolution: Theory and Practice*. Brighton: Wheatsheaf Books, p. 143.

<sup>38</sup> Venkat Raman, A., & J.W. Bjorkman (2009). *Public Private Partnerships in Health Care in India: Lessons for Developing Countries*. London. Routledge.

<sup>39</sup> Rosenau, J. (1999). *Toward an Ontology for Global Governance*. In Hewson M., Sinclair T. J., *Approaches to Global Governance Theory* (Albany, NY: State University of New York Press).

<sup>40</sup> Flinders, M. (2005). The Politics of Public-Private Partnerships. *The British Journal of Politics & International Relations*, 7(2), 215-239.

## **1.8 Methodology**

This study utilized both primary and secondary sources of data. The primary source of data was informal interviews with officials of Public Private Partnership Unit of the Treasury (Ministry of Finance). The interview was face-to-face and interactive, not based on specific questionnaires. This was to ensure that as much information as possible was obtained from the respondent. It also helped in getting first-hand information on what is really happening on the ground. Further, it sought to achieve a holistic understanding of the interviewee's point of view on the issue of dispute resolution on PPPs, thus enriching the study.

The researcher did conduct library research and internet research to review the available literature, administrative publications as well as various statutes that govern PPPs in Kenya. The researcher did a review the resources availed by the World Bank Public Private Partnerships Advisory Facility (PPIAF).

A global wealth of information is available on the internet. The internet provides soft copies of materials that would otherwise be difficult to obtain. Internet sources will constitute a broader base of the research. This is in terms of what has been written on the topic and diverse and various recommendations made. Such data will build upon the foundation of the study as well as expose gaps that the study will seek to fill. The study will be both descriptive and towards the end analytical.

## **1.9 Literature review**

In the light of the problems sought to be addressed, the particular issues under review and the theoretical framework, the study draws from various sources of literature. It is



important though to note that literature on the concept of dispute resolution in PPPs in Kenya is scanty. This study, therefore, plays one of the pioneering roles on the issues it seeks to address.

Akitoye and Nah define PPPs as a long-term contractual arrangement between a public sector agency and a private sector concern, whereby resources and risk are shared for the purpose of developing a public facility.<sup>41</sup> The principal aim of a PPP for the public sector is to achieve value for money in the services provided while ensuring that the private sector entities meet their contractual obligations properly and efficiently. Through this agreement, the skills and assets of each sector (public and private) are shared in delivering a service or facility for the use of the general public. In addition to the sharing of resources, each party shares in the risks and rewards potential in the delivery of the service and/or facility.<sup>42</sup>

Public-Private Partnerships are a variation of Privatization in which elements of a service previously run solely by the public sector are provided through a partnership between the government and one or more private sector companies. Unlike a full Privatization scheme, in which the new venture is expected to function like any other private business, the government continues to participate in some way.<sup>43</sup>

PPPs can involve design, construction, financing, operation and maintenance of public infrastructure and facilities, or the operation of services, to meet public needs. They are often privately financed and operated on the basis of revenues received for the delivery of

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<sup>41</sup> Akitoye, B. and Nah, F. (2010), "PROJECTS +e.projects + a new vision for entprojectsrise system. in Managing Internet and Intranet Technologies in Organizations: Challenges and Opportunities, Idea Group Publishing, Hershey,

<sup>42</sup> Venkat Raman, A., & J.W. Bjorkman (2009), pp16

<sup>43</sup> Kieran Lynch, (2005). Privatisation & Regulation Case Study. A report on UK transport policy, specifically the privatization of the London Underground through Public-Private Partnership, December 2005

the facility and/or services. One key to this is the ability of the private sector to provide more favourable long term financing options than may be available to a government entity and to secure the financing in a much quicker time frame. Such contracts are long-term in nature and typically 25-30 years.<sup>44</sup>

McIntyre notes that as PPP projects increase in size and complexity, so then does the risk of cost and time overruns, which invariably leads to disputes.<sup>45</sup> Ball believes that the failure to act, or incorrect action, to cope with information systems, communications and knowledge are the primary causes of PPP disputes.<sup>46</sup>

Mitropoulos and Howell and Cheung and Yin, associate disputes to project uncertainty, contractual problems and opportunistic behaviour.<sup>47</sup> Chan associate disputes with, first, a combination of issues including time, cost and defects; second, the contractor's cash flow; and three, extra difficulty of the private sector to negotiate for commercial settlement whereas public organizations usually seek determination of a dispute by a competent tribunal.<sup>48</sup> Vorster finds: one, uncertainty causes change beyond the expectation of the parties; two, that the process problems including imperfect contracts and unrealistic performance expectations; and, third that the peoples issues, problems due

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<sup>44</sup> Alinaitwe, H., Ayesiga, R. and Rugumayo, A. (2012) Success factors for implementation of private public partnerships in the construction industry in Uganda *In: Laryea, S., Agyepong, S.A., Leiringer, R. and Hughes, W. (Eds) Procs 4th West Africa Built Environment Research (WABER) Conference, 24- 26 July 2012, Abuja, Nigeria, 355-365.*

<sup>45</sup> Mc Intyre, J., (1991). Disputes Under Review. *Chartered Quantity Surveyor*, 55-56.

<sup>46</sup> Ball, R., Heafey, M., King, D., 2000. Managing and concluding the PFI process for a new high school: room for improvement? *Public Management* 2 (2), 159–179.

<sup>47</sup> Cheung, S.O and Yin, T.W., 2006, Are Construction disputes inevitable?. *IEE Transactions on Engineering Management*, 53 (3), 456-470; Mitropoulos, P and Howell, G., 2001, Model for understanding, preventing and resolving project disputes. *Journal of Construction Engineering and Management*, May/June, 223-231.

<sup>48</sup> Chan, H.W., (2008). Innovations in construction disputology. *A half day professional workshop on international construction contract management, 23 October 2008 Kuala Lumpur: Universiti Teknologi Malaysia, 5-17.*

to poor communication, poor interpersonal skills and opportunistic behaviour, as the common causes of disputes.<sup>49</sup>

Lian stresses that the aim of managing disputes in PPP projects is to undertake damage control measures by recognizing the disputes earlier. He maintains that although measures can be taken to avoid disputes, it frequently occurs, and there must be adequate mechanisms to resolve them before they become chaotic.<sup>50</sup>

The roles of the public and the private sectors in the development of infrastructure have evolved considerably in history. Public services such as gas, street lighting, power distribution, telegraphy, and telephony, steam railways and electrical tramways were launched in the nineteenth century and in many countries, they were provided by private companies that had obtained a licence or a concession agreement from the government. Numerous privately funded road or canal projects were carried out at the time that there was a rapid development in international project financing bond, including international bond offerings to finance railways or other major infrastructure.<sup>51</sup>

However, during most of the twentieth century the international trend was, in turn, towards public provision of infrastructure and other services. Infrastructure operators were often nationalised and competition was reduced through mergers and acquisitions.

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<sup>49</sup> Vorster, M.C. (1993). *Dispute Prevention and Resolution*. Construction Industry Institute, Dispute Prevention and Resolution Task Force. Virginia Polytechnic Institute and State University, Blacksburg, Virginia.

<sup>50</sup> Lian, O.S., (2006). Avoidance and management of construction disputes-enhancement of QS role, *Quantity Surveying National Convention, 4-5 September 2006 Malaysia*: Universiti Sains Malaysia , 1-9.

<sup>51</sup> UNCITRAL (2001). *Legislative Guide on Privately Financed Infrastructure Projects*. Prepared by the United Nations Commission on International Trade Law (UNCITRAL), United Nations, New York.

Infrastructure sectors remained privately operated only in relatively small number of countries, often with little or no competition.<sup>52</sup>

The current reverse trend towards private sector participation and competition in infrastructure sectors started in the early 1980s and has been driven by general as well as country-specific factors.<sup>53</sup> Among the general factors are significant technological innovations; high indebtedness and stringent budgetary constraints limiting the public sector's ability to meet increasing infrastructure needs; the expansion of international and local markets, with consequent improvement in access to private funding; and increasing number of successful international experiences with private participation and competition in infrastructure. In many countries, these factors have led to the adoption of new legislation, not only to govern such transactions, but also to modify the market structure and the rules of competition governing the sectors in which they were taking place.<sup>54</sup>

In identifying the best practices that may be employed to the effective resolution of PPP disputes, there is need to consider the role of Public-Private Partnerships to improve the provision and sound management of infrastructure and public services in the interest of sustainable economic and social development as well as recognising the need to provide an enabling environment that encourages private investment in infrastructure. It is also important to take into account the public interest concerns of the country, with emphasis

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<sup>52</sup> Stonehouse, J. H., Hudson, A. R. and O'keefe, M. J. (1996) Public-private partnerships: the Toronto Hospital experience. *Canadian Business Review*, 23(2), 17-20.

<sup>53</sup> UNCITRAL (1999). Yearbook of the United Nations Commission on International Trade Law, 1999. United Nations Commission On International Trade Law, Vol 30, 251-259

<sup>54</sup> <sup>54</sup> Lian, O.S., (2006), the *Guide* at page 2

on the importance of efficient and transparent procedures for the award of privately financed infrastructure.<sup>55</sup>

The United Nations Commission on International Trade has issued the Model Legislative Provisions on Privately Financed Infrastructure Projects (hereafter “*PPP model legislation*”) to supplement the *Guide* towards the establishment of a favourable legislative framework for private participation in infrastructure development and operation and to assist states especially developing countries, in promoting good governance and establishing an appropriate legislative framework for such projects.<sup>56</sup>

The set of general recommended legislative principles entitled “legislative recommendations” and model legislative provisions (the “*model provisions*”) contained therein are intended to assist domestic legislative bodies in the establishment of a legislative framework favourable to privately financed infrastructure projects.<sup>57</sup> The legislative recommendations and the model provisions consist of a set of core provisions dealing with issues that deserve attention in legislation specifically concerned with privately financed infrastructure projects.<sup>58</sup>

The model provisions are designed to be implemented and supplemented by the issuance of regulations providing further details. Areas more suitably addressed by regulations rather than statutes are identified accordingly. Moreover, the successful implementation

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<sup>55</sup> Harris, Clive, John Hodges, Michael Schur and Padmesh Shukla. (2003). Infrastructure Projects: A Review of Canceled Private Projects. *World Bank Viewpoint Note No.252*. Washington, D.C.: World Bank.

<sup>56</sup> Resolution adopted by the General Assembly [on the report of the Sixth Committee (A/58/513)] 58/76 Model Legislative Provisions on Privately Financed Infrastructure Projects of the United Nations Commission on International Trade Law.

<sup>57</sup> UNCITRAL (2004). Model Legislative Provisions on Privately Financed Infrastructure Projects. *Prepared by the United Nations Commission on International Trade Law (UNCITRAL)*, United Nations, New York.

<sup>58</sup> Kerf, Michael and Warrick Smith. (1996). Africa Region Series Privatizing Africa’s Infrastructure Promise and Challenge. *World Bank Technical Paper No. 337*. Washington, D.C.: World Bank.

of privately financed infrastructure projects typically require various measures beyond the establishment of an appropriate legislative framework. These include adequate administrative structures and practices, organisational capability, technical, legal and financial expertise, appropriate human and financial resources and economic stability.<sup>59</sup>

Notably, the legislative recommendations and the model provisions do not deal with other areas of law that also have an impact on privately financed infrastructure but on which no specific legislative recommendations are made in the *Guide*. Those other areas of law include, for instance, promotion and protection of investments, property law, rules on government contracts and administrative law, tax law and environmental protection as well as consumer protection laws. The relationship of such other areas of law to any law enacted specifically with respect to privately financed infrastructure projects should be borne in mind.<sup>60</sup>

In a paper prepared for The Institute of Economic Affairs, David O Ong'olo has discussed the PPP practice and regulatory policy in Kenya.<sup>61</sup> He argues that the general euphoria around policy encouragement for PPPs ignores a range of concerns about PPPs based on public interest considerations. Most fundamentally according to him, there are questions as to why PPPs should be unambiguously preferred to public sector investment and operation of services, and the need to evaluate the social and economic impacts of the risks and future liabilities created by PPPs. There are a number of specific

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<sup>59</sup> Yuan, J., Zeng, A. Y., Skibniewski, M. J. and Li, Q. (2009) Selection of performance objectives and key performance indicators in public-private partnership projects to achieve value for money. *Construction Management and Economics*, 27, 253 – 270.

<sup>60</sup> UNCITRAL (2004).

<sup>61</sup> Ong'olo, D (2006), *Public private partnerships(ppp) practice and regulatory policy in Kenya* , The Institute of Economic Affairs, Nairobi, Retrieved September 15, 2012, [www.ieakenya.or.ke](http://www.ieakenya.or.ke)

public interest concerns: about the way PPPs transfer the costs of paying for investment from the present generations to future generations; about the dangers of fragmenting, casualising and worsening conditions of employment of public service workers in areas soon to be brought under PPPs; about the real transparency of the processes by which PPPs are likely to be effectively established, operated; and about the comparative economic consequences of PPPs and public sector options.<sup>62</sup>

Ong'olo concludes that the issues discussed by his paper raise significant challenges to the conduct of successful PPPs in Kenya. The paper states that the complexity of such arrangements and the high costs involved is enough cause for the Government to take a careful approach to PPPs. In line with Evatt Foundation publication, the paper states that the government should also recognise that PPPs pose many of the same problems inherent in procurement or privatisation and are not a panacea for development.<sup>63</sup> The paper recommends that the government must determine clear operational guidelines with respect to acceptable forms of PPPs and their prioritization, procedural clarity on the basic steps of establishing PPP projects, basic approaches to risk allocation, value for money and principles around the provision of guarantees and financial and budget evaluation criteria.<sup>64</sup>

The paper, written prior to the establishment of the PPP Unit of the Ministry of Finance, argues that there are several issues that must be tackled. Firstly, it stresses the need to review, analyse, and recommend draft amendments to existing legislation clarifying the

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<sup>62</sup> Ibid, p6-7

<sup>63</sup> Evatt Foundation (2005). The myths of PPPs Paying for private profit. Retrieved 4th July 2006, <http://evatt.labor.net.au/publications/papers/117.html>

<sup>64</sup> Ong'olo, D (2006), p37-38

power and the authority of the local and central governments as well as public enterprises to enter into long term contractual arrangements with private sector service providers. Secondly, it argues for the need to develop minimum standard regulations governing PPP contracts. Thirdly, it advises that the PPP Unit needs to establish policies and procedures for preparing and packaging projects and ensure quality control over these activities. There is further argument for capacity building in project planning, co-ordination and monitoring of PPP projects among public officers as being essential.<sup>65</sup>

On dispute resolution, the paper states that the multiplicity of parties in privately financed projects makes conflicts predictable. Yet despite its perceived negative impact, conflict within PPPs can lead to creative and constructive outcomes when it is managed by encouraging open discussion that allows full exploration of the participant's needs, concerns, values, meanings and interests –the essential ingredients of authentic communication.<sup>66</sup> This process he argues can contribute significantly to the accountability and transparency that PPPs strive for, and serves itself as a mechanism for channelling constructive conflict towards positive outcomes.<sup>67</sup> However, the mechanisms that can possibly be employed to achieve the positive outcomes were not discussed in the paper.

Looking at other jurisdictions, in the United Kingdom for example, there is the British Treasury Standardisation of PFI Contracts 2007.<sup>68</sup> This is a revised version of the first edition of Standardisation of PFI Contracts (“SOPC”) that was published in 1999. The

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<sup>65</sup> Ibid, p37

<sup>66</sup> UNISON (2005). Overview of Public Private Partnerships in the UK. June 2005. Retrieved November 2<sup>nd</sup>, 2012, <http://www.unison.org.uk/acrobat/B1924.pdf>.

<sup>67</sup> Ong'olo, D (2006), p17-18

<sup>68</sup> HM Treasury, (2007). *Standardization of PFI Contracts Version 4*. p18 -234



aim was to provide guidance on the key issues that arise in PFI projects in order to promote the achievement of commercially balanced contracts and enable public sector procurers to meet their requirements and deliver best value for money. The main objectives are first, to promote a common understanding of the main risks which are encountered in a standard PFI project; secondly to allow consistency of approach and pricing across a range of similar projects; and thirdly, to reduce the time and costs of negotiation by enabling all parties concerned to agree in a range of areas that follow a standard approach without extended negotiations. Dispute resolution is also discussed. Then there is an array of decisions made by various arbitral tribunals of the International Centre for Settlement of Investment Disputes. The awards made by the different tribunals discuss myriads of complex issues and exhibit the very complex and interrelated agreements involving different parties' characteristic of PPPs.<sup>69</sup>

Even though Guidebooks and policy documents are not considered as proper part of literature review for academic works, this thesis has looked at the Guidebook on Promoting Good Governance in Public-Private Partnerships authored by the United Nations Economic Commission for Europe. It is merely considered to illustrate some points advanced in the arguments made by the researcher. On disputes it states that lawsuits in PPP cases can be expensive and burdensome and implores governments to improve the framework in which commercial disputes are solved.<sup>70</sup> It states that overall the investor needs to have confidence that the judiciary will enforce the laws and contracts.

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<sup>69</sup> Julie Hill and Joanna Collins (2004). *PFI: Meeting the sustainability challenge*. London: Green Alliance Publishers, July 2004

<sup>70</sup> United Nations Economic Commission for Europe (2008). *Guidebook on promoting good governance In public-private partnerships*. New York and Geneva,

Another piece of literature is Delmon's book entitled *Private Sector Investment in Infrastructure: Project Finance, PPP Projects and Risk*<sup>71</sup>. With a view to addressing the broad range of issues encountered in a PPP project, general issues have been addressed first, followed by more specific issues consistent with particular sectors. These range from an overview of private investment in infrastructure. Risk mitigation products and legal issues have also been discussed. On dispute resolution, Delmon reiterates that large infrastructure projects are ripe for complex and often debilitating disputes. Parties have available to them a range of options for public and private forms of dispute resolution. Such structures he states can include arbitration, court resolution, adjudication, expert determination or other alternative dispute resolution mechanisms.

Locally, it is important to note that there is little literature on PPPs. No doubt therefore that no strong case has been made for a critical analysis of the dispute resolution practices and processes with a view to examining their suitability for the facilitation of more efficient and cost-effective prevention and resolution of PPP disputes which is of paramount importance to the successful implantation of PPPs.<sup>72</sup> This study seeks to discuss dispute resolution procedures and processes applicable to PPP contract disputes and highlight those that guarantee efficiency and cost-effectiveness in the resolution of disputes arising under such contracts described as the best practices in resolution of disputes.

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<sup>71</sup> Delmon, J. (2009). *Private sector investment in infrastructure* Kluwer Law International, Alphen The Netherlands.

<sup>72</sup> Robert R. Bruce, Timothy J. Ellam , Rory Macmillan, Theresa Miedema, Hank Intven, (2004). *Dispute Resolution in the Telecommunications Sector: Current Practices and Future Directions. World Bank Working Paper No. 20*

The study addresses a gap in previous PPP literature, this is because PPP literature seems somewhat fragmented, and that it has not sufficiently addressed PPP policy regulation and dispute resolution in a proper perspective, with the consequence that the general knowledge about these important PPP issues has so far been rather limited.

### **1.10 Justification for the study**

The Government (GoK) in its long term development agenda has identified PPPs as critical and vital to the delivery of modern infrastructure and services that would in turn play a more vital role in economic growth and poverty alleviation.

Consequently, GOK has recognised the importance of fostering a legal and regulatory environment for PPPs to encourage investment into the infrastructure of Kenya and achieve a successful and sustainable PPP program. As observed above, in recent years GoK has taken several steps towards the establishment of a comprehensive PPP framework. The PPP framework is intended to address the key shortcomings in the infrastructure finance and PPP framework in Kenya.<sup>73</sup> It focuses mainly on the institutional capacity within the Ministry of Finance, and line Ministries, PPP law and regulation, project preparation and investment support. However, little has been mentioned about PPP dispute resolution. This is so despite the fact that many PPPs contracts are not successful and are not sustained due to disputes that are not well resolved often culminating to contract termination.<sup>74</sup>

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<sup>73</sup> Tito Kodiaga. (2012). Kenya Infrastructure Finance & Public-Private Partnership (IFPPP) Program. Environmental And Social Management Framework (ESMF),

<sup>74</sup> Gupta, A.P. (2011). Governance Mechanisms for Infrastructure Public-Private Partnership: Focus on India. *Master of Science in Technology and Policy Thesis*, Massachusetts Institute of Technology

PPPs require the establishment of a network of interrelated contractual and other legal relationships involving various parties. They are by their nature large infrastructure projects and are ripe for complex debilitating disputes which may often involve problems that do not frequently arise in connection with other types of contracts. Further, these projects usually involve governmental agencies (state corporations or authorities) and a high level of public interest.<sup>75</sup>

An understanding of the nature of PPP disputes can lead to the adoption of an efficient and cost-effective methods and processes of resolving disputes that may arise out of PPP contracts and this would in turn contribute to the desired objectives of promoting a common understanding of the main issues which are encountered in a PPP contract, allow consistency of approach to dispute resolution and reduce times and costs of dispute resolution by enabling all parties concerned to agree on a range of areas that can follow a standard approach.<sup>76</sup> This is the ideal whose translation into reality is to be explored in this dissertation.

To that extent, therefore, the study is driven by a desire not only to delve into legal and policy bases but also for purposes of stimulating, stirring and instigating academic discourse and public debate. Finally, the nature of the partnership between a public and a private sector partner points to the need for developing a viable framework to facilitate a common ground for business and that includes aspects of dispute resolution

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<sup>75</sup> Julie Hill and Joanna Collins (2004). P 34.

<sup>76</sup> Government of Nepal (2011). *Public Private Partnership (PPP)*. Government of Nepal's White Paper National Planning Commission March 2011

## **1.11 Chapter Analyses**

The first chapter will be the introduction. It will trace the genesis of the dissertation on this topic. It shall chronicle the objectives of the dissertation, the hypotheses, the methodology of the research, the theoretical perspective and basically all that went into the writing of this dissertation.

Chapter 2 will outline the theory and practices of PPPs, distinguishing it from other methods of public procurement, giving its historical perspective, and generally outlining its practice and perceived benefits.

There are various PPP projects. However the Build, Operate Transfer (BOT) models are common. BOT projects are large and complex undertakings, usually involving major infrastructure such as roadways and power plants. They raise the type of issues addressed in most other PPP projects and are therefore an ideal structure to assess for purposes of this research. For this reason, chapter 3 will identify and briefly discuss PPP projects and contracts undertaken in the international context. It will discuss some of the disputes that have arisen and the sequence of events leading to contract termination dispute resolution mechanisms that were employed. This chapter lays a basis for discussing the integration of the different dispute settlement methods into PPP dispute management in chapter 4

Chapter 4 concludes by discussing the various broad categories of PPP disputes, the general considerations for prevention and settlement of disputes and the different settlement methods that may be applied.

## CHAPTER TWO

### THEORY AND PRACTICE OF PPPS

#### 2.0 Introduction

This chapter discusses and outlines the theory and practice of PPPs, distinguishing it from other methods of public procurement, giving its historical perspective, and generally outlining its practice and perceived benefits.

#### 2.1 Background

Traditionally, social scientists have treated government as distinct from civil society hence the public –private dichotomy. According to Max Weber, this public-private distinction underlay his conception of a rational hierarchical. In Weber’s view, “it was left to the complete depersonalisation of administrative management by bureaucracy and the rational systemization of law to realise the separation of public and private fully and in principle”.<sup>77</sup> Weber famously defined the state as a “compulsory political association with continuous organisation...having administrative staff [that] successfully upholds a claim to the monopoly of the legitimate use of physical force in the enforcement of its order”. Under this conception, the state governs civil society; the state does not enter into governance networks with it.<sup>78</sup>

Similarly, the American democratic theorist Robert Dahl conceives of a clear separation between public and private. Borrowing from Weber, Dahl defines government in terms of its “exclusive regulation of the legitimate use of force in enforcing its rules within a given territorial area. Under Dahl’s conception of “polyarchy” however, political leader’s

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<sup>77</sup> Weber, Max (1946). *From Max Weber: Essays in Sociology*. New York: Oxford University Press p.239).

<sup>78</sup> Weber, Max (1947). *The Theory of Social and Economic Organization*. New York: Oxford University Press P154.

control of the state is legitimised through a pluralist democratic political process.<sup>79</sup> Dahl notes, however, that the forms of determining economic policy complement and supplement those of the price system and bargaining between governmental actors and key social groups within the nation-state. Even though Dahl's notion of polyarchy (where leaders are controlled indirectly through a pluralist process) is the reverse image of the notion of hierarchy (where control is exercised unilaterally by the state over its citizens), both concepts are based on a differentiation of the roles of the government (public) and the governed (private).<sup>80</sup>

Institutional economists, in contrast, are primarily concerned with the mechanisms used to coordinate, control and ultimately allocate resources and thereby determine economic outcome.<sup>81</sup> According to Chaffer, they refer to these mechanisms as systems of "governance", as opposed to government. Oliver Williamson, a prominent institutionalism economist is quoted by Chaffer as to differentiate between two primary mechanisms of allocating resources: governance by hierarchy and governance by markets.<sup>82</sup>

Although Williamson focuses much on the operation of firms, his ideas can, according to Shaffer be applied to political economy in general.<sup>83</sup> Under the concept of hierarchy, governments allocate resources by command, as through acts of legislatures, courts and

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<sup>79</sup> Dahl, R.A. 1976. *Modern Political Analysis*, 3rd ed. Englewood Cliffs: Prentice-Hall, p10

<sup>80</sup> Dahl, R. A., & Lindblom, C. (1976). *Politics, Economics, and Welfare*, 2nd ed. Chicago: University of Chicago Press, p171.

<sup>81</sup> Gregory C Shaffer, (2003). *Defending Interests: Public Private Partnerships in WTO Litigation*. Washington, D.C. : Brookings Institution Press

<sup>82</sup> Campbell, J.L., Hollingsworth, J.R., & Lindberg, (1991). *Governance of the American Economy*. New York: Cambridge University Press, May 31, 1991; Williamson, O. (1996). *The Mechanisms of Governance*. New York, Oxford University Press, p47.

<sup>83</sup> Yarbrough, B.V., & Yarbrough, R.M. (1990). Economic Integration and Governance: The Role of Preferential Trade Agreements. *Journal of Economic Integration* 35(2):1–20.

bureaucracies. Governments issue regulations, impose fines and collect taxes. Markets in contrast, allocate resources through the uncoordinated decisions of individuals, as reflected in the price systems. Markets thus reflect a private ordering of goods, services and wealth, in contrast to a hierarchical public one.<sup>84</sup>

This thesis will be concerned with what Shaffer may call a third form of governance. That complements public hierarchies and private markets: governance through public-private partnerships. These partnerships bring together public and private actors to address discrete policy issues or provide essential goods and services thereby blurring the public-private distinction. In a world of growing numbers and complexity, governments are delegating traditionally “public” functions to the private sector. Governments then attempt to “steer” outcomes by overseeing these ‘private actors’ activities. Donald Kettle is quoted by Shaffer stating that “Government’s role has changed. Government is less the producer of goods and services, and more the supervisor of proxies who do the actual work.”<sup>85</sup>

Public-Private Partnerships (PPPs) refer to innovative methods used by the public sector to contract with the private sector, who bring their capital and their ability to deliver projects on time and to budget, while the public sector retains the responsibility to provide these services to the public in a way that benefits the public and delivers economic development and improvement in the quality of life.<sup>86</sup> PPPs aim at financing,

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<sup>84</sup> Shaffer(2003) p12

<sup>85</sup> Kettle (1993). *Sharing Power: Public Governance and Private Markets*. Washington D.C: Brookings Institution, p.21

<sup>86</sup> United Nations (2008). *Guidebook on Promoting Good Governance In Public-Private Partnerships*. Geneva: United Nations Economic Commission for Europe



designing, implementing and operating public sector facilities and services. Their key characteristics include: long-term service provisions; transfer of risk to the private sector; and, different forms of long-term contracts drawn up between legal entities and public authorities.<sup>87</sup>

Locally, the Public Procurement and Disposal (Public Private Partnerships) Regulations, 2009 define a PPP agreement as an agreement between a procuring entity and a private party under which<sup>88</sup>: –

- (i) The private party undertakes to perform a public function or provide a service on behalf of the procuring entity;
- (ii) The private party receives a benefit from performing the function, either by way of compensation from a public fund; charges or fees collected by the private party from users or customers of a service provided to them; or a combination of such compensation and such charges or fees; and,
- (iii) The private party is generally liable for risks arising from the performance depending on the terms of the agreement.

## **2.2 Different Types of PPPS**

There are different types of PPPs with a strong upsurge recently of the contractual type consisting of the concession model where the user pays and the Private Finance Initiative (PFI) where the public sector pays based around different types of contract and risk transfer. The various types of PPPs are established for different reasons, across a wide

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<sup>87</sup> David I. Wilson, Nick Pelham, & Colin F. Duffield, (2010). A review of Australian PPP governance structures", *Journal of Financial Management of Property and Construction*. 15(3), pp.198 - 215

<sup>88</sup> Kenyatta, U. (2010). Public Procurement And Disposal (public Private Partnerships) Regulations, 2009. *Ministerial Report*, February 27, 2009

range of market segments, reflecting the different needs of governments for infrastructure services.<sup>89</sup> Even though these types vary, there can be said to be two broad categories of PPPs that is the institutionalized kind that refers to all forms of joint ventures between public and private stakeholders; and contractual PPPs.<sup>90</sup>

### **2.2.1 Concession Model of PPPs**

Concessions are contractual arrangements whereby a facility is given by the public to the private sector, which then operates the facility for a certain period of time. In most cases, this also includes building and designing the facility as well. The normal terminology of these contracts describes more or less the functions they cover. Concessions have the longest history of public-private financing. Most PPPs are in form of concessions.<sup>91</sup>

Contracts that concern the largest number of functions are “Concession” and “Design, Build and Operate” contracts because they tend to cover all the above-mentioned elements; that is, finance, design, construction, management and maintenance. They are often financed by user fees (e.g. for drinking water, gas and electricity, public transport etc and not for social programs and services like health, prisons, courts, education etc.<sup>92</sup>

### **2.2.2 Private Finance Initiative (PFI) Model**

In contrast to the concession model, financing schemes are structured differently. Under PFI schemes, privately financed contracts for public facilities and public works cover the

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<sup>89</sup> Brooks, H., Liebman, L., & Schelling, C., (1984). *Public-Private Partnership: New Opportunities for Meeting Social Needs*. Cambridge, MA: Ballinger.

<sup>90</sup> Stephen Thomsen, (2005). Encouraging Public-Private Partnerships In The Utilities Sector: The Role Of Development Assistance. OECD, Retrieved on February 29, 2012, <https://docs.google.com/viewer?a=v&q=cache:Ovr6skMZJ-wJ>:

<sup>91</sup> United Nations Economic Commission for Europe (2008), p21

<sup>92</sup> David I. Wilson, Nick Pelham, & Colin F. Duffield, (2010), p3

same elements but in general are paid for by a public authority and not by private users.<sup>93</sup> For example hospitals, schools and roads with shadow tolls where payments based on traffic volume is paid by the government in lieu of tolls. This model is based on the UK Private Finance Initiative which was developed in the UK in 1992 and has been adopted by some countries including parts of Canada, France, Australia, Singapore and the United States of America among others as part of the wider reform programme for the delivery of public services.<sup>94</sup>

As mentioned earlier, flowing from these two broad categories, there are a range of PPP models that allocate responsibilities and risks between the public and private partners in different ways. The following are some of the common used terms describing some of the partnership agreements and arrangements.

**(a) Buy-Build –Operate (BBO):**

This partnership involves the transfer of a public asset to a private or quasi-public entity usually under contract that the assets are to be upgraded and operated for a specified period of time. Public control is exercised through the contract at the time of the transfer.<sup>95</sup>

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<sup>93</sup> Hilderbrand, M. E., & Grindle, M. S., (1995). Building sustainable capacity in the public sector: What can be done?, *Public Administration and Development* 15: 441-63.

<sup>94</sup> Barlow, J. Roehrich, J.K., & Wright, S. (2010). De facto privatisation or a renewed role for the EU? Paying for Europe's healthcare infrastructure in a recession. *Journal of the Royal Society of Medicine*. 103:51-55

<sup>95</sup> Richard G. Little, (2010). Public Private Partnerships. *An Informational Summary prepared for The IEI Business Committee on Infrastructure*, North Carolina State University, November 2010.

**(b) Build- Own-Operate (BOO):**

In a BOO partnership, the private sector finances, builds, owns and operates a facility or service in perpetuity. The public constraints are stated in the original agreement and through on-going regulatory authority.<sup>96</sup>

**(c) Build-Own-Operate-Transfer (BOOT):**

Under BOOT partnership, a private entity receives a franchise to finance, design, build and operates a facility and to charge user fees for a specified period, after which ownership is transferred back to the public sector if not already transferred upon completion of the facility.<sup>97</sup>

**(d) Build-Lease-Operate-Transfer (BLOT):**

Under BLOT, a private entity receives a franchise to finance, design, build and operate a leased facility and to charge user fees for the lease period, against payment of rent.

**(e) Design-Build-Finance- Operate (DBFO):**

Under DBFO, the private sector designs, finances, and constructs a new facility under a long term lease and operates the facility during the term of the lease. The private partner transfers the new facility to the public sector at the end of the lease term.<sup>98</sup>

**(f) Finance only**

A private entity for example a financial service company may fund a project directly or use various mechanisms such as long-term lease or bond issue.<sup>99</sup>

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<sup>96</sup> Ibid, p1

<sup>97</sup> Yuan, J., Zeng, A. Y., Skibniewski, M. J. and Li, Q. (2009), p261

<sup>98</sup> Fiona Poole (1997). Roads and Private Finance. *Research Paper 97/85*, July 2, 1997

<sup>99</sup> Richard G. Little, (2010), p1

**(g) Operation & Maintenance Contract. (O&M):**

Under O&M, a private operator, under contract, operates a publicly owned asset for a specified term. Ownership of the asset remains with the public entity. It is noteworthy that an O&M may not fit squarely within PPP spectrum and may well be considered as a service contract.<sup>100</sup>

**(h) Design-Build (DB):**

In DB's, the private sector designs and builds infrastructure to meet public sector performance specifications, often for a fixed price, turnkey basis, so the risk of let's say cost overruns is transferred to the private sector. Again many do not consider DB's to be within the spectrum of PPPs and consider such contracts as public works contracts.<sup>101</sup>

**(i) Operations License:**

Under this arrangement, a private operator receives a license or rights to operate a public service, usually for a specified term. This is often used in IT projects. Notably, PPP arrangements come in many forms and are still an evolving concept which must be adapted to the individual needs of each project and project partners.<sup>102</sup>

Successful PPPs require an effective legislative and control framework and for each partner to recognize the objectives and the needs of the other. It is also important to note that while the benefits of partnering with the private sector in PPPs are clear, such relationships should not be seen as the only possible course of action and are indeed

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<sup>100</sup> Meador, R.J. (1995). *Maintaining the Solution to Operations and Maintenance Efficiency Improvement*. World Energy Engineering Congress, Atlanta, Georgia

<sup>101</sup> Richard G. Little, (2010), p1

<sup>102</sup> Abraham C. Lynn, Abraham C. Lynn and Robert Reitherman, (2011). AEI 2011: Building Integration Solutions. *Proceedings of the 2011 Architectural Engineering National Conference*. American Society of Civil Engineers (May 15 2012)

complex to design, implement and operate. Many alternative sources of financing are available. Therefore, PPPs should be carefully assessed in the context of the projects, the public benefit and the relative gains to be achieved under the various approaches.<sup>103</sup>

The options available for delivery of public services range from direct provision by a ministry or government department to outright privatization, where the government transfers all responsibilities, risks and rewards for service delivery to the private sector. Within this spectrum, PPPs can be categorized based on the extent of public and private sector involvement and the degree of risk allocation. In the figure the above mentioned models of public-private partnerships has been shown.<sup>104</sup>

### **2.3 PPPs Differentiated from Privatization and Public Procurement**

It is notable that differentiating privatisation and public procurement can be difficult. The definition of privatisation is rather muddled, however, as there are numerous definitions each one focusing on only one narrow aspect of managerial technique.<sup>105</sup>

In countries with many state-owned enterprises, privatisation is the transfer of enterprise ownership –in whole or in part–from the state to private hands. This is also called decentralisation. While there is a general agreement that the sale of government enterprises represent privatisation, there is less unanimity about the sale of other government assets such as land and buildings, as examples of privatisation. In countries such as the United States, which has relatively few state-owned enterprises, the term

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<sup>103</sup> European Commission (2003), p23

<sup>104</sup> Ibid, p24

<sup>105</sup> E.S. Savas. (2000). *Privatization And Public-Private Partnerships*. New York: Chatham House Publishers/ Seven Bridges Press.

“privatisation” is commonly applied to the act of contracting for public services.<sup>106</sup> Confusingly, in the financial world, the term privatisation can refer to the act of transforming a company from one whose shares are listed in a stock exchange and can be bought by members of the general public to one that is no longer listed or publicly traded because it has been bought by a private group.

From the foregoing, it is fair to conclude that privatisation is the act of reducing the role of government or increasing the private institutions of society in satisfying people’s needs. It means relying more on the private sector and less on government. It follows therefore that PPPs is malleable as form of privatisation. It is broadly defined as an arrangement in which a government and a private entity jointly perform or undertake a traditionally public activity.<sup>107</sup>

For purposes of this thesis, rather than differentiate between PPPs and privatisation, it is better to highlight the unique characteristic of PPPs as forms of privatisation. This uniqueness helps single out a PPP. PPPs are complex relationships often involving at least one government unit and a consortium of private firms, created to build large, capital intensive, long-lived public infrastructure such as a highway, airport, public building or water system or to undertake a major civic redevelopment project. Private capital and management of the design, construction and long-term operation of the infrastructure is characteristic of such projects, along with eventual public ownership.<sup>108</sup>

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<sup>106</sup> Salvador López Carbajal. (2012). Public-Private Partnerships for Private Sector Development: Shifting the Perspective of State Involvement. *Masters of Arts Dissertation*, Brussels School of International Studies

<sup>107</sup> E.S. Savas. (2000), p2

<sup>108</sup> Ibid, p1

On the other hand, PPPs can be distinguished from public procurement. Public procurement refers to the purchase, lease, rental or hire of a good or service by a state or a state organ. Procurement may be chosen because of the simplicity of goods or services desired the possibility to choose from numerous providers, and the wish to contain costs.<sup>109</sup>

PPPs, are more complex frequently larger in financial requirements, and are long-term as opposed to one-off relationships. They often provide the developer with the right to operate over an extended term, to charge fees to users and to assume key responsibilities e.g. design, construction, finance, technical and commercial operation, maintenance etc. However, PPPs are related to traditional public procurements in that PPP providers are often selected on the basis of public procurement procedures.<sup>110</sup>

## **2.4 Why PPPs?**

Development issues and challenges have become too complex and interdependent while the financial and managerial resources for addressing them too scarce, for any one single institution alone. Partnerships and people participation in development are forms of development modalities that need to be explored in addressing today's socio-economic problems.<sup>111</sup>

In Kenya, like many other African countries, public agencies are facing increasing difficulties in implementing development agendas, due to financial, ideological and social reasons. For example, the performance of the public sector in providing social services,

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<sup>109</sup> European Commission (2003), p1

<sup>110</sup> Ibid; United Nations 2008, Guidebook on promoting good governance in public-private partnerships,

<sup>111</sup> Richard Bailey, Dave Collins, Paul Ford, Áine MacNamara, Martin Toms, Gemma Pearce. (2010). *Participant Development in Sport: An Academic Review*. March 2010



including infrastructure is generally poor. Studies conducted by some development agencies buttress this point.<sup>112</sup>

These problems are often attributed to rapid population growth, coupled with low economic growth, contracting public sector expenditure, rising unemployment and impoverishment which have widened the gap between provision of social services and infrastructure and what is needed. Further, shrinking budgets are forcing governments to reduce expenditures on social services. These challenges are forcing governments to think strategically and creatively in order to improve infrastructure networks and enhance service delivery to their people. In this respect, the concept of PPPs receives serious consideration.<sup>113</sup>

As result, in the recent past, there has been a surge in government efforts to share responsibilities in the delivery of basic social services, including infrastructure, with private sector and sometimes the civil society. Another important driver for partnership is that public provision of social services is lagging behind both in terms of quality as well as quantity. Against this background, discussions on the significance of government working in partnership with the private sector and civil society have emerged as a golden opportunity for government to engage non state actors in providing infrastructure and related services.<sup>114</sup>

In a nutshell, PPPs have developed in part due to financial shortages in the public sector. PPPs have demonstrated the ability to harness additional financial resources and

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<sup>112</sup> UNDP, (2003). Human Development Report, 2003

<sup>113</sup> Bloomfield, P. (2006). *The Challenging Business of Long-Term Public-Private Partnerships: Reflections on Local Experience*. Public Administration Review, 400-411

<sup>114</sup> UNECA (2005). Partnership modalities for enhancing good governance. *ECA/DPMD/TP/05/4*, December 15, 2005

operating efficiencies inherent to the private sector.<sup>115</sup> Additionally, there is a growing realization that cooperation with the private sector, in PPP projects, is able to offer a number of advantages, including:

#### **2.4.1 Acceleration of Infrastructure Provision**

PPPs often allow the public sector to translate upfront capital expenditure into a flow of ongoing service payments. This enable projects to proceed when the availability of public capital may be constrained (either by budgetary constraints), thus bringing forward much needed investment.<sup>116</sup>

#### **2.4.2 Faster Implementation.**

The allocation of design and construction responsibility to the private sector, combined with payments linked to the availability of a service, significantly incentivizes the private sector to deliver capital projects within shorter construction timeframes.<sup>117</sup>

#### **2.4.3 Reduced Whole Life Costs**

PPP projects which require operational and maintenance service provision significantly incentivizes the private sector to minimize costs over the whole life of a project. This would be inherently difficult to achieve within the constraints of traditional public sector budgeting.<sup>118</sup>

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<sup>115</sup> European Commission (2003), p5

<sup>116</sup> United Nations, (2006). *The Contribution of the Private Sector to the Implementation of the New Partnership for Africa's Development (NEPAD)*. Published by the Office of the Special Adviser on Africa, New York.

<sup>117</sup> Karim Bakhteyari , (2007). *Public Private Partnerships: As a public infrastructure optimizer. Diploma Work 20P*, Nottingham Trent University

<sup>118</sup> Ibid p7

#### **2.4.4 Better risk allocation.**

A core principle of any PPP is the allocation of risk to the party best able to manage it at the least cost. The aim is to optimise rather than maximise risk transfer to ensure best value is achieved.

#### **2.4.5 Better incentives to perform.**

The allocation of project risk should incentivise a private sector contractor to improve its management and performance in any given project. Under most PPPs projects, full payment to the private sector contractor will only occur if the required service standards are being met on an ongoing basis.

#### **2.4.6 Improved quality of service.**

Generally, the quality of service achievable under a PPP is often better than that achieved under traditional procurement. This may reflect the better integration of services with supporting assets, improved economies of scale, the introduction of innovation in the delivery of services or the performance incentives and the penalties often included within a PPP contract.

#### **2.4.7 Generation of additional revenue.**

The private sector may be able to generate additional revenues from third parties, thereby reducing the cost of any public sector subvention required. Additional revenue may be generated through the use of spare capacity or the disposal of surplus assets.

#### **2.4.8 Enhanced public management.**

By transferring responsibility for providing public services government officials will act as regulators and will focus upon service planning and performance monitoring instead of

the management of the day to day delivery of public services. In addition, by exposing public services to competition, PPPs enable the cost of public services to be benchmarked against standards to ensure that the very best value for money is being achieved.

Internationally, the interest in PPPs is attributable generally to three main drivers:

#### **2.4.9 Investment in infrastructure.**

Economic growth is highly dependent on the development and enhancement of infrastructure, particularly in utilities such as power, water and telecommunications and transport systems. Furthermore, in many countries there is an urgent need for new social infrastructure such as hospitals and healthcare equipment, prisons, education facilities and housing. For many governments this is seen as the most pressing area of private sector involvement.

#### **2.4.10 Greater efficiency in the use of resources**

The experience of privatisation has shown that many activities, even those traditionally undertaken by the public sector, can be undertaken more cost effectively with the application of private sector management disciplines and competencies.

#### **2.4.11 Generating Commercial Value from Public Sector Assets**

Significant amounts of public resources are invested in the development of assets such as defence technology and leading edge information systems that are often used for narrow range of applications within the public sector. Engaging private sector expertise to exploit these assets in a wider range of applications can lead to the realisation of substantial incremental value for the public sector.

#### **2.4.12 Overall aim of PPPs and Nexus with Dispute Resolution**

From the discussions above, the overall aim of PPPs is therefore to structure the relationship between the parties, so that risks are borne by those best able to control them and increased value is achieved through the exploitation of private sector skills and competencies. In order to work successfully with the private sector, public bodies need to be clear about the fundamental principles and objectives behind PPPs. Under PPP arrangements, private sector contractors become long term providers of services rather than simply upfront asset builders, combining the responsibilities of designing, building, operating and possibly financing assets in order to deliver the services needed by the public sector. As result, central and local government agencies become increasingly involved as regulators and focus resources on service planning, performance monitoring and contract management rather than on the direct management and delivery of services. The result is that the public mission is delivered through the private sector.

Designed appropriately, PPPs can generate substantial benefits for consumers and tax payers. The scope of potential benefit will, however, depend on the type of project being undertaken and the exact term of the contract governing the PPPs. It is important to note that public bodies have a critical role to play in the management and regulation of PPPs during the design, construction and operation. PPPs require effective contract monitoring procedures to ensure that contractual obligations continue to be met in terms of both quality and timing. Conflict resolution is vital component of a contract monitoring process. It is the subject of this project paper.

## 2.5 Understanding the basic structure of PPPs: Build-Operate-Transfer (“BOT”)

Many PPP projects around the world are structured and financed on the BOT model. The basis for all projects structured on the BOT model is likely to be the granting of a concession or licence (or similar interest) for a period of years involving the transfer and re-transfer of all or some of the project assets. There are many definitions describing BOT projects and one of the more illustrative is:

“A project based on the granting of a concession by a principal, usually a government, to a promoter, sometimes known as the concessionaire, who is responsible for the construction, financing, operation and maintenance of a facility over the period of the concession before finally transferring to the principal, at no cost to the principal, a fully operational facility. During the concession period, the promoter owns and operates the facility and collects revenues in order to repay the financing and investment costs, maintains and operates the facility and makes a margin of profit.”<sup>119</sup>

The key features are, therefore, the grant of a concession, the assumption of responsibility by the promoter (or sponsor) for the construction, operation and financing of the project and the re-transfer at the end of the concession period of the project <sup>120</sup>

BOT projects are highly complex, commercially driven projects requiring extensive documentation and negotiation. A BOT project represents a serious investment of money and time by everyone involved. The project company and in turn the lenders, will

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<sup>119</sup> See note 26 below

<sup>120</sup> Denton Wilde Sapte (2006): *Public Private Partnerships: BOT techniques and project finance* 2<sup>nd</sup> Edition, London: Euromoney Books.

undertake extensive and expensive technical, financial and legal due diligence exercises to analyze the risk allocation for a project. A reasonable and efficient contractual structure with commercially appropriate risk allocation is a deciding factor in the bankability<sup>121</sup> of the project and whether the lenders will wish to go forward with the project financing of infrastructure development.<sup>122</sup>

### **2.5.1 Commercial Agreements Involved and the General Structure of BOTs**

In a typical BOT project the public sector grantor grants the rights to a private company to develop and operate what would traditionally be a public sector project. The private company or Project Company obtains financing for the project, and procures the design and construction of the works and operates the facility during the concession period. Therefore, the project company must have or obtain access to resources sufficient to meet these obligations.

The project company coordinates the construction and the operation of the project in accordance with the requirements of the concession agreement. The operation of the facility will generate revenues from an off take purchaser who compensates the project company for delivery of the project output or provision of the project service. Such arrangements are complex and require extensive documentation and negotiation. Consequently, the following agreements form integral part of BOTs.

### **2.5.2 Financing agreement**

This agreement contains the terms and conditions pursuant to which the lenders agree to lend funds to the project company. These lenders may include commercial banks, export

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<sup>121</sup> Bankability of a project involves the assessment of its economic, financial and technical viability.

<sup>122</sup> Supra note 26 at 94

credit agencies, bondholders and multilateral and bilateral lending institutions. Lenders are responsible for the financing of substantial portion of the project and are therefore very influential on the drafting of agreements involved in the BOT project in order to ensure the bankability of the project.

### **2.5.3 Shareholders' Agreement**

This agreement governs the relationship between the shareholders within the project company. It involves several documents, for example a sponsor's agreement for the pre-financial close phase, joint venture agreement, memorandum and articles of association, shareholder loan, stand-by equity and other similar documentation.

The shareholders' agreement will cover issues such as the business of the project company, conditions precedent to its creation, the issue of new shares, the transfer of shares, the allocation of project costs and the management of the project company including decision-making and voting. Such an agreement will often also include non-competition clause to bar shareholders from entering into any activities directly or indirectly in competition with the project company.<sup>123</sup>

### **2.5.4 Concession Agreement**

In this agreement, the grantor grants a concession in form of a series of rights to the project company to build and operate infrastructure for a predetermined period. The agreement may also set out the legal and tax regimes applicable to the project, environmental obligations of the project company, and the requirements of all the project

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<sup>123</sup> Ibid at 100



participants, including lenders. In some cases, the concession agreement, the offtake agreement and the input or the supply agreement can be combined in one agreement.

### **2.5.5 Off take Purchase Agreement**

An offtake purchase agreement obliges the offtake purchaser to procure a certain amount of project output or pay for an amount of project service over a given time. It therefore secures the project payment stream. The offtake purchaser will be looking for a guaranteed long term output from the project. The offtake purchase agreement may provide sanctions if the project company fails to deliver output as promised; in particular if the construction of the project is not finished within the time for completion or does not perform as required when completed. The obligation to purchase output may require that the offtake purchaser has sufficient facilities to receive the output delivered or to use the services provided.

### **2.5.6 Input supply agreement**

This agreement obliges an input supplier to deliver to the project company a specified quantity of input necessary to the operation of the project, at a certain level of quality. The agreement allocates certain elements of the market risk associated with the price and availability of the input. The agreement will only be needed where some supply of input is necessary for operation of the facility.

### **2.5.7 Construction contract**

The construction phase of the BOT project is generally governed by turnkey construction contract or an engineering procurement contract. The lenders who will seek certainty of exposure to risk will require that a construction contract establishes a fixed lump-sum

price and a set time for completion. The lender places the majority and in some cases all the risk of the construction on the contractor.

### **2.5.8 Operation and maintenance agreement**

The project company will want to ensure proper operation of the works during the concession period and will therefore enter into an operation and maintenance agreement with the operator of the facility. The operator's obligations will mirror those set out in the concession agreement, the offtake purchase agreement and those required to ensure continued and efficient operation of the project.

### **2.5.9 Direct agreements.**

The lenders and the grantor may enter into direct agreements with project participants to cover issues such as security over project assets, secondment of personnel, accommodation and costs. Similarly, these direct agreements may consider the management of know-how between the project participants and the project company including transfer, duration, licensing rights, exclusivity, and distributorship among other considerations. Direct agreements may contain collateral warranties in favour of the lenders and the grantor and will set out step-in rights, notice requirements, cure periods and other issues intended to maintain the continuity of the project where the project company defaults or falls away.

### **2.5.10 Parties Involved in A BOT Project**

As discussed above a number of parties will be involved in a BOT project and each may have different interests, levels of sophistication and available resources.

## **2.6 Lenders**

The profile of a lender's group can range from project to project, and may include a combination of private sector commercial lenders together with export credit agencies and bilateral and multilateral finance organizations. Funding is sometimes provided by project bonds, sold on the capital markets, sovereign wealth funds and other financial intermediary.

As a general premise, the lenders will only want to take those risks which are measurable and are measured. They also want to have certainty as to financial exposure. The lenders may be involved in most of the important phases of the works, including the drafting of the project documents and certification of completion. The lenders may require that direct agreements be entered into between themselves and each of the project participants.<sup>124</sup> They will generally maintain their review powers over the project with the assistance of independent experts like engineers.

## **2.7 Grantor and host government**

BOTs are primarily based on the provision of a concession by a national or local government, a government agency or some regulatory authority ("grantor"). The grantor will generally be responsible for the interface between the project and the government authorities of the host country. These may include rights of access, protection from nationalization or expropriation, protection from changes in law, regulations and tax, and foreign exchange availability and convertibility issues.

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<sup>124</sup> See Direct Agreement among the Government of Kenya, Kenya Railways Corporation, Sheltam Rail Company(Pty) Ltd, RVR Investments(Pty) Ltd, Rift Valley Railways (Kenya) ltd, International Finance Corporation and KfW ("Project Participants")

In some cases, the grantor is required to have the authority to grant the concession. It may be necessary to pass legislation or even a constitutional amendment before the concession as let by the grantor can be considered as valid. This arises from the ultra vires rule where acts outside the scope of a grantors legal mandate can render the concession void and available legal remedies are not likely to compensate the sponsors satisfactorily.<sup>125</sup>

The government and the national or local government may play an important role in providing guarantees and generally insuring that the project commences and is completed successfully through its more or less active support. The government will also play an important role during operation, in relation to regulatory requirements and taxation or tariff restrictions.

Where the government is not a party to and is therefore not legally bound by the concession agreement, the project participants will need to ensure continued support from the government, which generally involves taking into consideration the interests of the government. For its part, the government may prefer to limit its involvement in the project and minimize the risk it may have to bear. As far as possible, the project participants should ensure that the project and any project activities continue to be consistent with the host government's interests.

## **2.8 What may constitute government interests?**

As illustrated elsewhere above, BOTs (PPPs) imply the participation of a wide range of actors and stakeholders, which are involved as contracting parties. These include consumers, users, regulators, NGOS, trade unions, environmental groups and

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<sup>125</sup> Supra note 86 at 104

independent operators. Because of the complexity and quality of relationships among the contracting parties, an appropriate distribution of roles between national and local authorities and the private partner is essential.

Relatedly, efficient and professional management of social service delivery is vital in achieving financial sustainability, customer responsiveness and optimal use of resources. Most public utilities owned and run by the government entities in Kenya have been widely unsuccessful in providing reliable services. An example in point is water supply and sanitation services. Furthermore, government monopoly over the provision of those services has resulted in lack of accountability and community ownership in the planning, implementation and management of these services hence low quality and limited service alternatives.

However, there are often fears that the private sector involvement in service delivery will result as they often do in higher tariffs and that private sector providers will favour high-income consumers and thus major social goals may not be met. It is also important to note that the private sector, operating in the context of a better regulatory environment and greater autonomy of service provider authorities and utilities, is more effective in servicing low-income consumers.

The above and other cross cutting issues inform the government's interest in BOTs.

One of the most challenging aspects of PPPs remains the need to reconcile the two competing aspects: government's need to find ways to fulfil their socioeconomic responsibilities for ensuring services to all citizens, on the one hand, while striving to preserve the interests of private investors on the other. Another important factor is that

private companies operating in the sector need to be convinced that investing in any particular social service project offers more attractive returns than other available investment opportunities.<sup>126</sup> All said, host government interests may include:

- i. Perceived public or national interest;
- ii. public control of the project during the concession to ensure protection of public interests and improved public perception of the host government;
- iii. Public safety including environmental and social impact; response of the relevant constituency. This is often related to tariff restrictions and levels of environmental impact and public nuisance;
- iv. minimising the need for injection of public funds, investment, guarantees and assistance; and
- v. Minimizing public risk while maximizing public control; smooth and efficient transfer of the project (if applicable) at the end of the concession period in good mechanical condition with no need for replacement of major parts or equipment; and attracting benefits for political personalities or parties in power

## **2.9 How Does the Host Government Get Involved in BOTs?**

The government will always get involved in the aspects of the project. The extent to which they get involved may be defined under local law. Any existing framework provided for will define to some extent the grantor's approach to the project and the risk/obligations the grantor can undertake. The government's role will also depend

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<sup>126</sup> ibid UNCEA page 39

largely on the position of the government in the project and the need for relevant support in order to attract the necessary private investment in infrastructure development.

### **2.9.1 Tendering**

The grantor may involve the government, or be instructed by the government, in the original promotion of the project, identifying the need for the project and defining its requirements. The government may also be instrumental in choosing the successful bidders.

### **2.9.2 Risk Sharing**

The project company will require the grantor to bear certain risks. In many cases the intention is not so much for the grantor to compensate the project company for the occurrence of the risk, but rather for the grantor to place pressure on the government, through its relationship with the grantor, to be a primary obligor in relation to such risks. The government may therefore be called on where such risks arise or are likely to arise.<sup>127</sup>

### **2.9.3 Attracting Investment**

Once the government has decided to go forward with a project, it will want to attract the necessary foreign investment. In order to attract the best quality at the least direct cost, the host country may provide some incentives to the project company, such as tax benefits (including tax holidays, the use of tax heavens or creative use of tax credits), assistance in procuring land, relaxation of legal requirements including licensing and administration procedures, grants, debt financing, improved tariffs on utilities and other

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<sup>127</sup> *ibid* at 106

services or fuel, new improved infrastructure, use of project resources for non project related purposes or involvement in bids for further projects in the country.

#### **2.9.4 Political Marketing**

The project company may need assistance in selling or promoting the project to the public and any other relevant government organizations. The government is generally in a good position to advise or assist in conveying to the relevant parties the benefits of the project.

#### **2.9.5 Setting of Government Policy**

Most PPP projects will involve a traditionally public sector service. Therefore, government policy will have a direct relation to the success of the project, including issues such as the setting of tariff requirements, environmental, service, health and safety restriction, laws on taking of security and lender's rights, exchange and convertibility of the currency matters and taxation. This may include passing legislation to facilitate implementation of BOT projects.

#### **2.9.6 Provision of information basic to the feasibility of the project.**

Most certainly, PPP projects will involve use of land. The site therefore is usually located within the territory of the government and will often involve the land either within the country or provided by the government. In either case, the government might have a certain amount of information about the site. This information can either be geographical, archaeological, hydrological, or meteorological which can be useful for the development phase of the project.



### **2.9.7 Documentation**

The government may provide draft documentation for use in the project, in particular concession and offtake purchase agreements.

### **2.9.8 Assistance with finance**

The government may provide some finance or assist in obtaining financing, insurance and/or guarantees from local lenders, multilateral agencies, international organizations or export credit agencies.

### **2.9.9 Guarantees**

A PPP project company may need guarantees from the government concerning various aspects of the project, possibly including the offtake purchaser's and the input supplier's obligations; availability, transferability and convertibility of local currency; and other such risks that the project company and grantor cannot manage efficiently.

### **2.10 Multilateral, bilateral and export credit agencies**

These are international and sometimes political entities who are frequently involved in BOT projects. They can have an important impact on the risk allocation and financing used in a project. When involved in such projects, these agencies will place strict requirements on the project structure and lending arrangements especially in relation to environmental and social safeguards.

### **2.11 Multilateral agencies (MLAs) and bilateral agencies (BLAs)**

MLAS represent a group of nations and are owned and funded by their members. Their purpose will often be set out in the charter of documentation and many include fostering transition to market economies, alleviating poverty, supporting the development of new

markets, and providing commercial banks and companies with support and incentives to enter certain markets. Some MLAs are mandated to finance projects in specific geographical regions, such as the African Development Bank (AfDB).<sup>128</sup>

MLAs can participate in projects through equity investments, by providing guarantees or insurance or by providing loans. MLAs can also provide financing from their own funds or act as a conduit for funding from commercial banks. Some of the more active MLAs in international project finance are the IFC, the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (ERDB) and the European Investment Bank (EIB).

Certain international organizations specialize in providing political risk coverage. An example is the Multilateral Investment Guarantee Agency (MIGA) of the World Bank.<sup>129</sup>

BLAs which are sometimes referred to as development finance institutions are principally similar in purpose and approach to MLAs, but are funded only by one nation. They are generally mandated to provide support to specific developing countries in the form of debt or equity investment. They are politically oriented, in that they carry out the political will of their donor nation.

An example of a BLA is the Investment and Promotions Company for Economic Cooperation (PROPACO). Created in 1977, PROPACO is a development financial

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<sup>128</sup> The African Development Bank (AfDB) Group's Mission is to reduce poverty, improve living conditions for Africans and mobilize resources for the continent's economic and social development. The institution aims at assisting African countries individually and collectively in their efforts to achieve sustainable economic development and social progress. The African Development Bank Group –Fast Facts [www.afdb.org](http://www.afdb.org)

<sup>129</sup> As a member of the World Bank Group, MIGA's mission is to promote foreign direct investment into developing countries to support economic growth, reduce poverty, and improve lives. MIGA provides three key services: political risk insurance for foreign investments in developing countries, technical assistance to improve investment climates and promote investment opportunities in developing countries, and dispute mediation services, to remove possible obstacles to future investment. About MIGA [www.miga.org](http://www.miga.org)

institution partly held by Agence Francaise de Developpement (AFD) and private shareholders. Its mission is to be a catalyst for private investment in developing countries which targets growth, sustainable development and reaching the Millennium Development Goals (MDGs).<sup>130</sup>

## **2.12 Export credit agencies (ECAs)**

An ECA is an agency attached to a given country and can be an arm or a department of the government of that country. Its general role is to encourage and assist foreign investment and the export of goods and services by its nationals. The ECA can provide financing, insurance or guarantees for the goods and services exported by its source-country nationals. An example of an ECA is the Japan Bank for International Cooperation (JBIC).

ECAs may provide direct lending, or guarantee or insure repayment of commercial lender financing in case of political risk and/or commercial risk. The political risk borne by the ECAs will generally include political violence, war, hostilities, expropriation and currency transfer risk.<sup>131</sup>

## **2.13 Project Company**

It is a practice in BOTs that the sponsors identify a project and put together a bid in an effort to be awarded the project. Once, selected, they will create a special purpose vehicle (SPV) which will contract with the grantor to design, construct, operate, maintain and transfer the project. The use of an SPV is likely to enable the sponsors to finance the

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<sup>130</sup>Societe de Promotion et de Participation pour la Cooperation Economique S.A About us [www.proparco.fr](http://www.proparco.fr)

<sup>131</sup> Supra note 86 at 110

project on a limited recourse basis. For purposes of taxation, sometimes the nationality of the project company becomes important.

The project company will generally include shareholder companies which specialize in one or several of the tasks which need to be performed under the concession agreement. The grantor may also require that the project company includes local investors in order to improve transfer of technology, and provide jobs and training to local personnel. There will be a shareholder's agreement which will include provisions related to deadlock, excluding shareholders from decisions associated with a contract to which that shareholder is counterparty, pre-emption rights in respect of retiring of shareholders and how to address default in shareholders particularly in relation to their financial obligations.

The project company is mandated with the duty of deciding how to distribute revenues to its members. Shareholders may also include specialist investment vehicles which provide equity financing to projects, for example mezzanine financing and venture capital funds. Shareholders of the project company will often be both shareholder and subcontractor, for example the construction contractor or operator may also be shareholder. Where this arises, they will be in a position of conflict of interest. This conflict of interest will need to be managed amongst the shareholders, the grantor and the lenders. For example the shareholder should not be in a position to negotiate or influence the negotiation of the original contract or set prices.

## **2.14 Construction Contractor**

A project company may have to enter into a construction agreement. Completion and performance risk is thereby placed on the construction contractor. The construction contract will be as far as possible back- to- back with the concession agreement, and therefore any construction risk placed on the project company by the concession agreement will, through the construction contract flow through to the construction contractor.<sup>132</sup>

## **2.15 Operator**

The operator will operate and maintain the project over an extended period, often from the completion of construction, or the first completed section, until the end of the concession period. It will need to manage the input supply and offtake purchase, monitor testing of the project and ensure proper operation and maintenance. The operator will also need to manage the interfaces with the construction contractor, when the tests on completion are performed and when the project is handed over to the operator after completion; with the offtake purchaser, to ensure timely delivery; with the input supplier , to ensure complaint provision of input, and with the grantor for confirmation of performance levels and confirming proper maintenance and testing of the works at the end of the concession period, if the project is to be transferred back to the grantor.

An illustration of this point can be drawn from the agreement providing for the concession of the Kenya and Uganda railway freight and passenger services in which an interface agreement relating to matters common to the Kenya freight and passenger

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<sup>132</sup> Ibid at 112

concession and the Uganda freight concession was signed between the various parties. The agreement makes provisions inter alia; for concession shareholding arrangements and harmonization and joint railway commissions.<sup>133</sup>

### **2.16 Offtake purchaser**

In order to divert market risk away from the project company and the lenders, an agreement may be made with a purchaser for the use of the project or the purchase of any output produced. The offtake purchase agreement will require the offtake purchaser to pay for a minimum amount of the project output or for all fixed costs no matter how much output it takes, and thereby create a secure payment stream. This forms an important basis for financing. Sometimes the offtake purchaser may also be the grantor, or a government entity such as a public utility. In such a case the offtake purchase agreement and the concession agreement may be one and the same document.<sup>134</sup>

### **2.17 Input Supplier**

The input supplier assumes the supply risk for an input necessary for operation of the project. Therefore, the project company is protected from the risk that the project will not reach its intended production level for lack of essential input, such as fuel or raw materials. The input supplier ensures a minimum quantity is delivered. However, there are some projects that may rely on market availability of input or may not need input at

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<sup>133</sup> Interface Agreement relating to matters common to the Kenya Freight and Passenger Services and the Uganda Freight Concession.

<sup>134</sup> Supra note 94 at 113

all. Others may require service rather than an input for example removal of sludge from a water treatment facility.<sup>135</sup>

### **2.18 Stages of Development and Negotiation of A BOT Project.**

A BOT project is generally preparation intensive, requiring careful analysis and negotiation before the project is performed. Negotiating, documenting and structuring the financing of BOTs are mostly time consuming. Because of the amounts of money involved, the grantor and the project company must allow sufficient time for this important stage.

Similarly, there is need to seek appropriate specialist advice from legal, insurance and financial advisers as well as technical and operational experts and parties experienced in operations in the host country, its customs, politics and market.<sup>136</sup> Failing to consult such advisers may prove costly to the private partner. Thus in *Kenya Transport Association versus Municipal Council of Mombasa & another [2011] eKLR*, a PPP Agreement was declared unlawful, null and void by a constitutional court.

In that case, the Municipal Council of Mombasa had entered into a partnership with a private company, to develop parking for heavy commercial vehicles. The council allocated land to the private company which developed thereon private parking yards for heavy commercial vehicles. The council gazetted the privately developed parking yards as public parking yards for purposes of parking for heavy commercial vehicles. A policy was then introduced by the council requiring owners of all heavy commercial vehicles to park at the designated yards for such fees that were gazetted. Pursuant to the PPP

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<sup>135</sup> *ibid* at 114

<sup>136</sup> *Ibid* at 115

agreement, a private company was mandated to collect parking charges to enforce such policies that ensure the yards are utilised.

Kenya Transport Association were aggrieved. They stated that the PPP entered into by the Council did not comply with the terms of the Public Procurement and Disposal Act, 2005 (Cap. 412C) Laws of Kenya and was contrary to the terms of the constitution of Kenya. They further contended that designating parking yards operated by the private company without inviting bidders or expression of interest by competitors among them members of the association was inconsistent with the constitution and infringed on the association's rights to equal protection and equal benefit of the law.<sup>137</sup>

The court in its ruling expressed itself thus;

“The claim of discrimination under Article 27 of the Constitution is integrally linked to the functioning of the Public Procurement and Disposal Act; only by due compliance with the enactment, would the 1<sup>st</sup> respondent as a public authority, give fulfilment to the safeguards of that Article, with regard to the contract for parking services. But the petitioner has shown by evidence that the 1<sup>st</sup> respondent had rendered the contract to the 2<sup>nd</sup> respondent without complying with the Public Procurement and Disposal Act... It was a discriminatory process which without a lawful cause, entirely excluded those such as members of the petitioner their fundamental rights and freedoms under Article 27 of the Constitution had been infringed.”<sup>138</sup>

There are various mechanisms for selecting the project company. This may include the open tender procedure which involves an extension of an invitation to tender a price

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<sup>137</sup> Republic of Kenya (2009). The Public Procurement And Disposal (Public Private Partnerships) Regulations, Chapter 412C, Revised.

<sup>138</sup> Jurist (2011). Justice J B Ojwang' and the Organic Law. June 14, 2011



against a fixed specification and contract terms. There can also be a semi negotiated tender where the shortlisted bidders are to negotiate based on draft documentation, and to provide proposed modifications in their bids. A fully negotiated process involves the preferred bidder selected based on its own abilities, with the project documentation negotiated, often after selection.<sup>139</sup>

The Public Procurement and Disposal (Public Private Partnerships), Regulations 2009, sets out the approval steps for all PPPs including BOTs.<sup>140</sup> This gives an indication of the phases of a BOT Project.

### **2.18.1 Project Conceptualization**

This involves project conceptualization, identification, prioritization and pre-feasibility analysis by the procuring entity promoting or sponsoring the project. Prior to preparation of the concept paper, the public sector agency is expected to conduct a systematic screening on all their planned priority infrastructure projects to determine which ones might better be delivered through public private partnership arrangements including BOTs.<sup>141</sup>

At this stage, the Regulations require an approval of the preliminary concept by a Steering Committee established pursuant to Regulation 4. The Committee is then required to register the concept as a PPP and if necessary advise the procuring entity to

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<sup>139</sup> European Commission (2003). Guidelines For Successful Public – Private Partnerships. Directorate-General Regional Policy March 2003

<sup>140</sup> Republic of Kenya (2009), Regulations 2009, rule 3(3), first schedule

<sup>141</sup> Republic of Kenya (2008). *Guidelines on Public-Private Partnerships*. Public Private Partnership Steering Committee, Ministry of Finance.

procure advisory services if the procuring entity does not have the necessary expertise.<sup>142</sup>

### **2.18.2 Preparation and conduct of feasibility study.**

At this stage the procuring entity is required to carry out a feasibility analysis and the proposed risk allocation structure. This should clearly outline the project's required output levels of services or goods, demand analysis, financial feasibility analysis, economic feasibility analysis, as well as preliminary environmental, legal and institutional analysis. The procuring entity should also identify and analyze all the material risks to PPP. It should also clearly outline the PPP concept including specific functions to be carried out by the private party and the procuring entity and any assets belonging to the procuring entity to be transferred to the PPP.<sup>143</sup>

### **2.18.3 Submission**

The third phase is the submission by the procuring entity of the project concept and feasibility study to the Steering Committee and the evaluation of the same by a PPP secretariat under Regulation 7.<sup>144</sup>

### **2.18.4 Consideration**

The fourth stage involves consideration of the project concept and feasibility study including the risk sharing arrangements. If the project value is of US\$ 10 million and above, then the Minister responsible for the sector and the Minister for Finance are

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<sup>142</sup> Norman LaRocque (2008). Public-Private Partnerships in Basic Education: An International Review. *CfBT Education Trust*, May 2008; Ibid, p46

<sup>143</sup> Paulsson, Jaul. (1996). Dispute Resolution. In Robert Pritchard, ed., *Economic Development, Foreign Investment and the Law: Issues of Private Sector Involvement, Foreign Investment and the Rule of Law in a New Era. International Bar Association Series*. Boston: Kluwer Law International and International Bar Association.

<sup>144</sup> Fishbein, Gregory, and Suman Babbar. (1996). Private Financing of Toll Roads. *Resource Mobilization and Cofinancing (RMC) Discussion Paper Series 117*. Washington, D.C.: World Bank.

required to submit a joint Memorandum to the cabinet for cabinet approval or guidance.<sup>145</sup>

#### **2.18.4 Preparation of Bid Documents**

The next phase is that of the preparation of bid documents including the Requests for prequalification (RfQ), the Request for Proposals (RfP) and the proposed PPP contract.

#### **2.18.5 Approval by the Steering Committee**

This phase requires the approval by the Steering Committee of the bid documents. Upon approval, authority will be granted to advertise for RfQ and or RfPs as necessary. Prequalified firms will be allowed to make comments on RfPs. If there are material changes to the RfPs and the proposed contract at this stage, further clearance will be required from the Secretariat. If the changes result in a material departure in the project concept and transaction structure from what had been approved by the Cabinet, Cabinet clearance will also be required. The RfPs, receipt of bids, evaluation of bids and submission of bid evaluation reports are to be submitted to the Steering Committee for approval.<sup>146</sup>

#### **2.18.6 Contract Negotiation**

This phase involves contract negotiation by the procuring entity.

#### **2.18.7 Review of contract and further approval**

This phase involves a review of the negotiated contract and the granting of approval by the Steering Committee for the procuring entity to sign the approved PPP contract.<sup>147</sup>

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<sup>145</sup> Paulsson, Jaul. (1996), p 78.

<sup>146</sup> Request For Proposal (RFP) For Appointment Of Transaction Adviser For Setting Up Schools Through PPP

<sup>147</sup> Government Of The Republic Of Liberia. (2009). Public Procurement And Concessions Act, 2005, Implementation Manual. Public Procurement And Concessions Commission,

## **CHAPTER THREE**

### **EXAMPLES OF PUBLIC PRIVATE PARTNERSHIPS THAT ENDED UP WITH DISPUTES**

#### **3.0 Background**

In the course of studying Arbitral Awards concerning PPP disputes, the Researcher has benefited from extensive and detailed analysis of contractual disputes relating to PPPs. Although these contractual disputes have been the subject of very full and careful consideration by the Researcher, it was neither practical nor necessary to recite the complete factual records and judicial analysis in this Thesis. Instead, the Researcher provides a brief distillation of the relevant background facts and events as well as the contracts in issue, by way of context for the subsequent portions of this Thesis with focus upon specific factual matters and judicial pronouncements in so far as they are relevant to the Research.

A careful analysis gives an indication of various problems that dodge PPP and the dispute resolution process. Ranging from political intervention, coercion, allegations of corruption and in the invocation of Bilateral Treaties between states, PPP disputes appears to be very complex processes that need special and careful consideration.<sup>148</sup>

#### **3.1 B.O.T Contract for *Ras Sudr* International Airport**

Following an earlier announcement by the Arab Republic of Egypt, the Egyptian Directorate of Civil Aviation, acting on behalf of the Republic, launched a call for tenders

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<sup>148</sup> Johan A. Minnie (2011). Critical Success Factors For Public-Private Partnerships In South Africa. *Doctor of Philosophy Dissertation*, Stellenbosch University, January 2011

for the building of *Ras Sudr* International Airport on the basis of the PPP Model known as BOT in August 1999. This meant that the successful bidder was to undertake to construct and operate the airport for a specific contract term, after which the airport was to be transferred to the State. The tender was awarded to Malicorp Limited, a company incorporated on August 6, 1997 and registered in the United Kingdom of Great Britain and Northern Ireland. Its share capital according to its Memorandum and Articles of Association of July 30, 1997 was UK £ 1000 divided into 1,000 shares of one pound sterling each.<sup>149</sup>

Malicorp's bid in reply to the call for tenders stated the intention to enlist the technical and financial support of Nordic Engineering Resources Group A.S (NERG), a Norwegian company active in the civil aviation sector and a specialist in equipping and managing airports and a subsidiary of the Nordic Aviation Resources Group (NAR), Joannou & Paraskvaid, (Overseas), (J&P), a company active in airport construction, incorporated in Guernsey in the United Kingdom, and General Mediterranean Holding (GMH), the holding company of an international investment group based in the Grand Duchy. ASMA Company for Trade and General Contracting of Egypt as well as Digitel Telecom Company for Contracting and Technical and Electronic Establishment were also mentioned.<sup>150</sup>

The Contract was subsequently executed. The objectives sought primarily the construction of an airport as part of the general policy of developing and extending

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<sup>149</sup> International Centre For Settlement Of Investment Disputes. (2011). *Malicorp Limited (Claimant) v. The Arab Republic Of Egypt (Respondent)*: ICSID Case No. ARB/08/18. Award of February 7, 2011)

<sup>150</sup> *Ibid*, P3

airports with a view to developing the neighbouring tourist region. Malicorp (Concessionaire) was called upon to contribute thereto and to receive additional land so as to enhance the attractiveness of the region and therefore the airport. Malicorp was granted exclusive right for a term of Forty One years to operate the concession and carry out the project at its own cost subject to early termination or extension.<sup>151</sup>

Prior to the submission of its bid, on September 15, 1999, Malicorp had amended its Memorandum and Articles of Association with the effect that the share capital was increased to UK £ 100 million divided into one million shares of UK£100. After winning the award and signing the contract, on February 18, 2000, Malicorp received a letter from a company expressing interest in a possible collaboration between the two companies for purposes of financing the contract. On March 22, 2000, Malicorp's Board of Directors decided to cancel the resolution to increase the share capital to £100 million and to replace it by a value of £ 1000.<sup>152</sup>

### **3.1.1 Disputes and Disagreements from Signing Of Contract to Its Rescission**

Under the Contract, Malicorp had to take a number of measures quickly, in particular setting up an Egyptian company. According to the Contract, it was to be a limited company with an authorised capital of 100 million Egyptian pounds of which 10 million Egyptian pounds were to be subscribed immediately.<sup>153</sup>

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<sup>151</sup> Ibid p22

<sup>152</sup> Ibid p42

<sup>153</sup> Ibid p7; Nathalie Bernasconi-Osterwalder, & Vyoma Jha (2011). Recent Developments in International Investment Disputes: Investment treaty cases from September 2010 to October 2011. *International Institute for Sustainable Development Publication*

For this purpose, but at a date which was not been communicated, Malicorp instructed the firm of Mustapha Shawki, a major Egyptian firm of chartered accountants and auditors (hereinafter the “founders’ agent”), and entrusted it with taking the necessary steps for setting up the company. That firm submitted the necessary documents, duly legally authenticated, as well as the draft articles of association, to the Investment Authority, the department with competence to register investment companies in accordance with Egyptian Law no. 8 of 1997 on investment incentives.<sup>154</sup>

On 11 December 2000, the ECAA sent Malicorp a first notice concerning the non-performance of the Contract, notably the obligation to provide a bank guarantee.

On 4 January 2001, Mr. Shaker, a representative of Malicorp who was an Egyptian national, submitted a land allocation request to establish a tourist centre on behalf of “Malicorp Misr Company for construction of Ras-Sudr International Airport”. According to the ICSID Tribunal, the names mentioned in that request did not correspond either to those on the Certificate of Establishment, or to those on the application dated 12 March 2001.<sup>155</sup>

On 20 January 2001, the ECAA notified Malicorp that it had not complied with its contractual obligations, concerning the establishment of an Egyptian company and concerning increasing the bank guarantee to two million Egyptian pounds. On 4 February 2001, the 90-day time limit granted to Malicorp to set up the company under the terms of the Contract expired without the Egyptian company having been incorporated.<sup>156</sup> On 18 February 2001, the ECAA sent Malicorp a “Third and Last Notice,” threatening to take

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<sup>154</sup> International Centre For Settlement Of Investment Disputes. (2011). p 7

<sup>155</sup> Ibid p9

<sup>156</sup> Ibid pg 8

measures to end the Contract by the end of February 2001 if Malicorp did not comply with its contractual obligations.<sup>157</sup>

On 12 March 2001, the founders' agent filed an application for approval of the Egyptian company. The application mentioned the names of three founders: Malicorp, Mibo Gawli and Sayed Hanafy Mahmoud. On 12 May 2001, Mr. El Ela, one of Malicorp's founders, informed the Government of the Republic of certain problems concerning the Malicorp Company and the information furnished by it.

The Parties differed as to his position in relation to Malicorp. According to Malicorp, he was a former founder while Egypt's position was that he was a shareholder and representative of the company. The record showed that Mr. El Ela used Malicorp's letterhead for his letter and signed it stating that he was one of Malicorp's founders .

On 30 May 2001, following a letter from Dr. Shawki dated 27 May 2001 and a letter from Dr. Abbe Mercer dated 28 May 2001, the Government of the Republic, through Pilot Kato, invited Malicorp to provide it with complete and correct copies of various documents by 30 June 2001.<sup>158</sup>

On 19 June 2001, the shareholders of the Egyptian company in the process of being established deposited 10% of the issued capital with Banque Misr, namely one million Egyptian pounds, which was to remain blocked until registration of the company with the Commercial Register. On 30 June 2001 the time limit for Malicorp to provide the information required in the letter from the Republic expired. Following the deposit of the

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<sup>157</sup> Ibid, p8

<sup>158</sup> Ibid, p9



said amount with Banque Misr, Malicorp waited several months during which the founders' agent contacted the various authorities concerned or their key staff in order to obtain a clear reply concerning the incorporation and registration in the Commercial Register of Malicorp's Egyptian subsidiary.

On 1 July 2001, the Minister of Transport sent a letter to the General Commission for Investments, approving the incorporation of the Egyptian company following review of the documents received and confirmation by the Norwegian Embassy, the British Embassy and the Egyptian Embassy in Norway of the company's capability to carry out the project. Afterwards, Malicorp began to receive formal notices of breach of its contractual obligation to set up an Egyptian company. Malicorp objected that this delay had been caused by the failure of those same Egyptian authorities to register the last formalities for the setting up of the Egyptian company.<sup>159</sup>

On 21 July 2001, a meeting of the Egyptian Special Commission for the Ras Sudr Airport was held to discuss the problems concerning the Contract and the setting up of the local company. The official minutes of this meeting held at the Cabinet of the Minister of Transport show that the decision to refuse incorporation of the Egyptian company was made on that day; fourteen agencies of the Government of the Republic took part.<sup>160</sup>

On 22 July 2001, a letter was sent to the Shawki firm, informing it that the competent security authorities had decided to refuse to approve the incorporation of the company.<sup>161</sup>

On 23 July 2001, Malicorp wrote to the Egyptian Prime Minister. In its letter it

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<sup>159</sup> Ibid, p9

<sup>160</sup> Ibid, page 9

<sup>161</sup> Ibid

mentioned two former generals who had allegedly had links to the company and used unlawful methods in order to divert Malicorp from its objective, including by means of racketeering, extortion and threats:

*“There were among the company personnel two retired generals Adel Darwish and Sayed Aboul Alaa who were layed off for reasons related to their behavior towards the company which was concretized by threats, extortion and racketeer confirming their grip and proving that they were capable of some acts which were thereafter withdrawn or cancelled without anyhow forcing the company to abide by their extortion [...]. The above-mentioned retired generals threatened the company of cancelling the contract and not letting the company continue in Egypt [...]. The Company refused such cheap blackmail [...]”<sup>162</sup>*

Malicorp requested the support of the Prime Minister to resolve this matter.

On 28 July 2001, Malicorp wrote to the President of the Republic asking him to personally intercede on its behalf with the persons who were preventing performance of the Contract. Malicorp Claimant once again described the practices of which it accused the two generals described above.<sup>163</sup>

*The company had sought the assistance of the retired generals Sayed Aboul Alaa and Adel Darwish to help in some matters. The first was put aside from the first day for having fought with persons in charge at the Aviation Authority and the proof of his lack of competence and his failure in carrying out his assignment. The second was*

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<sup>162</sup> Ibid page 9

<sup>163</sup> Ibid p 12

*also put aside for having adopted the style of arrangement, extortion, racketeering, death threats and thereafter pretending that he was a relative to the Head of the Aviation Authority [...].*<sup>164</sup>

In that letter, Malicorp complained, among other things, of the methods allegedly used by General Kato, the President of Civil Aviation, who had allegedly sent a letter to the British Embassy containing insults and attacks against the representatives of Malicorp. He had also allegedly written to the Norwegian Embassy in order to obtain information concerning Malicorp, though Malicorp was an English company.

In the same letter to the President, Malicorp raised questions about Dr Al Ghamrawy. He was alleged to have promised to assist in resolving the problem, which he had not done, but had even promised General Adel Darwish, previously accused of extortion, racketeering and threats, that he would prevent the Egyptian company from being incorporated.<sup>165</sup> On 12 August 2001, the “Ministry of Transportation; Egyptian Holding Company for Aviation; A Joint partnership of Business Sector” notified Malicorp of the termination of the Contract.<sup>166</sup>

### **3.1.2 Events Subsequent to the Rescission**

On 13 August 2001, in reaction to the termination of the Contract, Malicorp wrote to the ECAA setting out a list of fourteen arguments why the rescission was void.<sup>167</sup> On 1 September 2001, the Egyptian Ministry of Transport notified the British Embassy that the

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<sup>164</sup> Ibid page 10

<sup>165</sup> Malicorp-vs-Egypt page 10 paragraph 32

<sup>166</sup> Ibid paragraph 33

<sup>167</sup> Ibid paragraph 34

Contract with Malicorp had been “nullified”.<sup>168</sup> On 4 September 2001, the Egyptian Ministry of Transport confirmed the “cancellation” of the Contract by the Egyptian Aviation Holding Company.<sup>169</sup>

On 12 December 2001, the First Under Secretary of the Minister of Transport wrote to Head of the Commercial Sector of the British Embassy in Cairo, informing her that Malicorp could contact the Investment Authority and follow the formal procedure in order to establish the Egyptian company.<sup>170</sup>

On 3 January 2002, Malicorp wrote to the Minister of Transport. In that letter it asked the Minister to write to the General Commission for Investments informing it that the Contract was going forward, and requesting its authorisation for the establishment of the Egyptian company as provided in the Contract. On 23 January 2002, by letter to the Minister of Transport, Malicorp requested authorisation from the Investment Authority to establish the Egyptian company. That attempt nevertheless failed, as the President of the Civil Aviation Holding Company of the Ministry of Transport replied on 27 February 2002 confirming that National Security had renewed its refusal.<sup>171</sup>

Thereafter, the matter was also raised via diplomatic channels; the British and Norwegian Embassies expressed their surprise and then the British Minister of Foreign Affairs, discussed the matter with the President of the Republic, in the course of an official visit to Egypt.<sup>172</sup> On 7 October 2002, the Minister of Civil Aviation confirmed to the

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<sup>168</sup> Ibid paragraph 35

<sup>169</sup>

<sup>170</sup> Ibid p Paragraph 37

<sup>171</sup> Ibid, p11

<sup>172</sup> Ibid p 12 paragraph 40

Ambassador of Great Britain in Cairo that the project had been cancelled. By that time the ECAA had already liquidated and cashed the bank guarantee deposited by Malicorp with Banque Misr.<sup>173</sup>

On 15 January 2003, the British Minister of State for International Commerce and Investment, wrote to the representative of Malicorp, confirming that the Embassy in Cairo was continuing to press Malicorp's case and that the Ambassador was trying to arrange a meeting with the, Minister of Civil Aviation. In her letter, she also stated her intention to obtain a meeting with the Minister of Civil Aviation during her next trip to Egypt.<sup>174</sup> In the period prior to the commencement of the arbitration proceedings before the Cairo Centre, the ECAA was replaced by several holding companies, each managing a part of Egypt's civil aviation service.<sup>175</sup>

### **3.1.3 Arbitration Proceedings before the CRCICA**

On 20 April 2004, Malicorp filed a request for arbitration with the Cairo Regional Centre for International Commercial Arbitration (hereinafter "CRCICA"). The CRCICA proceedings were between Malicorp as claimant and three respondents, namely the Arab Republic of Egypt, the Egyptian Holding Company for Aviation and the Egyptian Airport Company. On 31 May 2004, the arbitral tribunal set up under the aegis of the CRCICA (hereinafter the "CRCICA Arbitral Tribunal") was constituted. On 15 July 2004, the Minister of Civil Aviation applied for a stay of the arbitration proceeding as a criminal complaint had been lodged with the Egyptian courts. The Minister complained of

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<sup>173</sup> Ibid paragraph 41

<sup>174</sup> Ibid p10

<sup>175</sup> Ibid p11

fraudulent practices by the claimant and by civil servants with the Egyptian Directorate General of Civil Aviation. The CRCICA Arbitral Tribunal refused to stay the proceedings and decided to continue with its examination of the case.<sup>176</sup> On 19 February 2005, Malicorp filed its Statement of claim. It alleged that the respondents had wrongfully terminated the Contract thereby entitling Malicorp to claim damages for the losses sustained.

On 21 May 2005, the respondents filed their Statement of Defence. In it they asserted that Malicorp had breached its contractual obligations, that it had acted in bad faith and that the Contract was null and void due to the production of a falsified extract from the Companies Register.<sup>177</sup> On 26 July 2005, Malicorp filed its Reply (“Claimant’s Reply regarding the claim,” reiterating its submissions and arguments with respect to the liability of the respondents for the damage sustained. On 21 September 2005, the respondents filed their Rejoinder (“Rejoinder in Counter Evidence of the Republic to the Claimant concerning the Claim;” On 11 and 12 February 2006, the parties submitted their post-hearing submissions.<sup>178</sup>

On 19 February 2006, the Council of State Administrative Court of Cairo held that the arbitration clause contained in the Contract was void and ordered the CRCICA Arbitral Tribunal to suspend the arbitration proceedings. That decision followed the filing by the Arab Republic of Egypt of a claim for the arbitration clause to be ruled null and void. On

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<sup>176</sup> Ibid p46

<sup>177</sup> Ibid p12

<sup>178</sup> Ibid p13

15, 16 and 17 November 2005, the CRCICA Arbitral Tribunal held a hearing with the parties.<sup>179</sup>

On 27 February 2006, Mr. Gabr, one of the co-arbitrators, gave notice by letter to Mr. Mohamed Aboul Einein, Director of the CRCICA, that he had decided to suspend his participation in the CRCICA proceedings because of the decision of the Council of State Administrative Court of Cairo finding the arbitration clause null and void. Notwithstanding that resignation, the CRCICA Arbitral Tribunal went ahead with the proceedings; it stated that it was doing so in reliance on (Egyptian) Arbitration Law no. 27/1994.

On 7 March 2006, the CRCICA Arbitral Tribunal issued an arbitral award. It held first of all that the arbitration agreement in the Contract was binding on the Republic. It went on to hold that the Republic had been the victim of a fundamental error in signing the Contract in that it had wrongly believed that the capital registered and paid by Malicorp was 100 million pounds sterling and that for this reason the Contract was void. It therefore dismissed the submissions of the Claimant claiming damages for the loss caused by the termination of the Contract.<sup>180</sup> It nevertheless decided to order the respondents to reimburse Malicorp for costs, invoices and the salaries of its employees. In this regard, it ordered the respondents to pay Malicorp the sum of 14,773,497 dollars, with interest.

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<sup>179</sup> Ibid p14

<sup>180</sup> Ibid p15

### 3.1.4 Attachment and Enforcement Proceedings

On 9 August 2006, one of the Vice-Presidents of the Paris *Tribunal de Grande Instance* issued an *ex parte* order for the exequatur of the CRCICA arbitral award on the application of Malicorp. The French enforcement order was served on the Egyptian Embassy in Paris. Consequently, on 10, 12 and 13 October 2006, assets of the Republic in the possession of Banque Misr, UBAF and LCL were attached on the application of Malicorp.<sup>181</sup>

On 16 October 2006, Egypt appealed against the enforcement order issued on 9 August 2006 and On 20 October 2006, Egypt applied to the enforcement judge of the Paris *Tribunal de Grande Instance* to lift the attachment orders.<sup>182</sup> It principally argued State immunity from execution and the absence of risk with respect to its solvency. On 31 October 2007, the enforcement judge of the Paris *Tribunal de Grande Instance* held a hearing. Egypt through its various agencies and bodies proposed a compromise solution to Malicorp: the delivery of a surety bond by Banque Misr in exchange for Malicorp's agreement to lift the attachment orders and its undertaking not to take any steps to enforce the CRCICA arbitral award (either in France or abroad). The agreement referred to above was finalised on 16 November 2007 after Banque Misr proposed and delivered the original of the surety bond on behalf of Egypt in favour of Malicorp. Malicorp thereafter went before the enforcement judge to have the contested attachments lifted.<sup>183</sup>

On 19 June 2008, the Paris Court of Appeal granted the appeal filed by Egypt against the decision of the enforcement judge and dismissed the application for exequatur. It based

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<sup>181</sup> Ibid paragraphs 60-61

<sup>182</sup> Terrill, Richard J. (2009). *World Criminal Justice Systems: A Survey*, 7 ed. Elsevier.

<sup>183</sup> International Centre For Settlement Of Investment Disputes. (2011). p15 paragraphs 64-65



its decision on one of the four arguments of Egypt: it ruled that the issuing of an arbitral award by an arbitral tribunal on the basis of a provision that had not been previously submitted to the parties amounted to a denial of justice. It accordingly found that it was superfluous to examine the other arguments. Consequently, on 22 August 2008, Malicorp lodged its first *pourvoi en cassation* (appeal in a higher court)<sup>184</sup> against the decision of the Paris Court of Appeal, arguing the lack of sufficient reasons for the decision of 19 June 2008.

On 11 March 2009, the two Parties were informed that Malicorp's first *pourvoi* had been held inadmissible because it was procedurally flawed as Malicorp had, indeed, omitted to append to its *pourvoi* a copy of the judgment appealed against. Accordingly, on 13 March 2009, Malicorp lodged a second *pourvoi en cassation*. The *Cour de cassation* (court of last resort)<sup>185</sup> dismissed the *pourvois* in a decision of 23 June 2010. It considered that the CRCICA Arbitral Tribunal had violated the adversarial principle by basing its decision on provisions of the Egyptian Civil Code that had not been pleaded by the parties.<sup>186</sup>

### **3.1.5 Criminal Proceedings before the Cairo Court of Assizes**

In parallel to the CRCICA arbitration proceedings, criminal proceedings were instituted against individuals directly or indirectly connected with Malicorp. On 17 August 2005, the Public Prosecutor's office issued an order remanding the case to the Cairo Court of Assizes. The order referred to various unlawful and fraudulent acts committed by

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<sup>184</sup> Reichel, Philip L. (2002). *Comparative Criminal Justice Systems: A Topical Approach*, 3 ed. Prentice Hall.

<sup>185</sup> Reynolds, Thomas H. (1998). Introduction to Foreign and Comparative Law. In Rehberg, Jeanne; Popa, Radu D. *Accidental Tourist on the New Frontier: An Introductory Guide to Global Legal Research*. pp. 47–86.

<sup>186</sup> International Centre For Settlement Of Investment Disputes. (2011). P16 para 70

individuals connected with Malicorp, as well as certain Egyptian civil servants involved in examining the bid that Malicorp had submitted.<sup>187</sup>

A total of ten individuals were remanded for trial: five Egyptian civil servants, in particular, were charged with unlawful taking of interest and various unlawful acts in connection with the conclusion of the Contract. Five shareholders or alleged shareholders of Malicorp were charged, in particular, with having falsified the Companies Register with respect to Malicorp. The Cairo Court of Assizes also tried the five accused on charges of forgery of private documents since that offence was connected to the offences before the Court in the principal case, although the normal procedure would have been to remand the matter to the Criminal Court. On 2 September 2006, the Cairo Court of Assizes rendered its verdict: Two accused persons were found guilty of forgery and fraud and sentenced principally to three years' imprisonment. They appealed but were unsuccessful.<sup>188</sup>

### **3.1.6 Arbitration Proceedings**

On 21 October 2008, Malicorp, filed a Request for Arbitration against the Government of the Arab Republic of Egypt with the Secretariat of the International Centre for Settlement of Investment Disputes (hereinafter "ICSID"). It essentially alleged therein that the Republic violated its obligations under the Agreement of 11 June 1975 between the United Kingdom and Egypt for the promotion and protection of investments, and

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<sup>187</sup> Ibid, p16

<sup>188</sup> Ibid p 16 para 71,72 & 73

consequently requested that Egypt be ordered to pay compensation covering, above all, the losses and lost earnings resulting from termination of the Contract.<sup>189</sup>

At the hearing one of the issues canvassed by Egypt was that there was submission of inaccurate documents concerning Malicorps's financial capacities that was misleading. The argument advanced was that Malicorp held itself out as a company with capital of £100 million. Egypt accused Malicorp of fraudulent act. Malicorp argued to the effect that its issued capital was £ 1000 but authorised capital was £100 million. It argued that there was a difference between the two with the former constituting the actual capital and the latter being the amount up to which the board of directors may increase the capital without calling an extraordinary general meeting.<sup>190</sup>

In the arbitral proceedings, Malicorp sought to be compensated for reasons that the contract was terminated for reasons connected to national security and that such termination entitled it to compensation. The tribunal, in reaching its verdict, analysed the implication of Malicorps argument. The tribunal held that there was a substantial difference between issued capital and authorised capital. In the first case there are shareholders who have made a firm commitment to pay it, while in the second case there is only power given to the company's organs to decide when they should look for shareholders willing to commit. The tribunal held that for a project as monumental as of the Ras Sudr airport, knowing whether the company awarded the project is an empty shell or a company with exceptional resources was obviously fundamental and any error on that point justified calling the contract into question. It followed that the rescission of

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<sup>189</sup> *Malicorp Limited v. The Arabian Republic of Egypt* (ICSID Case No. ARB/08/18), Award, February 7, 2011

<sup>190</sup> *Ibid*, p16

the contract was well founded, and could not be considered a form of expropriation under international law.<sup>191</sup>

### **3.2 Power Purchase Agreement (PPA) vs Tanzania Electric Supply Company Limited (TANESCO)**

Tanzania Electric Supply Company Limited (TANESCO) a public utility charged with the responsibility the generation, supply and transmission of electric power throughout the country entered into a PPA in the form of a form of PPP to wit design, construct own, operate and maintain.<sup>192</sup> The agreement was entered into between TANESCO and Independent Power Tanzania Limited (“IPTL”) a joint venture company between VIP Engineering & Marketing Limited of Tanzania and Mechmar Corporation (Malaysia) Berhard, a Malasyian company.<sup>193</sup>

Under the agreement, IPTL agreed to design, construct, own, operate and maintain an electricity generating facility with a nominal net capacity of 100 megawatts, to be located in Tegeta Tanzania (“the Facility”) and to operate the facility and deliver electricity generated thereby to TANESCO for an initial period of 20 years subject to extension for further periods as was therein provided.<sup>194</sup> Under Article IV of the PPA, the price to be paid after the Initial Operations Date of the first unit comprised three basic elements; a ‘Capacity Payment’, an ‘Energy Payment’ and a ‘Test Energy Payment’ to be applied before the applicable commercial operations date.

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<sup>191</sup> Ibid, p22

<sup>192</sup> Karl P. Sauvart, Lisa Sachs, Ken Davies, Ruben Zandvliet. (2011). *FDI Perspectives: Issues in International Investment*. Vale Columbia Center on Sustainable International Investment, January 2011

<sup>193</sup> Tanzania Electric Supply Company Limited –v- Independent Power Tanzania Limited (ICSD Case No. ARB/98/8, Final Award of June 22<sup>nd</sup> 2001) page 2 paragraph 2

<sup>194</sup> Ibid, p3 para3

Under Appendix B to that Agreement, a ‘Reference Tariff’ was to be established comprising a ‘Capacity Purchase Price’ (which in turn consisted of two elements, namely a ‘Capital Component’ and ‘Debt Component’), and ‘Energy Purchase Price’ (also consisting of two elements, namely a ‘Fuel Cost Component’, and a ‘Variable Operations and Maintenance Costs Component’, which was subject to escalation/variation in accordance with the detailed provisions of the agreement so as to arrive at the actual price or tariff payable.<sup>195</sup>

Under Article IV it was a condition precedent to the obligation of TANESCO to purchase electrical energy and capacity from IPTL and that IPTL should have fulfilled certain conditions, including in particular under Article 4.1(b), the submission not less than 30 days prior to the commencement date a certificate from an independent engineer stating that the Facility, when constructed with the general layout drawings submitted therewith would (inter alia) conform with the description of the Facility, and under Article 4(c), the provision as soon as available but in any event prior to the Initial Operations Date of each unit, of a certificate from the independent engineer stating that the Facility has been designed (inter alia) in all material respects in accordance with the terms of the Agreement and the general layout drawings.<sup>196</sup>

On 8<sup>th</sup> June 1995, an Implementation Agreement and Guarantee Agreement was entered into between IPTL and the Government of the Republic of Tanzania. The above contractual relationship was entered into against the backdrop of a severe shortage of

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<sup>195</sup> Eric Frank Ringo (2011). Termination Compensation and State Concessions (Guarantees) under the public Private Partnership (PPP): Towards Tanzania New PP Horizon. *Master of Law Thesis*, Bucerius/WHU

<sup>196</sup> ICSD (2001). *Tanzania Electric Supply Company Limited (TANESCO) (Claimant) Vs Independent Power Tanzania Limited (Respondent)*, ICSD Case No. ARB/98/8, July 12, 2001.

electric power within Tanzania which was apparently due in part to developments in the economy which stimulated significant growth in the demand for electricity coupled with problems experienced within Tanzania's existing hydro-generated power system.<sup>197</sup>

Article XVIII of the PPA provided (inter alia) agreed machinery for the resolution of disputes. By Article 18.3, it was agreed that any disputes arising out of or in connection with the PPA should be settled by Arbitration in accordance with the Rules of the Procedure for Arbitration Proceedings of the International Centre for Settlement of Investment Disputes (the "ICSID Arbitration Rules") established by the Convention on the Settlement of Investment Disputes between States and Nationals of other States (the "ICSID Convention"), and that for the purposes of consenting to the jurisdiction of the Centre, it was agreed that ITPL was a foreign-controlled entity, unless the amount of the voting stock in ITPL held by non- Tanzanian investors decreased to less than fifty per cent of the voting stock. Such an arbitration was to be held in London, England and, unless otherwise agreed by the parties, before a tribunal of three arbitrators –one to be nominated by TANESCO, one to be nominated by IPTL , and a third to be nominated by the party –nominated arbitrators or failing their agreement by the High Court of England and Wales.<sup>198</sup> Disputes did arise and were referred to arbitration pursuant to the aforesaid contractual provision.

### **3.2.1 Dispute Genesis**

In due course, on 4<sup>th</sup> February 1997, an Engineering, Procurement and Construction Contract (the "EPC Contract") was concluded between IPTL and Stork-Wartsila Diesel

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<sup>197</sup> Arthur Mwakapugi, Waheeda Samji and Sean Smith (2010). *Tanzania Energy Sector: The potential for Job Creation and Productivity Gains Through Expanded Electrification*. Special Paper 10/3

<sup>198</sup> ICSD (2001). p2, Para 10

B.V (“Stock-Wartsila”), a company established in The Netherlands, for purposes of constructing the generation plant required to perform the PPA. In addition, on 21, May 1997, IPTL entered into a Fuel Supply Agreement (the “FSA”) with Galana Petroleum Limited (“Galana”) and Total International Limited (“Total”) for an initial term of 5 years to supply the fuel necessary to operate the Facility.<sup>199</sup>

As the Facility was being constructed and the prospect of commencing common operations came nearer, disagreements developed. In particular, TANESCO took issue with the fact that the EPC Contract with Stork-Wartsila called for the provision of 10 MW medium speed diesel engines, instead of the five 20 MW slow speed diesels originally envisaged in the PPA agreement. Further, it was becoming necessary for the parties to discuss adjustment of the Reference Tariff foreseen an Addendum to the PPA.<sup>200</sup>

Of interest, these events took place against the background of apparent controversy within Tanzania regarding a competing project, known as the SONGO-SONGO Gas-to-Electricity or “SONGAS” Project, in respect of which agreements had been initialled on the 23<sup>rd</sup> of March 1997 between (inter alia) the Government of Tanzania, TANESCO and two Canadian companies, Ocelot Energy Inc. (“Ocelot”) and TransCanada Pipelines Limited. This rival project was to be built by Canadian interests and financed by the International Bank for Reconstruction and Development. According to the Tribunal, there was evidence in the arbitration that, notwithstanding the urgency with which the PPA was had been concluded in 1995, pressures were thereafter exerted both on and within the

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<sup>199</sup> Ibid, p6 para14

<sup>200</sup> Ibid, p3, para 15

Government of Tanzania and TANESCO to defer it, if not eliminate it, in favour of the SONGAS Project.<sup>201</sup>

Accordingly, on 9 April 1998, on the eve of the scheduled discussions, between TANESCO and IPTL on the Adjustment of Reference Tariff, TANESCO served on IPTL a Notice of Default asserting that IPTL was in default on its obligations to supply install the slow speed diesel generating sets as per the PPA and calling upon IPTL to cure the defect within 90 days.<sup>202</sup>

Negotiations were attempted but were unsuccessful and on 25<sup>th</sup> November 1998, TANESCO lodged a claim with for arbitration asserting that;

- (a) “The medium speed diesel engines had been substituted for the required slow speed diesel engines without obtaining prior written consent of TANESCO entitling TANESCO to terminate the PPA; alternatively,
- (b) That pursuant to an Addendum (Addendum No. 1) the Capacity Purchase Price was to be “cost based”, but IPTL was refusing to share the relevant information with TANESCO and the cost seemed excessive, so that in the event the PPA could not be terminated the tariff should be adjusted”.<sup>203</sup>

On the 14<sup>th</sup> December 1998, TANESCO gave IPTL a Notice of Intent to Terminate pursuant to the PPA. Meanwhile on 30<sup>th</sup> November 1998, five days after lodging of the Request for Arbitration by TANESCO, IPTL filed a Petition in the High Court of Tanzania in Dar es Salaam, directed against TANESCO and three officials of the Government of Tanzania, seeking both declaration that commercial operation of the

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<sup>201</sup> Ibid, p3 para 16

<sup>202</sup> Ibid, p8 para18

<sup>203</sup> Ibid, p8 para19



IPTL's facility be deemed as having commenced 15<sup>th</sup> September 1998 and an order for payment to IPTL by TANESCO of a "Capacity Payment" in the amount of \$ 3,623,000 monthly beginning on that date.<sup>204</sup>

On 7 December 1998, TANESCO petitioned the Tanzanian High Court to stay the proceedings recently commenced against them. The next day, on 8<sup>th</sup> December 1998, IPTL submitted to the same Court a Objection on a Preliminary Point of Law asserting in effect that TANESCO had waived its right to pursue the arbitration. On 5<sup>th</sup> March 1999 the High Court of Tanzania sustained the preliminary objections of IPTL and proceeded immediately to grant the relief requested by IPTL in its original petition. Leave to appeal was granted to TANESCO and it sought stay of execution pending such appeal.<sup>205</sup>

In response, on 7 April 1999, IPTL applied for an order of execution in the amount of \$23,670,266.67 that being the accumulated sum of the monthly "Capacity Payments" due pursuant to the High Court's Order up to April 1, 1999. Thereafter, IPTL agreed that it would not execute for a limited period.<sup>206</sup>

At the Arbitral hearing of the parties for provisional measures, IPTL revised its request by (1) withdrawing its demand for a lump sum payment of the alleged arrears accumulated in respect of the order of the High Court of Tanzania, and (2) requesting that a requested order that sought permission of commercial operations also enjoin TANESCO to co-operate with IPTL, including conducting operational tests and connecting the Facility to the Tanzanian power grid. The demand for a monthly Capacity Payment remained. In the final Award, the Tribunal upheld the validity of the PPA and

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<sup>204</sup> Ibid p9 para21

<sup>205</sup> Ibid page 9 paragraphs 22-24

<sup>206</sup> Ibid page 10 paragraph 25

parties were ordered to comply with their obligations. A compromise was reached between the TANESCO and IPTL.<sup>207</sup>

### **3.3 Dar es Salaam Water Supply and Sanitation Project**

#### **3.3.1 Background: Water Situation in Dar es Salaam**

The Lease Contract concluded by the City Water and the Republic, represented by Dawasa was signed on February 19<sup>th</sup> 2003. At that time, according to the World Bank, the water situation in Dar es Salaam was precarious. Poor management, lack of resources, increased demand and capital expenditures over a period of decades had led to a progressive worsening of the situation. Although Tanzania has sufficient surface and ground water to meet most of its needs, water was not equally available in all regions. When City Water took over, infrastructure had degraded over time. Before 1991, water was provided without charge to users. Thereafter low tariffs were introduced but the same had been insufficient to fund capital expenditures.<sup>208</sup>

In a long term effort to address the serious public health and economic efforts of the poor state of water and sewerage services, the Republic had decided in the 1990s to reform its public policies in these areas. The leasing of the Dar es Salaam water and sewerage system to a private operator was a keystone of the reform process for the residents of the City and the nearby coastal region.<sup>209</sup> Consequently in 2003, the United Republic of Tanzania was awarded World Bank, African Development Bank and European

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<sup>207</sup> Chung 'Henry' Fai Chan (2010). To Talk Or To Fight? Collective Effects Of Strategic, Cultural, And Institutional Factors On Investors' Renegotiation Approach In Public Private Concessions. *Doctor of Philosophy Dissertation*, Stanford University

<sup>208</sup> ICSID (2010). Biwater Gauff (Tanzania) Limited (Claimant) v. United Republic of Tanzania (Respondent) (ICSID Case No. ARB/05/22), Award Date July 24, 2008 p32 para96

<sup>209</sup> Ibid, p32 para97

Investment Bank funding in the amount of USD 140,000,000 for the purpose of commissioning a comprehensive program of repairs and upgrades to, and the expansion of, the Dar es Salaam Water and Sewerage Infrastructure: The Dar es Salaam Water Supply and Sanitation Project (“the Project”). The shortfall was to be funded by DAWASA and the newly appointed operating company: approximately USD 12,500,000 by DAWASA and USD 8,500,000 by the operating company.<sup>210</sup>

As a condition of the funding, the Republic was required to appoint a private operator to manage and operate the water and sewerage system, and carry out some of the works associated with the Project. After a failed first Bid Process, the Republic therefore invited tenders for the Project in 2002 (“the Bid Process”). Biwater International Limited (“Biwater”), a company incorporated under the Laws of England and Wales, and HP Gauff Ingenieure GmbH and Co. KG-JBG (“Gauff”), a German Corporation submitted a joint tender for the project and were awarded preferred bidder status by the Republic in December 2002. Biwater and Gauff incorporated BGT for the purpose of their investment. Biwater held 80% of BGTs shares and Gauff held the remaining 20%.<sup>211</sup>

Under the terms of the request for tender, the parties submitting a successful tender were obliged to incorporate a local Tanzanian operating company to enter into the contracts associated with the Project (the “**Operating Company**”). The request for tender also required that a minimum number of shares in the Operating Company were to be held by a local Tanzanian company or a Tanzanian national. BGT decided to cooperate in this respect with Super Doll Trailer Manufacture Co. (T) Limited (“**STM**”), a company

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<sup>210</sup> Ibid, p34 para102

<sup>211</sup> Ibid, p39 para119

incorporated in Tanzania. Biwater and Gauff incorporated City Water Services Limited (“**City Water**”) under the laws of Tanzania on 17 December 2002, as the Operating Company. STM subsequently agreed to acquire a minority shareholding in City Water. BGT held 51% of the shares in City Water, and STM held the remaining 49%.<sup>212</sup>

City Water, as the Operating Company, entered into three key contracts for the implementation of the Project with the Dar es Salaam Water and Sewerage Authority (hereinafter “DAWASA”) on 19 February 2003. The Water and Sewerage Lease Contract (the “Lease Contract”); the Supply and Installation of Plant and Equipment Contract (“SIPE”); and the Contract for the Procurement of Goods (“POG”); together the “Project Contracts”.<sup>213</sup>

DAWASA is a Tanzanian public corporation, established under the DAWASA Act 1981, partially repealed by the DAWASA Act 2001. Prior to the handover of operations to City Water on 1 August 2003 (the “Handover”), DAWASA was responsible for the provision of water and sewerage services to the residents of Dar es Salaam and the surrounding area. The existing infrastructure proved to be insufficient to provide adequate services to the majority of the City’s population. After the Handover from DAWASA, City Water’s role was to operate the water production, transmission and distribution systems, operate and maintain the sewerage system, and to build and collect revenue from the customers receiving these services.<sup>214</sup>

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<sup>212</sup> Ibid, para121

<sup>213</sup> Emma Saunders-Hastings, (2011). *Chapter 19: The Asymmetrical Legalization of Investment Regimes in Africa: Lessons from Water Privatization*. in Marie-Claire Cordonier Segger , Markus W. Gehring , et al. (eds), *Sustainable Development in World Investment Law*, Global Trade Law Series, Vol 30, pp. 457 - 479

<sup>214</sup> ICSID (2010). p23 para123

Under the Lease Contract, City Water agreed to provide water and sewerage services on behalf of DAWASA, pursuant to the terms of the Lease Contract, for a ten year period. City Water also agreed to implement and manage the implementation of certain capital works associated with the Project, including under Appendix P of the Lease Contract (“Delegated Capital Works”), the design and expansion of the distribution network. The services were to be provided within the City of Dar es Salaam and neighbouring coastal regions as shown on the map attached as Map 1 to Appendix 1 to the Lease Contract. When the Handover took place, DAWASA passed to City Water all of its day-to-day activities and City Water took over the operation of the water and sewerage services within the designated areas. Under the Lease Contract, City Water assumed certain tariff and rental fee payment obligations to DAWASA and DAWASA in turn agreed to facilitate City Water’s operations, including:

- by allowing City Water exclusive access to and use of the Assets (as defined in the Lease Contract) which City Water leased from DAWASA and without interruption from any other person (Article 1.6 (b)(i) of the agreement);
- by not retaining any other operator to operate the designated water services and by not operating in any way so as to hinder or conflict with City Water’s operations (Article 1.6 (b)(ii) of the agreement).<sup>215</sup>

Under the SIPE, City Water agreed to “*design, manufacture, test, deliver, install, complete and commission*” certain plant and equipment, including pumps, ancillaries, and water meters. Under the POG, City Water agreed to supply potable water meters. With

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<sup>215</sup> Ibid, p10 para9

regard to the SIPE, the supply part of the contract was subcontracted to BGT and in turn subcontracted by BGT to Biwater Pty, another Biwater group company. The installation part of the contract was retained by City Water (although staff from Biwater Pty was seconded to City Water to perform the installation). Similarly, with regard to the POG Contract, performance was subcontracted to BGT, and in turn subcontracted by BGT to Biwater Pty.<sup>216</sup>

For Performance Bonds & Guarantee requirements, CRDB Bank Limited (“CRDB”), a bank operating under the laws of the Republic, provided Performance Bonds to DAWASA on behalf of City Water in respect of City Water’s performance under the Project Contracts, and Advanced Payment Bonds in respect of the SIPE and POG Contracts. CRDB received bank counter-guarantees from Barclays Bank Plc. and Bayerische Hypo-und Vereinsbank AG, and also from STM, in respect of its liability under the Lease Contract Performance Bond. Biwater Plc. (BGT’s ultimate parent) and Gauff stood as surety in respect of this counter-guarantee. CRDB received a separate bank counter-guarantee from the Standard Bank of South Africa Limited on behalf of Biwater Pty in respect of the SIPE and POG Performance and Advance Payment Bonds.<sup>217</sup>

### **3.3.2 VAT Exemption**

City Water also applied to the Tanzanian Investment Centre (“TIC”) for a “Certificate of Incentives” under Section 17(1) of the Tanzanian Investment Act (the “TIA”). City Water was registered with the TIC on 24 June 2003 and was awarded a Certificate of Incentives

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<sup>216</sup> Ibid p9 para10 and 11

<sup>217</sup> Ibid p10 para12

dated 15 July 2003. Pursuant to this Certificate, City Water was entitled to a range of benefits including, *inter alia*, an exemption from VAT.<sup>218</sup>

### 3.3.4 Dispute

Following the Handover, and until the events which took place in May 2005, and which culminated in the seizure of City Water's operations on 1 June 2005, City Water supplied water and sewerage services under the Lease Contract. The nature of this performance, the problems which were encountered by the parties during this period, and the discussions which took place with respect to the financial terms of the Lease Contract, are all in issue in this dispute and are examined in relevant detail later in this Research.

Between 13 May 2005 and 1 June 2005, a series of events took place which, according to BGT, constituted breaches by the Republic of its obligations under international and domestic law. These events are considered in detail later in this Research but by way of overview:

- (a) On 13 May 2005, the Minister of Water and Livestock Development (“**the Minister**”) purported to terminate the Lease Contract;
- (b) On 16 May 2005, a call was made on the entire amount of the Performance Bond established by City Water in connection with the Lease Contract;
- (c) on 17 May 2005, DAWASA issued a cure notice for the reinstatement of the Performance Bond under Article 50.1 of the Lease Contract;
- (d) on 24 May 2005, the Tanzania Revenue Authority withdrew a VAT exemption;

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<sup>218</sup> Ibid paragraph 13

- (e) on 25 May 2005, DAWASA issued a Notice to Terminate under Article 51.3 of the Lease Contract, on the ground of failure to remedy the alleged breach notified in the cure notice of 17 May 2005; and,
- (f) finally on 1 June 2005, City Water’s senior management were deported, and representatives of the Republic and DAWASA seized the company’s assets, installed a new management (representatives of DAWASCO, a newly formed Government entity) and took over City Water’s business.<sup>219</sup>

According to BGT, these events constituted the expropriation of BGT’s investment and amounted to a breach of the Republic’s international and domestic obligations, in particular its obligations to grant fair and equitable treatment, not to take unreasonable and discriminatory measures, the obligation to grant full protection and security to investors and to guarantee the unrestricted transfer of funds.<sup>220</sup> BGT based its case on the Agreement between the United Kingdom of Great Britain and Northern Ireland and the United Republic of Tanzania for the Promotion and Protection of Investments signed at Dar es Salaam on 7 January 1994, and entered into force on 2<sup>nd</sup> August 1996 (the “BIT” or the “Treaty”) and also on the TIA, which entered into force on 9<sup>th</sup> September 1997.<sup>221</sup>

### **3.3.5 Lease Agreement**

The most important of the three contracts together forming the PPP arrangement was the Lease Contract. It had duration of ten Years and by its terms, City Water was to lease certain defined “Assets” belonging to DAWASA and to use them to supply water and sewerage services to customers on DAWASA’s pipeline network. Overall, City Water

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<sup>219</sup> Ibid p12 para15

<sup>220</sup> Ibid p13 para16

<sup>221</sup> Waibel, Michael, Kaushal, Asha, Chung, Kwo-Hwa and Balchin, Claire, (2010). The Backlash Against Investment Arbitration: Perceptions and Reality. In Michael Waibel, Asha Kaushal, Kyo-Hwa Chung & Claire Balchin, eds, The Backlash Against Investment Arbitration (Kluwer Law International, 2010)



was responsible for running the water and sewerage systems for ten years and for billing and collecting tariff payments from customers. DAWASA continued to own all of the assets, including the building City Water used as its offices, the pipelines, etc. The Lease Contract provided that:

“for the avoidance of doubt, the ownership of the Assets, including Small Equipment, shall remain vested in the Lessor ... and, at the end of this Contract, the Operator shall hand back the Assets to the Lessor in accordance with the provisions of this Contract”.<sup>222</sup>

In exchange for using the assets, City Water was required to make monthly rental payments to DAWASA, defined in the Lease Contract as the “Rental Fee”. The more significant financial terms, however, were those concerning the “Customer Tariff”, i.e., the amounts that customers would be billed. The Customer Tariff comprised three components: the Operator Tariff; the Lessor Tariff; and, the First Time New Domestic Water Supply Connection Tariff (“FTNDWSC”).<sup>223</sup> For completeness, there were separate Customer Tariffs for water and sewerage services. The water tariff consisted of the three components listed in the text, whereas the sewerage tariff had only two components: The Operator Tariff and the Lessor Tariff. Further, the Water Tariff was subdivided into domestic and non-domestic tariffs.

City Water’s duty was to collect the full Customer Tariff and then disburse the three components as described herein. The Operator Tariff was City Water’s portion. With the

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<sup>222</sup> Victoria R. Delmon, (2008). PPP in Infrastructure Resource Center for Contracts, Laws and Regulations (PPPIRC). Retrieved March 14, 2008, <http://www.worldbank.org/ppp>

<sup>223</sup> ICSID (2010). *ibid* p40 para124

Operator Tariff (sewerage) for sewerage service, it represented City Water's essential source of cash. The Lessor Tariff was DAWASA's portion. DAWASA depended on it as the main source of cash for its own operating expenses.<sup>224</sup>

As far as the FTNDWSC Tariff is concerned, City Water was supposed to deposit this into a trust account in order to subsidise the connection of poor customers to the system. More precisely, City Water was required to "*pay all amounts received by way of First Time New Domestic Water Supply Connection Tariff into the First Time New Domestic Water Supply Connection Fund*", a separate bank account that City Water was required to establish and maintain under the Lease Contract.<sup>225</sup> The Lease Contract explicitly fixed the Customer Tariff, and the three underlying components, for the first five Contract Years, that is, from August 2003 to August 2008.<sup>226</sup> The tariffs were fixed in real terms. Under an Indexation Formula adjustment, they were to be adjusted at least annually to account for inflation and exchange-rate fluctuation.

During City Water's tenure, one application was made for an adjustment on this basis: on 12 August 2004, the Interim Regulator approved in full the increase sought by City Water. Apart from the adjustment of tariffs under the Indexation Formula, the Lease Contract contained three provisions under which the Operator Tariff might be revised the Annual Review; the Interim Review; and the Major Review.<sup>227</sup>

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<sup>224</sup> Ibid para126

<sup>225</sup> Ibid para127

<sup>226</sup> Ibid para128

<sup>227</sup> Ibid p41 para130

### 3.3.6 Annual Review

The Annual Review was to take place after the EMP during which City Water was required to collect more reliable data than that available to the bidders. The Lease Contract defined the EMP as “*a period of twelve (12) months commencing on the Commencement Date and to end maximum of eighteen (18) months after the Commencement Date*”. In practice, the parties interpreted this to mean that the EMP could begin after the Commencement Date (i.e., 1 August 2003, when City Water took over the system) but had to last for twelve months and had to be completed no more than eighteen months after the Commencement Date. During the EMP, City Water was to “*determine [...] Base Values and Water and Sewage quality data ...*”<sup>228</sup>

A “Base Value” was defined as: “*the value of Performance Targets or Key Performance Targets as existed at the Commencement Date such value being determined after the end of Enhanced Monitoring Period (EMP) as agreed between the Operator and Lessor*”.<sup>229</sup>

“Performance Targets” and “Key Performance Targets” included such things as collection efficiency; percentage of customers with inadequate water pressure or no service at all; water quality; and the amount of water lost during transmission and distribution. If, based on the data collected by BGT during the EMP, it appeared that BGT’s original assumptions turned out to be sufficiently inaccurate to affect the Operator Tariff by at least 5%, either City Water or DAWASA could request an Annual Review to obtain the necessary upward or downward adjustment. No Annual Review was in fact requested either by City Water or DAWASA.

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<sup>228</sup> Ibid p42 para131

<sup>229</sup> Ibid p42 para132

### 3.3.7 Interim Review

Besides the Annual Review, the Lease Contract provided for an Interim Review. Notably, the parties disagreed on the conditions on which an Interim Review could take place. According to Article 41.4 (a) of the Lease Contract, such a review could be undertaken at the request of either the Lessor or the Operator, where either party could demonstrate that an event of “Material Change of Circumstances”, as defined in Article 42, had occurred. Any proposed changes as a result of such an Interim Review were subject to the approval of the Regulator. Article 41.4(b) further provided that the Regulator could direct the parties to undertake an Interim Review where the Regulator had reasonable grounds to believe that the Operator Tariff needed revision or could demonstrate that a Material Change of Circumstances had occurred.<sup>230</sup>

Within six weeks of the receipt of a request for an Interim Review, the Lessor would appoint a Technical Auditor to investigate and report to the Lessor, the Regulator and the Operator. Upon receipt of the report, after applying to the Regulator for its approval, the Lessor had to make its determination with all reasonable expedition. If the Lessor, acting reasonably, concluded that there had been a Material Change of Circumstances, he had to authorise appropriate specific modifications or variations to the levels of the Operator Tariff following approval by the Regulator. Finally, there could not be more than two Interim Reviews in any continuous period of twelve months.<sup>231</sup>

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<sup>230</sup> Ibid p36

<sup>231</sup> Ibid p43 para133

### **3.3.8 Major Review**

Finally, a Major Review was also to take place half way through the lease period, during the fifth year of operation (2008). Tariffs were fixed for the first five years, subject to Index Formula adjustments and the possibility that the criteria for an Annual or Interim Review would be met. The Major Review would have provided an opportunity for a more extensive analysis taking into account factors such as the progress of the capital works, experience over the first five years concerning efficiency gains, and so on. On the basis of such factors, tariffs would have been set for the second five years of the Lease Contract. Since the Contract was terminated during the second year of operations, the Major Review never occurred.<sup>232</sup>

### **3.3.9 Financial Projections**

The financial projections BGT submitted with its bid showed that City Water would lose Tsh 7.9 billion over the first two years of operation, and would not reach a break-even point until year 7. Therefore, City Water would require a significant injection of capital to get it through the first two years of operating losses and survive for four more years thereafter. That capital was to come from two sources: equity from City Water's shareholders, and the related Sub-Loan from DAWASA.<sup>233</sup>

BGT's bid promised a contribution of USD 8.5 million in equity, which BGT proposed would be made entirely during the first two years of operation: USD 2.5 million initially, USD 3 million during the first year, and a further USD 3 million during the second year. In addition to equity capital, City Water was also to have access to up to USD 5.5 million

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<sup>232</sup> Ibid p44 para136

<sup>233</sup> Ibid p37

from a Sub-Loan facility provided by DAWASA. The basic agreement was that City Water would draw down one dollar from the Sub-Loan for every dollar of equity contributed by City Water's shareholders. Under the schedule to BGT's bid, the shareholders were to put in USD 5.5 million in the first year, enabling City Water to draw down the entire Sub-Loan and giving it access to a total of USD 11 million of debt and equity capital during its first year of operations.<sup>234</sup> In the long run, City Water's source of funds would be the Operator Tariff.

### **3.3.10 SIPE, POG AND Delegated Capital Works**

Besides the Lease Contract, City Water and DAWASA entered into two main ancillary agreements, the SIPE and the POG (the Priority Works).

(a) **SIPE:**

The SIPE called for capital improvements to the critical elements of the water system. City Water was to install or refurbish pumps at the treatment plants, enabling more water to be drawn from the Upper and Lower Ruwu River and, after treatment, to be pumped into the transmission mains toward the reservoirs. The transmission mains themselves were also to be repaired and modernised, mostly in order to reduce leakage.<sup>235</sup>

The effect of the work on the treatment plants and the transmission mains would be more water in the reservoirs. To measure the amount of water flowing through these major portions of the system, City Water was required to install 15 zonal bulk meters under the

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<sup>234</sup> Ibid p38 para138&139

<sup>235</sup> Thelma Triche (2012). A Case Study Of Public-Private And Public-Public Partnerships In Water Supply And Sewerage Services In Dar Es Salaam. *Water Papers No 69032*, April 2012

SIPE. The latter also covered emergency repairs to eliminate known major sources of water loss.<sup>236</sup>

**(b) POG**

The POG was a contract for the supply of customer meters, that is, meters that would measure water consumption by an individual household or institutional customer. The goal was universal metering.<sup>237</sup> Data from customer meters would help to correct assumptions about the quantity of water that different categories of customers were using. The data could also help in making a more accurate hydraulic model of the system.<sup>238</sup> Customers' meters could in addition enhance City Water's collection ratio by increasing customers' payment of bills. This was especially true of institutional customers

**(c) Delegated Capital Works:**

In addition to the SIPE and POG works, City Water also took responsibility for design and management of the so-called "Delegated Capital Works". The Delegated Capital Works were likewise important to City Water's overall operations, but they were not set out in a separate contract as were the SIPE and POG works. City Water's role in the Delegated Capital Works was that of contract manager for works to be carried out by others. City Water's obligations in this respect and the payment it would receive, were attached to the Lease Contract as Appendix B.<sup>239</sup>

The purposes of the Delegated Capital Works were twofold: to bring piped drinking water to more people in Dar es Salaam; and to help City Water meet the performance

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<sup>236</sup> Ibid p

<sup>237</sup> Centers for Disease Control and Prevention and American Water Works Association. (2012). *Emergency water supply planning guide for hospitals and health care facilities*. Atlanta: U.S. Department of Health and Human Services.

<sup>238</sup> ICSID (2010). p40 para143

<sup>239</sup> Ibid p46 para144

targets in the Lease Contract. City Water subcontracted the SIPE and POG to BGT, which in turn subcontracted to Biwater Pty, a South African affiliate of Biwater Plc. The value of the various contracts was as follows: SIPE, USD4.8 million; POG, USD4.2 million; Delegated Capital Works, around USD39 to 40million. SIPE and POG payments were to pass through City Water to Biwater Pty, and City Water would in principle retain nothing. Similarly, a significant portion of the Delegated Capital Works were subcontracted first to BGT and then to Gauff, with the same effect.<sup>240</sup>

### **3.3.11 Performance of the Lease Contract**

#### **3.3.11.1 Overview**

As set out below, serious difficulties were experienced by both City Water and DAWASA in their respective performance of the Lease Contract. Overall, however, although City Water made improvements to the water system, in difficult operating conditions, its performance failed to achieve the level that was anticipated at the time of conclusion of the Lease Contract - even taking into account the complications that DAWASA's own failures posed.<sup>241</sup>

The failure of the Project was attributed to numerous factors. The task, on any view, was formidable. When City Water took over, DAWASA had left the water system in a very poor condition. On the other hand, it was clear from the evidence before the Tribunal, taken overall, that BGT had seriously underestimated the amplitude of the task. It had submitted a poorly structured bid, and then failed to perform as anticipated during the

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<sup>240</sup> Ibid p47 para145

<sup>241</sup> Ibid p47 para149



Mobilisation Period and the EMP, with the consequence that it encountered serious financial problems at a very early stage.<sup>242</sup>

### **3.3.11.2 Mobilisation Period: 19 February – 1 August 2003**

According to the Lease Contract, the Mobilisation Period extended from the signature of the contract on 19 February 2003 until 1 August 2003. According to the Tribunal, BGT's bid emphasised the importance of the mobilisation period in the following terms:

“the transition from the current operational structure to the new structures envisaged under the Lease Contract represents one of the major challenges facing all the parties involved. ... The success or failure of the transition, of which the mobilisation is a part, may influence the way the delivery of the contracts develops especially in the critical early years.

It is therefore essential that the Operator, the Lessor and the other agencies and authorities involved work together and apply significant levels of effort to the transition. The intention must be to make the transition as seamless as is possible. However, by the nature and scale of the proposals it will be a period of great change. It is in this transition period that the Operator will begin not only to prepare for the management of the water and sewerage utility service but will also need to initiate the management of “change” itself”.<sup>243</sup>

The bid also detailed all the tasks that BGT intended to operate during the Mobilisation Period. It was apparent to the Tribunal that City Water did not take the full benefit of the Mobilisation Period, and did not accomplish during that period what it had anticipated doing.<sup>244</sup>

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<sup>242</sup> Kumar V Pratap. (2011). Sustaining Privatization. *Doctor of Philosophy Dissertation*, University of Maryland

<sup>243</sup> ICSID (2010). p49 para155

<sup>244</sup> Ibid p49

### **3.3.11.3 Enhanced Monitoring Period: 1 August 2003 (Commencement) – 1 August 2004**

According to the Tribunal, it was clear from the record before it that City Water did not perform during the EMP as was originally anticipated. For example, City Water had planned to replace the old DAWASA outdated billing system by a new system within six months of the Commencement. Indeed, the billing software was the lifeblood of the system. In a letter dated 19 March 2004, Mr. Mutalemwa of DAWASA wrote to City Water in relation to “*DAWASA’s poor billing system*”, stating that all parties knew this (billing system) would be a problem from the beginning and that is why CWS promised in their mobilization plan to replace the old system within six months of commencement.<sup>245</sup>

It is important to note that one of the main – and vital – purposes of the EMP was for City Water to collect data, in order to re-calibrate base values, and thereby address the known inadequacies in the initial data for the Project. Yet this collection of data was not performed as anticipated; the EMP was delayed; and the record evidences that this is the reason why City Water did not take the benefit of an Annual Review.<sup>246</sup>

### **3.3.11.4 August 2004: Request for Interim Review**

After the first eleven months of operations, in July 2004, City Water was collecting far less revenue than had been projected. It reached the conclusion that in order for the

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<sup>245</sup> R. Mutalemwa, (2004). DAWASA’s Poor Billing System. Letter to City Water, March 2004

<sup>246</sup> ICSID (2010). page 50 paragraph 155

company to continue to function on a financially viable basis, the Lease Contract needed to be reviewed and in particular, the Operator Tariff needed to be increased.<sup>247</sup>

Subsequently, City Water requested an Interim Review of the Operator Tariff, and further requested that some of the base assumptions of its bid be re-examined on grounds that the operating costs, especially those for local staff, exceed those assumed in the economic evaluation of the project and the determination of the base Operator Tariff used in the Contract and that the assumed volume of water available for distribution in Dar es Salaam may not be in line with bid expectations.<sup>248</sup>

On 20 August 2004, a meeting was held between City Water and Minister Lowassa, in his capacity as Interim Regulator, to discuss the request. The minutes of the meeting recorded that after one year of operations, a number of problems had arisen that threatened the well being of the project.<sup>249</sup> These problems, which included contractual breaches amounting to non-performance by the operator, were listed below as follows:

- (a) City Water Services Ltd was supposed to contribute Tshs 5.5 bn in equity and to borrow Tshs 4 bn from the government subloan by the end of their first year. However, by the end of the year City Water Services shareholders had contributed only Tshs 3,340,633,728 and borrowed only Tsh 2,378,200,000 from the sub loan. The remaining deficit has been substantially financed by not paying DAWASA amounts due under the Lease Contract and using collections of the First Time

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<sup>247</sup> Ibid p61 para163

<sup>248</sup> WaterAid (2008). Why did City Water fail? *The rise and fall of private sector participation in Dar es Salaam's water supply*. WaterAid in Tanzania, March 2008.

<sup>249</sup> Epaminontas E. Triantafilou (2009). *No remedy for an investor's own mismanagement: the award in the ICSID case Biwater Gauff v. Tanzania*. White & Case LLP, January 7 2009

New Domestic Water Supply Connection Tariff that properly should be held in trust for making connections to poor domestic customers.<sup>250</sup>

- (b) The minutes also emphasised failures on the part of City Water to report to DAWASA; substantial delays in SIPE and POG; and lack of improvement in collection performance which had decreased to approximately one per cent.

At the same time, the relationship between BGT and STM substantially deteriorated. STM was refusing to put any more equity into City Water. This resulted in a shortfall of the equity that the company was expecting. According to a witness, there were at least three reasons why STM adopted such an attitude: it was unhappy with the financial and operational performance of City Water; it complained about the incompetence of BGT's appointed management; and also it complained about the fact that the SIPE and POG contracts had been subcontracted entirely to Biwater and Gauff entities.<sup>251</sup>

According to that witness, the poor relationship with STM created management and operational problems for City Water. Following the 20<sup>th</sup> August meeting with Minister Lowassa, City Water produced a report entitled "*A summary of Issues giving rise to the Request for a Review of the City Water Lease Contract*", which was forwarded to the Interim Regulator who ordered DAWASA to appoint an auditor. The purpose of the audit was to determine "*whether there are reasonable grounds for interim review of tariff as provided for in the lease contract*". The auditor was mandated to investigate

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<sup>250</sup> ICSID (2010), p44

<sup>251</sup> ICSID (2010). p51-52 para165-167

*“parameters relevant to the material changes of circumstances as stipulated in Article 42.1 of the lease contract”*.<sup>252</sup>

The Interim Regulator also directed that the auditor review and verify the equity injections made by City Water’s shareholders.<sup>253</sup> Price Water House Coopers (PwC) was appointed auditor, together with engineering firm Howard Humphreys. City Water prepared a submission entitled *“Interim Review of Operator Tariff”*, which it transmitted to PwC.

### **3.3.11.5 PwC Final Report**

PwC issued its final report on 26 November 2004.<sup>61</sup> It concluded that no tariff adjustment was warranted. Section I of the PwC Report considered each of the nine possible events proposed by City Water and concluded that City Water had not established the grounds for a Material Change of Circumstances.<sup>254</sup> In respect of the issue of water available for billing (a change of more than 10% could have qualified as such a material change), PwC concluded that insufficient data had been gathered to enable it to reach a determination:

“historically, there has been little accurate data collected on flows in the water supply system. The Operator has made no progress during the first year of operation in installing bulk flow meters or in refurbishing existing meters at the treatment works. There is therefore no reliable flow meter data on which to base an audit of actual volumes supplied during year one of the Lease Contract. ... We made use of the information and the data provided by the Operator, especially flow values taken with portable ultrasonic flow meters. The Operator had concluded that there had been a

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<sup>252</sup> Ibid p52-53 para168-169

<sup>253</sup> Epaminontas E. Triantafilou (2009). P11.

<sup>254</sup> WaterAid (2008), p4

20,9 % reduction in water available for distribution and that this equated to a loss of revenue of over Tshs3 billion. Our audit concluded that there was insufficient data submitted to be able to confirm a reduction in water available for billing”<sup>255</sup>

In Section II of its Report, PwC considered matters raised by City Water which fell outside the scope of the definition of Material Change of Circumstances in Article 42.1 but which City Water believed constituted a change from assumptions at the time of the bid, including: historic over-billing of customers by DAWASA leading to the inflation of DAWASA’s revenue figures; inaccurate calculation of the Customer Tariff at the start of the Lease Contract; significant increase in staff costs; and poor repair of boreholes. PwC concluded that these issues fell outside the scope of the grounds for an Interim Review.<sup>256</sup>

In Section III, PwC considered “*other issues raised by [City Water] in their submission on 4 October 2004*”, including: DAWASA withholding the 10% commission owed to City Water in respect of collections from customers of amounts outstanding at the effective date of the Lease Contract; the impact of the 2003 drought; and the failure of government agencies to pay their water/sewerage bills. PwC concluded that these matters fell outside the scope of the grounds for an Interim Review.<sup>257</sup>

### **3.3.11.6 October – December 2004: The Request for Re-Negotiation**

Following receipt of the PwC Report, City Water continued to supply water and sewerage services under the Lease Contract. However, the problems identified by City Water in July 2004 remained unresolved and its financial viability continued to worsen. City Water and DAWASA held meetings in October and November 2004 to try to develop a

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<sup>255</sup> Ibid p53-54 para172-173

<sup>256</sup> Ibid, p47 para174

<sup>257</sup> Ibid p47 para175

new financial model to serve as the basis for future discussions.<sup>258</sup> Between October and December 2004, at the shareholders' level, Mr. Adrian White (on behalf of Biwater), corresponded, and discussed the situation, directly with Minister Lowassa (outside of the contractual methods of review). The matter was discussed, in particular, at a meeting on or around 11 October 2004, one week after City Water had made its Interim Review submission.

On 3 December 2004, Mr. White wrote to the Minister putting forward proposals for the rescue of the Project. The letter recounted a very serious situation, stating that City Water was not viable with the then its current cost base and revenue projections. The financial analysis based on the agreed assumptions made from the information provided, showed that the company would require a total of Tsh13billion of cash flow support in its then current financial year to the end of June 2005 and that this would rise to a total of Tsh 25 billion by the end of year 4.<sup>259</sup>

Minister Lowassa answered Biwater on 10 December 2004, agreeing that that City Water is in serious financial problems, but stating that the answer was equity injection and improvement in revenue collection. According to him, without capital injection and radical improvements in revenue collections, City Water could not survive. He advised City Water to formally make a submission of the proposals confirming that they wish the contract to be renegotiated. The options given by City Water to improve its financial

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<sup>258</sup> Ibid p55 para176

<sup>259</sup> Ibid paragraph 178

situation, amounted to a renegotiation of the terms of the agreement.<sup>260</sup> On 6 January 2005, a formal renegotiation request of the Lease Contract was made by City Water.

### **3.3.11.7 – May 2005: Re-Negotiation Process**

As the parties convened in January 2005 to discuss how the renegotiation process would proceed, they were faced with an extremely difficult situation. Resources were constrained, and both DAWASA and City Water were under financial pressure: without radical changes in the Lease Contract, it was manifest that City Water couldn't survive.<sup>261</sup> It is in this context that on 25 January 2005, the parties met with the Interim Regulator to discuss the framework.<sup>262</sup>

In the context of the renegotiation, the World Bank recommended the appointment of TRC Economic Solutions (“TRC”) as expert mediator. On 17 February 2005, the Government of Tanzania appointed TRC and more specifically a one Dr. Tony Ballance. The renegotiations encompassed the whole Lease Contract, rather than any particular division or article.<sup>263</sup> In the meantime, and over the following weeks, the financial situation of City Water remained critical and given that, since January 2004, City Water had not been remitting the full collections and had not been paying DAWASA all the monthly lease fees, DAWASA's financial position was also in a very precarious state.<sup>264</sup> On its part, the Republic demanded a tight timetable to complete the renegotiation process. Initially, the work plan devised by Dr. Ballance provided for a final report on 4

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<sup>260</sup> Ibid paragraph 179

<sup>261</sup> Aldo Baietti, William Kingdom, & Meike van Ginneken (2006). Characteristics Of Well performing Public Water Utilities. *Water Supply & Sanitation Working Notes Note No. 9*, May 2006

<sup>262</sup> ICSID (2010). p67 para185

<sup>263</sup> Ibid para186

<sup>264</sup> Ibid p59 para190



July 2005.<sup>265</sup> However, the Republic forced a far shorter timetable on the parties. A period of a period of three weeks was accepted by the parties.

In March 2005 and continuing into April 2005, DAWASA and City Water discussed the financial arrangements that would apply during the renegotiation, particularly whether City Water would remit the Lessor Tariff on a current basis and whether DAWASA would call the Performance Bond if City Water failed to do so. At this time, the parties realised that the situation was extremely delicate and that a successful and quick renegotiation was the last chance to salvage the Project.<sup>266</sup>

In late March 2005, Dr. Ballance prepared an “Inception Report”, summarising the situation and the parties’ positions, and setting forth a plan for substantive negotiations. He mentioned *inter alia* that “*the Lease Contract as currently structured may not be financially sustainable*”, that “*CWS’s own performance has contributed to its poor financial situation*” and that “*CWS is not in compliance with the terms of the Lease Contract*”.<sup>267</sup>

On 8 April 2005, the interested parties met to set the stage for intensive negotiations. A deadline of 29 April 2005 was set for reaching an agreement. The formal renegotiation process commenced on 19 April 2005. From that date until 28 April 2005, the parties negotiated with the assistance of Dr. Ballance. On 28 April 2005, Dr. Ballance prepared an *aide-mémoire* setting forth the progress of the negotiations. He noted that the deadline had been extended by one week and proposed the program for the first week of May to

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<sup>265</sup> Ibid para191

<sup>266</sup> Ibid para193

<sup>267</sup> Ibid p60 para196

enable the renegotiation to reach a conclusion by 6 May 2005.<sup>268</sup> Dr. Ballance's last day in Tanzania was 5 May 2005 (one day before the final deadline), when he presented a final compromise proposal for the parties' consideration. Instead of simply accepting the proposal, Mr. Stone wrote to DAWASA on 9 May 2005 setting out his comments and suggesting a further meeting "*to clarify certain details*". There was no follow-up to this letter.

### **3.3.11.8 Termination of the Lease Contract 12<sup>th</sup> May – 7<sup>th</sup> June 2005**

It had been clear to City Water for some time that if the renegotiations failed, DAWASA would likely terminate the Lease Contract. Three days after Mr. Stone's letter of 9 May, on 12 May 2005, DAWASA's Board of Directors convened. The same day, the Chairman of the Board wrote to advise Minister Lowassa that the renegotiation had failed because City Water's proposals were inadequate and would have left DAWASA with a shortfall of Tsh 10 billion and that DAWASA's counterproposal would have extended the Lease Contract by five years, but only after City Water's shareholders had put in the USD 8.5 million of promised equity and a further additional USD 1.5 million.<sup>269</sup>

TRC had made a compromise proposal that limited the shortfall to Tsh 2 billion, but City Water rejected both the DAWASA proposal and the TRC compromise. Following its meeting, DAWASA's Board endorsed actions to be taken including the steps for terminating the Lease Contract that would commence immediately; a transitional company to be created to take over operations and the calling of the Performance

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<sup>268</sup> Ibid para199

<sup>269</sup> Aldo Baietti, William Kingdom, & Meike van Ginneken (2006), p13

Bond.<sup>270</sup> TRC was required to write to City Water and DAWASA and formally note the failure of the renegotiation. The Board further recommended a fallback position that entailed putting in place measures to safeguard essential equipment and supplies and avoid disruption during the transition.<sup>271</sup>

On 12 May 2005, DAWASA started to implement this course of action. Mr. Mutalemwa wrote to CRDB Bank and made a call on the full amount of the Performance Bond. The Chairman of DAWASA also informed Minister Lowassa of the recommendations of the Board. The following day, the 13 May 2005, Mr. Mutalemwa faxed two letters to Mr. Stone. One confirmed that the renegotiation had terminated unsuccessfully and that consequently “*DAWASA will take other actions to ensure that its rights under the Lease Contract are protected*”. The other notified Mr. Stone of the call on the Performance Bond. Mr. Mutalemwa also requested a face to face meeting with Mr. Stone on the following day. Mr. Stone received the two letters the day they were sent.<sup>272</sup>

Also on 13 May 2005, during the normally scheduled meeting of the Cabinet, Minister Lowassa, in his capacity as the Minister responsible for the water sector, tabled the 12 May letter he had received from DAWASA’s Chairman. The Cabinet discussed and largely accepted the course of action set out in that letter. It resolved that the Lease Contract should be terminated; the Performance Bond should be called; DAWASCO should be established as a public corporation as soon as possible and should act as the interim operator; the proceeds of the Performance Bond should be used in part to pay

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<sup>270</sup> Ibid p61 para201 and 202

<sup>271</sup> Ibid, p62

<sup>272</sup> Ibid p62 para204 and 205

City Water's debts to DAWASA and in part to fund the transition to DAWASCO; and the Minister should meet with the UK High Commissioner to explain the situation.<sup>273</sup>

The same day, at around 7:00 pm, Minister Lowassa spoke to reporters, informing them of the situation. As to the issue of termination, a written press statement released by the Minister read, *inter alia*, that following the failure of the renegotiations the DAWASA Board convened and decided to advise the Government that the Lease Contract should be terminated. That the Government, after giving due consideration to the way things were and the request from DAWASA, had agreed that the contract be terminated and had directed DAWASA to initiate the process of terminating the said contract forthwith.

On 14 May 2005, Mr. Stone wrote a letter to Mr. Mutalemwa in which he lamented the termination by press conference and sought a clarification on the status of the statements by the Minister.<sup>274</sup> On 16 May 2005, City Water was notified that the entire amount of the Lease Contract Performance Bond (a total of Tsh 5,490,845,296) had been called. According to Mr. Mutalemwa DAWASA applied the bond money to the payment of the Lessor Tariff, rental fees and also penalties for non-payment of those items under the Lease Contract. The money for the FTNDWSC was also recovered from the bond, leaving a surplus of Tsh 79 million. The surplus was given to DAWASCO.<sup>275</sup>

Also on 16 May 2005, City Water issued a Notice of Arbitration pursuant to Article 66 of the Lease Contract. On 17 May, DAWASA issued a Cure Notice under Article 50.1 of the Lease Contract, stating that City Water was in breach of its obligation under Article

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<sup>273</sup> Ibid para206

<sup>274</sup> Ibid. page 63 paragraph 209

<sup>275</sup> Ibid. page 64 paragraph 2010

47.1 to “*procure the maintenance of the performance guarantee*” for the duration of the Lease Contract. DAWASA requested that City Water remedy this alleged breach within seven days. On the same day, Minister Lowassa, acting with the assistance of DAWASA, called a meeting of all City Water’s staff. At this meeting, he stated that the Lease Contract had been terminated, and that the staff would be transferred to the new UROT entity which was to take over City Water’s operations.<sup>276</sup>

The Minister stated that City Water’s expatriate management had either left the country or were about to do so. On 19 May 2005, Counsel for BGT notified the Republic that the call upon the Performance Guarantee was considered totally unjustified, and therefore that they had decided to start an arbitration procedure pursuant to the Lease Contract, and in accordance with Article 7(1) of the UNCITRAL Rules.<sup>277</sup>

On 23 May 2005, City Water applied to the English High Court for an interim injunction to restrain DAWASA from taking any steps to terminate the Lease Contract, or purporting to give notice of termination, other than in accordance with the termination provisions contained in Articles 51 and 52; and terminating or purporting to give notice of termination of the Lease Contract on the basis of the Cure Notice of 17 May 2005, or on the basis of any matter specified therein.<sup>278</sup>

The interim injunction was granted by the English court, and was served on DAWASA by fax on the evening of 23 May 2005. On that day, Cliff Stone gave a press conference during which he indicated that City Water had not received any contractual termination

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<sup>276</sup> Ibid paragraph 211 and 212

<sup>277</sup> Ibid p65 para213

<sup>278</sup> Ibid para215

notice and would therefore continue to provide water and sewerage services to customers. He ended his speech by asserting that business was as normal.<sup>279</sup> On 24 May 2005, City Water was notified by the TRA that, as of 30 May 2005, it had lost its entitlement to VAT relief. City Water wrote to the TRA disputing this decision. No reply was received.<sup>280</sup> On 25 May 2005, DAWASA issued a Notice to Terminate under Article 51.3 of the Lease Contract, on the ground of failure to remedy the alleged breach notified in the Cure Notice of 17 May 2005. The 25 May notice gave City Water a further 30 days in which to remedy the alleged breach, expiring on 24 June 2005.<sup>281</sup>

On 26 May 2005, DAWASA wrote to City Water, stating that they feared “*that there are high chances of service interruption at this stage due to the termination notice*” and that since termination was imminent, it was imperative to mutually agree upon an amicable way to part company, in an expedited manner. It was suggested that the parties jointly appoint a management team that would assist in this regard. DAWASA also reminded Mr. Stone that in a meeting held on Friday 20 May 2005, he had promised to provide, by Monday 23 May 2005, names of the City Water’s officers who would work jointly with DAWASA to effect the handing over process. DAWASA invited City Water to attend to this issue immediately.<sup>282</sup>

The dispute escalated and on 1 June 2005, representatives of the Republic effected the deportation of City Water’s senior management: Cliff Stone, the CEO; Michael Livermore, the CFO; and Roger Harrington, Senior Adviser. Mr. Stone and the other

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<sup>279</sup> Ibid para216 and 217

<sup>280</sup> Ibid p66 para218

<sup>281</sup> Ibid para219

<sup>282</sup> Ibid para220

senior management were detained by police officers at about 11:30 am local time on the morning of 1 June 2005, and were held in custody, and without formal arrest, for the entire day. They were subsequently deported from Tanzania that evening on the ground that they were “*prohibited immigrants*” within the meaning of Section 10 of the Immigration Act 1995 and that their “*presence in the United Republic of Tanzania is unlawful*”.<sup>283</sup>

Simultaneously with the detention of City Water’s senior management, representatives of the Republic and DAWASA entered City Water’s offices with the purpose of taking control of the company’s assets and installing new management, i.e., representatives of DAWASCO, a newly formed government entity. The CEO of DAWASA, Archard Mutalemwa, personally attended City Water’s offices on the morning of 1 June 2005 to supervise the seizure of City Water’s assets and to introduce to City Water’s employees the new management, headed by Felix Kaaya.<sup>284</sup>

According to the evidence before presented to the Tribunal, as of 1 June 2005, City Water owed DAWASA approximately Tsh 3.4 billion in unpaid tariff and rental fees, including Tsh 184 million of collections of pre-commencement tariff; Tsh 2.3 billion of Lessor Tariff; Tsh 586 million of Lease fees; and Tsh 306 million of consumables and office equipment. According to one witness, an amount of Tsh 1.1 billion of penalties had to be added, making a total of Tsh 4.9 billion. Moreover, City Water had not been paying into the First Time Connection Fund. At the same time, DAWASA owed City Water USD 1.3 million. According to Mr. Mutalemwa, the money overdue was paid by

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<sup>283</sup> Ibid p67 para223

<sup>284</sup> Ibid para224

DAWASA to City Water on 24 and 25 May 2005. According to Mr. Stone, however, the payments had not been received before he left Dar es Salaam on 1 June 2005.<sup>285</sup>

### **3.3.11.9 ICSID Proceedings**

The proceedings in *Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania* is an illustration of the complex and protracted nature of PPP disputes. The series of events leading to the termination of the contract and the deportation of City Water's senior management as well as the seizure of City Water's assets and the takeover of its assets by DAWASA and the Government lends credit to the justification for this Research.<sup>286</sup>

The nature of this performance, the problems which were encountered by the parties during this period and the discussions which took place with respect to financial terms of the lease contract as examined in detail above, demonstrate a clear and urgent need for better understanding of PPPs and how best to structure them to meet the desired objectives. The complexity of this dispute was further evidenced during the ICSID arbitration. It was marked by a complex procedural background. The case involved three requests for provisional measures, two joint submissions regarding requests for production of documents and a petition seeking *amicus curiae* status. In addition to other pleadings, the applications generated 16 briefs and five ensuing procedural orders over a period of a little more than a year.<sup>287</sup>

In the final analysis, BGT's case was that the events described above were acts of expropriation of BGT's investments and as such amounted to a breach of the Republic's

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<sup>285</sup> Ibid p227&228

<sup>286</sup> Edward Charles Bourque (2010). *Urban Governance and Unequal Geographies of Water in Buguruni Ward, Dar es Salaam, Tanzania. PhD Thesis*, Kings College London

<sup>287</sup> ICSID (2010), p1-65



international and domestic obligations, in particular, the obligation to grant fair and equitable treatment, not to take unreasonable discriminatory measures, the obligation to grant full protection and security to investors and to guarantee the unrestricted transfer of funds. Basing its case on the Agreement between the United Kingdom of Great Britain and Northern Ireland and the United Republic of Tanzania for the Promotion and Protection of Investments and also on the TIA, BGT claimed damages.<sup>288</sup>

In a lengthy and detailed analysis of investment protection issues among others, the Tribunal determined that the public announcement on behalf of the Republic of the termination of the Lease Contract on 13 May 2005; the subsequent address to City Water staff on 17 May; the withdrawal of the VAT certificate by the TRA on 24 May; and the seizing of the assets of City Water, the immediate installation of DAWASCO, and the deportation of City Water's management on 1 June 2005 were acts that were discriminatory and unreasonable. They cumulatively amounted to expropriation. The act of seizing of the assets of City Water, the immediate installation of DAWASCO and the deportation of City Water's management was found to amount to a violation of the obligation to provide full protection and security.<sup>289</sup> Interestingly, the Tribunal concluded that none of the Republic's violations caused BGT compensable loss or monetary damages.

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<sup>288</sup> White & Case (2009). No Remedy for an Investor's Own Mismanagement: The Award in the ICSID Case *Biwater Gauff v. Tanzania*. *International Disputes Quarterly*, Winter 2009

<sup>289</sup> ICSID (2010), p249 para814

## CHAPTER FOUR

### 4.0 PPP DISPUTES AND DISPUTE RESOLUTION

#### 4.1 Introduction

As illustrated above, privately financed infrastructure projects typically require the establishment of a network of interrelated contracts and other legal relationships involving various parties. The legislative provisions on the settlement of disputes arising in the context of these projects may take into account the diversity of relations, which may call for different dispute settlement methods depending on the parties involved. However, it is also essential that legal representatives for the parties as well as other players in the dispute resolution process have an in-depth understanding of the intricate and highly specialised ways in which PPP contract documentation is created and the rights and obligations that result.<sup>290</sup>

Dispute resolution is an important factor for the implementation of privately financed infrastructure projects. The reason given is that investors, contractors and lenders will be encouraged to participate in projects in countries where they have the confidence that any disputes arising out of contracts forming part of the project will be resolved fairly and efficiently.<sup>291</sup>

Many legal issues in PPPs will be pressing and more complex. As demonstrated by the cases discussed above, PPPs may involve a combination of private financing, private

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<sup>290</sup> Zheng, J. Roehrich, J.K., & Lewis, M.A. (2008). The dynamics of contractual and relational governance: Evidence from long-term public-private procurement arrangements. *Journal of Purchasing and Supply Management*, 14(1): 43-54; Heather Fussell and Charley Beresford (2009). *Public-Private Partnerships: Understanding the Challenge*, 2<sup>nd</sup> Ed. Columbia: Centre for Civic Governance, June 2009

<sup>291</sup> UNCITRAL (2001), p173-74

contracting and private property interests. Effectively, a PPP agreement may confer upon a party private interest in public property in the form of long-term possessory interest in the leasehold and a franchise right to collect tolls for example in toll roads. As evidenced from the cases discussed in this Research and others not discussed, PPPs involve state actors.<sup>292</sup> Consequently, PPP disputes eventually crystallise into investment disputes. They end up being decided on the basis of investment protection clauses contained in various Bilateral Investment Treaties (BITs) between countries. Essentially, most PPPs are decided within the ICSID framework.<sup>293</sup>

#### **4.2 Jurisdiction Threshold in ICSID Arbitration**

For disputes referred to ICSID pursuant to BITs, one of the most important issues to understand for purposes of PPP dispute resolution is how jurisdiction is founded. Article 25(1) of the ICSID Convention sets out four conditions that must be met to found jurisdiction. That is (i) there must be a legal dispute; (ii) arising directly out of an investment; (iii) between a Contracting State and a national of another Contracting State; and, (iv) there was consent in writing from the parties to submit the dispute to the Centre.<sup>294</sup>

From the cases reviewed, it is a common practice for Contracting States to raise objections to jurisdiction on the basis of any of the above items. On the meaning of legal dispute, the case of *Empresas Lucchetti, S.A. and Lucchetti Peru, S.A. v. Republic of Peru*

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<sup>292</sup> EU. (2003). Guidelines For Successful Public – Private Partnerships. European commission Directorate-general regional policy

<sup>293</sup> Grossman, Seth A. (2012), The Management and Measurement of Public-Private Partnerships: Towards an Integral and Balanced Approach. *Public Performance & Management Review*, 35(4), June 2012.

<sup>294</sup> ICSID (2006). Convention, Regulations and Rules. *International Centre for Settlement of Investment Disputes, (ICSID)/15*, April 2006

deals with the legal meaning of dispute.<sup>295</sup> The dispute in that case concerned a pasta factory located in the Municipality of Lima. In 1997, Luccheti had obtained permits for the construction of the factory. These permits were revoked in 1998 and there followed judicial proceedings, which concluded in favour of Luccheti. In 1999 an operating license was granted to Luccheti. Following the publication in August 2001 of two Decrees of the Municipality of Lima, the operating license was revoked and the definitive closure of the factory was ordered.<sup>296</sup>

Subsequently, the Luccheti (Claimants) invoked an ICSID arbitration clause contained in the February 2, 2000 Agreement between Chile and Peru for the Promotion and Protection of Investments (the BIT) to resolve before ICSID their dispute with Peru. The respondent raised three objections to the Tribunal's jurisdiction. The Respondent alleged that: (i) the dispute arose before the entry into force of the BIT; (ii) that the dispute had previously been submitted to local courts and therefore the Claimants were precluded from submitting the dispute to ICSID under the BIT; and (iii) the investments were not made in accordance with the laws and regulations of Peru and therefore the BIT was not applicable.<sup>297</sup>

By an award rendered on February 7, 2005, the Tribunal dismissed jurisdiction on the basis of the first of the above outlined objections. In that award, the Tribunal first dealt with the legal meaning of the term *dispute* and indicated "a dispute can be held to exist when the parties assert clearly conflicting legal or factual claims bearing on their

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<sup>295</sup> Spackman, M. (2002). Public-private partnerships: lessons from the British approach. *Economic Systems*, 26(3), 283–301

<sup>296</sup> ICSID (2005). *Empresas Lucchetti, S.A. and Lucchetti Peru, S.A. (Claimants) v. Republic Of Peru (Respondent)*. International Centre For Settlement Of Investment Disputes Case No. ARB/03/4, Award Date February 7, 2005

<sup>297</sup> *Ibid*, p370-72

respective rights or obligations or that “the claim of one party is positively opposed by the other”.<sup>298</sup>

The Tribunal then noted that the parties in this matter had opposing views as to whether there were two disputes or one continued dispute. The Claimants contended that there were two disputes: one which arose in 1998 and ended with the 1999 judgments of the Peruvian Courts; and a second which arose as a consequence of the 2001 Decrees. In contrast, the Respondent claimed that there was only one continued dispute, which had arisen in 1998. The Tribunal considered that “the critical element in determining the existence of one or two separate disputes is whether or not they concern the same subject matter.”<sup>299</sup>

The Tribunal found that the subject matter of the 1998 dispute did not differ from the subject matter of the 2001 dispute and that therefore the dispute had crystallized by 1998. The Tribunal thereafter looked whether there were other legally relevant elements which might have made the Tribunal decide that the 2001 dispute should be treated as a new dispute; it concluded that the dispute arose in 1998 and continued throughout 2001.

On the other elements founding jurisdiction, we look at *Consortium Groupment L.E.S.I-Dipenta v. Algeria*<sup>300</sup>. The dispute arose out of a concession agreement granted in December 1993 by the Agence nationale des barrages (ANB) to the Italian companies L.E.S.I and DIPENTA (organised under a consortium) for the construction of a dam in

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<sup>298</sup> Ibid p197 para48

<sup>299</sup> Gabriela Alvarez Avila, (2002). *Empresas Lucchetti, S.A. and Lucchetti Perú, S.A. v. Republic of Peru*, ICSID Case No. ARB/03/4.

<sup>300</sup> Ibid p357-58.

the region of Wilaya of Bouira, Algeria. According to the Consortium, the execution of the encountered various problems mainly due to the region's lack of security.<sup>301</sup>

In 1997, the ANB modified the project and requested a new type of dam which required new financing and the approval of the original financing institution, the African Development Bank. In 2001, the ANB terminated the concession agreement for *force majeure*, the African Development Bank having requested a new international tender. The ANB agreed to offer some compensation to the Consortium, but the parties failed to agree on the amount and no payment had ever been made.<sup>302</sup>

The Consortium brought the request to ICSID and asked the Tribunal to declare that Algeria had breached its obligations under the BIT by not promoting, protecting and affording security to the Consortium's investment; by applying discriminatory measures against it; and by illegally expropriating it. Algeria raised objections to jurisdiction and admissibility. On the objection related to Article 25(1) of the ICSID Convention regarding the notion of investment that Algeria had argued was not fulfilled, the Tribunal considered that a construction contract would constitute an investment if three criteria were met.: (i) the contracting party made contributions in the host country; (ii) these contributions had a certain duration; and (iii) they involved risks for the contributor.<sup>303</sup>

Regarding the involvement of a Contracting State, Algeria argued that the dispute exclusively involved ANB as opposed to the Algerian State. The Tribunal stated that at the jurisdictional stage, its role was limited to a formal control that the claims were

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<sup>301</sup> Eloïse M. Obadia (2005). Consortium Groupement L.E.S.I.–DIPENTA v. Algeria. *ICSID Case No. ARB/03/8*,

<sup>302</sup> OECD (2006). Investor-To-State Dispute Settlement In Infrastructure Projects. *Working Papers On International Investment Number 2006/2*, March 2006

<sup>303</sup> Eloïse M. Obadia (2005), p423-26

brought against a State, unless it was obvious that there was no link between the underlying contract and the State.<sup>304</sup>

The Tribunal recalled that States could be responsible for contracts entered into by independent public entities as long as they could exercise their authority over the said entity. The Tribunal thus determined that without prejudice to its findings on the merits, the dispute was against a State, as the Algerian State participated, at least indirectly in the negotiations of the Contract and had a strong influence on the ANB's decision process.<sup>305</sup>

On Algeria's written consent to submit the particular dispute to ICSID, the Tribunal analysed the relevant provisions of the BIT. In this context, Algeria argued that there was no investment covered under the BIT, since for an investment to be made in accordance with the laws and regulations in force; it had to follow specific procedures. The Tribunal rejected that argument on the principal ground that an international treaty should be interpreted in consideration of the meanings given by both State Parties as opposed to a meaning based on one of the State Party's domestic laws. The Tribunal concluded that Algeria had given its written consent, which covered the investment at hand.<sup>306</sup>

Regarding the issue of the Consortium's standing, the Tribunal noted that the concession agreement was originally signed by a 'temporary' or 'informal consortium' consisting of two Italian companies L.E.S.I. and DIPENTA. It was only after the Italian companies were granted the bid that they formally registered as a consortium. However, the Tribunal found that the ANB was never clearly informed of this substitution and, hence, never

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<sup>304</sup> Ibid, p423

<sup>305</sup> Venkat Raman, A. and JW Bjorkman (2009). Public Private Partnerships in Health Care in India: Lessons for Developing Countries. London. Routledge.

<sup>306</sup> Eloïse M. Obadia (2005), para24

approved it. The Tribunal considered that under Italian law, the registered consortium was an autonomous legal entity, independent of the two companies which were composing it. As such the Consortium never benefited from the rights of the concession agreement and it could not therefore make any claim in its respect. Since the request was brought by the Consortium on its own behalf, it had had no standing.<sup>307</sup> In the absence of such standing, the Consortium could not be considered an investor pursuant to Article 25(1) of the ICSID Convention. Therefore the Tribunal concluded it lacked jurisdiction.<sup>308</sup>

### **4.3 Types of PPP Disputes**

Owing to the nature of PPP arrangements discussed above, dispute settlement method will depend on the type of dispute and the parties involved. There are three broad categories of disputes identified as;

- i. Disputes arising under agreements between concessionaire and the contracting authority and other governmental agencies;
- ii. Disputes arising under contracts and agreements entered into by the project promoters or the concessionaire with related parties for the implementation of the project
- iii. Disputes between concessionaires and other parties.<sup>309</sup>

There are general considerations on the methods that would be applied for prevention and settlement of disputes. The issues that would for example give rise to a dispute between the contracting authority and the concessionaire during the life of the project would generally be linked to possible breaches during the construction phase, the operation or in

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<sup>307</sup> Ibid, p422

<sup>308</sup> Ibid paragraphs 37-41

<sup>309</sup> UNCITRAL (2001), p99



connection with the expiry or termination of the agreement.<sup>310</sup> These disputes can be very complex and may often involve highly technical matters that need to be resolved speedily in order not to disrupt the construction or the operation of the infrastructure facility.

On disputes between project promoters and between the concessionaire and its lenders, contractors and suppliers, it is generally recognized that these are commercial transactions. In such transactions, parties are free to agree on the forum that will settle in a binding decision any dispute that may arise between them. In both international and national transactions, arbitration has become the preferred method whether or not it has been preceded by, or combined with, conciliation.<sup>311</sup>

On disputes involving customers or users of the infrastructure facility or service, depending on the type of project, the considerations and policies regarding the settlement of disputes arising out of any legal relationships may vary according to who the parties are, the conditions under which the services are provided and the applicable regulatory regime.<sup>312</sup> For example a concessionaire generating electricity would sell it to a government owned utility that purchases electricity like Kenya Power & Lighting Company Limited.

Generally, the service providers may be required to establish a special simplified and efficient mechanism for handling claims brought by the customers where customers are acting in their non commercial capacity. However, where customers are utility companies (such as a power distribution company) or commercial enterprises (for instance a large

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<sup>310</sup> Quiggin, J. (1996). Private sector involvement in infrastructure projects. *Australian Economic Review*, 1st quarter, 51–64.

<sup>311</sup> Moszoro M., & Gasiorowski P. (2008). Optimal Capital Structure of Public-Private Partnerships. *IMF Working Paper 1/2008*.

<sup>312</sup>

factory purchasing power directly from an independent producer) who freely choose the services provided by the concessionaire and negotiate the terms of their contracts, the parties would typically settle any disputes by methods usually used in trade contracts including arbitration. It therefore emerges that disputes between the contracting authority and the concessionaire are more prominent.<sup>313</sup>

### **4.3.1 Other Dispute Resolution Options**

#### **4.3.1.1 Court Dispute Resolution**

There are three main options for the resolution of disputes under a contract. The parties can resort to courts, arbitration proceedings or contractual dispute resolution procedure (sometimes but not necessarily) revolving around referring the dispute to an expert rather than an arbitrator), the parameters of which they set themselves.<sup>314</sup>

There are advantages and disadvantages to each option. According to Graham Vinter the courts present a better forum for deciding difficult points of law.<sup>315</sup> The reasons may be that courts determine various and numerous cases involving difficult points of law on a regular basis. On the process he argues to my satisfaction that judges and court officials are more brutal at imposing procedural deadlines than arbitrators. My explanation would be that Arbitrators are appointed by the parties. In most cases, parties may appear before them “voluntarily”. They are also paid by the parties. They may therefore be incentivized to appear friendly and amicable to the parties to retain their briefs and to attract more

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<sup>313</sup> United Nations Conference On Trade And Development (2010). *Investor–State Disputes: Prevention and Alternatives to Arbitration. UNCTAD Series on International Investment Policies for Development*, p41-74

<sup>314</sup> Orna Rabinovich-Einy\* & Ethan Katsh (2012). *Technology and the Future of Dispute Systems Design. Harvard Negotiation Law Review*, 17:151

<sup>315</sup> Vinter G, (2006). *Project Finance: A legal guide*. London: Sweet & Maxwell

briefs. To the contrary, courts are state sanctioned and parties are obliged to appear before them when summoned.<sup>316</sup>

The other advantage explained is that in courts, parties can commence, join or be joined in litigation rather easily. In arbitration, the parties must have an agreement to go to arbitration. Therefore, a third party affected by a dispute between two signatories to an arbitration agreement may not easily join in arbitration.<sup>317</sup>

In *Kenya Transport Association versus Municipal Council of Mombasa & another [2011] eKLR* an argument that an aggrieved party should have sought redress by invoking the administrative processes provided for under an enabling law was held untenable where constitutional rights had been infringed and the aggrieved persons had opted for enforcement by court process.<sup>318</sup>

Further, it is argued that courts have summary judgment procedures for pure debts, claims and the grater coercive powers. For example, they can commit a litigant to jail for wrong doing. An arbitrator does not have such powers. The disadvantages of litigation are given that they often conducted through public court hearings. It is therefore difficult to avoid a public hearing. The consequence being that commercial agreements which are at times regarded with secrecy become public knowledge. This exposes the parties especially the private companies to public scrutiny which may be prejudicial in their subsequent transactions. For example the details of the partnerships discussed earlier

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<sup>316</sup> Hosking, James M. (2004). The Third Party Non-Signatory's Ability to Compel International Commercial Arbitration: Doing Justice without Destroying Consent. *Pepperdine Dispute Resolution Law Journal*: 4(3), Article 6.

<sup>317</sup> Scott M. McElhaney (2012). Enforcing And Avoiding Arbitration Clauses Under Texas Law. *Jackson Walker L.L.P. Publication*, March 19, 2012

<sup>318</sup> Kenya Law Reports (eKLR) (2011). *Kenya Transport Association V Municipal Council Of Mombasa & Another*, Constitutional Petition no. 6 of 2011, p 16-17.

would not be easily accessible for public debate if the parties had gone to arbitration.<sup>319</sup> One may also argue that court proceedings are sometimes too inflexible. Judges are reluctant to hear cases outside normal court hours. On the contrary, an arbitrator or an expert appointed by the parties may easily accept to hear a claim outside the normal hours for example at lunch break or after 5pm.

Courts also tend to adhere strictly to procedures. In *Magnate Ventures Limited & Another v City Council of Nairobi & another* the applicants who were stakeholders in the advertising industry sought to challenge a partnership for Nairobi street lighting discussed between the City Council of Nairobi and Adopt-A-Light Limited.<sup>320</sup> Under the partnership, the City Council of Nairobi mandated a private entity, Adopt-A-Light Limited to undertake street lighting and advertising on street lighting poles in the city of Nairobi. The private entity was mandated to levy rates on such advertising activities. They brought an application under Judicial Review seeking various orders including order of certiorari, and order of mandamus and an order of prohibition with the sole goal of stopping the implementation of the agreement which in their opinion was unfair and granting a private company monopoly over street lighting and advertising. In dismissing the application, Justice R.V.P. Wendoh argued that the applicants could not challenge the contract of service by way of judicial review because a contract of service is a private matter and a dispute arising from breach thereof lies in the private law and they therefore lack the necessary standing (in judicial review) in such a matter where they have to show

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<sup>319</sup> Ibid, p3

<sup>320</sup> Kenya Law Reports, (2008). *Magnate Ventures Limited & Another v City Council of Nairobi & another*. HCCC 708/08, Retrieved on July 29, 2012, <http://www.kenyalaw.org>

cause that a specific legal right is threatened or breached arising from a public duty. “A contract can only be challenged by the other party to the contract.” She ruled.<sup>321</sup>

Similarly, in High Court Civil Case Number 434 of 2009-Milimani Commercial Courts; Kenya Airports Parking Services Limited and Kaps Municipal Parking Services Limited versus Municipal Council of Mombasa, the defendant (Council) argued that the court did not have jurisdiction to grant interim protective relief to the plaintiffs in reinforcement of an alleged agreement that was in its view plainly illegal and unlawful, hence invalid *ab initio*. The defendant insisted that the alleged agreement could not bind it by virtue of the provisions of **Section 143(8)** of the **Local Government Act** because it was executed by individuals in abuse of their offices.<sup>322</sup>

The defendant submitted that the issues it had raised in regard to the validity of the agreement were so fundamental that the court had jurisdiction to consider it and issue appropriate orders. The defendant explained that in view of the invalidity of the agreement, even the arbitration clause in the said agreement could not be enforced by the court. The trial judge in upholding the principle of separability of an arbitration clause in an agreement rejected the Councils line of argument and ruled that the issue as to the validity of the agreement was an issue that the arbitrator had jurisdiction to deal with. Parties were sent to Arbitration.<sup>323</sup>

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<sup>321</sup> Ibid p9

<sup>322</sup> Kenya Law Reports (2009). Kenya Airports Parking Services Ltd, KAPS Municipal Parking Services Ltd (Plaintiff) v. Municipal Council Of Mombasa(Defendant). *Nairobi Milimani Commercial Courts Civil Case No.434 OF 2009*

<sup>323</sup> L. Kimaru J. (2010). Kenya Airports Parking Services Ltd & another V Municipal Council of Mombasa [2010]. High Court at Nairobi, *Kenya Law Reports Journal*, March 24, 2010;

#### 4.3.1.2 Arbitration

Arbitration on the other hand is said to be having an upper hand especially when it comes to the enforcement of awards and judgments. In some cases for example there are countries that may not directly enforce court judgments obtained in another jurisdiction. For example a foreign judgement would have to be adopted and enforced in accordance with the local procedure. In arbitration, such countries may be signatories to the New York Treaty on the Recognition of Foreign Awards (1958).<sup>324</sup>

In recent times, arbitration has been used increasingly for settling disputes arising under commercial transactions including privately financed infrastructure projects. Arbitration is typically used both for the settlement of disputes that arise during the construction or operation of the infrastructure facility and for the settlement of disputes related to the expiry or termination of the project agreement. Arbitration is often conducted in a country other than the host country considered by the parties to be neutral. It is preferred, and in many cases required, by private investors and lenders, in particular foreign ones for various reasons seen as advantageous.<sup>325</sup>

First of all arbitral proceedings may be structured by the parties so as to be less formal than judicial proceedings and better suited to the needs of the parties and to the specific features of the disputes likely to arise under the project agreement. Secondly, the parties can choose as arbitrators persons who have expert knowledge of the particular type of project.<sup>326</sup> They may choose the place where the arbitral proceedings are to be conducted.

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<sup>324</sup> United Nations, Treaty Series, Vol. 330, No. 4379.

<sup>325</sup> Philip R. Weems (1993). Guidelines for Enforcing Money Judgments Abroad. *International Business Lawyer*, 21(11), pages 509-512

<sup>326</sup> UNCITRAL (2001), p183-84

They have the autonomy and can choose the language or languages to be used in the arbitral proceedings.

Another attraction for arbitration is that proceedings may be less disruptive of business relations between the parties than judicial proceedings. The proceedings and arbitral awards can be kept confidential, while judicial proceedings and decisions usually cannot. Furthermore, the enforcement of arbitral awards in countries other than the country in which the award was rendered is facilitated by the wide acceptance of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958.<sup>327</sup>

With reference, in particular, to infrastructure projects involving foreign investors, it may be noted that a framework for the settlement of disputes between the contracting authority and foreign companies participating in a project consortium may be provided through adherence to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States.<sup>328</sup> This forum or option of dispute resolution has been discussed in fair detail in relation to PPP agreements. ICSID conciliation and arbitration is voluntary but once the parties to a contract or dispute have consented to arbitration under the ICSID Convention, neither can withdraw its consent unilaterally. All ICSID members, whether or not parties to the dispute, are required by the Convention to recognize and enforce ICSID arbitral awards.<sup>329</sup> Under section 4 of the Investment Disputes Conventions Act (Cap 522), an award rendered pursuant to the Convention, and not stayed pursuant to the relative provisions of the Convention, are binding in Kenya,

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<sup>327</sup> United Nations, (1959). *Treaty Series*, vol. 330, No. 4739, 159

<sup>328</sup> United Nations. (1966). *Treaty Series*, vol. 575, No. 8359.

<sup>329</sup> ICSID (2006). p15

and the pecuniary obligations imposed by the award may be enforced in Kenya as if it were a final decree of the High Court.<sup>330</sup>

In the case of foreign investors, Bilateral Investment Agreements may also provide a framework for the settlement of disputes between the contracting authority and foreign companies. In these treaties, the host State typically extends to investors that qualify as nationals of the other signatory State a number of assurances and guarantees and expresses its consent to arbitration, for instance, by referral to ICSID or to an arbitral tribunal applying the UNCITRAL Arbitration Rules.<sup>331</sup>

#### **(i) Sovereign Immunity**

Where state actors are parties, one may be need to consider the applicable laws on sovereign immunity. When arbitration is allowed and agreed upon between the parties to the project agreement, the implementation of an agreement to arbitrate may be frustrated or hindered if the contracting authority is a state actor and is able to plead sovereign immunity, either as a bar to the commencement of arbitral proceedings or as a defence against recognition and enforcement of the award.<sup>332</sup> Sometimes the law on this matter may not be clear, which may raise concerns with the interested parties (for instance, the concessionaire, project promoters and lenders) that an agreement to arbitrate might not be effective. In order to address such possible concerns, it is advisable to be acquainted with the law on this topic and to understand the extent to which the contracting authority may raise a plea of sovereign immunity. Moreover, a contracting authority against which an

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<sup>330</sup> Ibid p17

<sup>331</sup> UNCITRAL (2001). p184; United Nations publication, Sales No E.77.V.6

<sup>332</sup> UNCITRAL (1999) P370-71; UNCITRAL (2001). p185



award has been issued may raise a plea of immunity from execution against public property.

There is a diversity of approaches to the question of sovereign immunity from execution. For example, under some national laws immunity does not cover governmental entities when engaged in commercial activities. In other national laws a link is required between the property to be attached and the claim in that, for example, immunity cannot be pleaded in respect of funds allocated for economic or commercial activity governed by private law upon which the claim is based or that immunity cannot be pleaded with respect to assets set aside by the State to pursue its commercial activities. In some countries, it is considered that it is for the government to prove that the assets to be attached are in non-commercial use.<sup>333</sup>

In some contracts involving entities that might plea sovereign immunity, clauses have been included to the effect that the government waives its right to plead sovereign immunity. Such a consent or waiver might be contained in the project agreement or an international agreement; it may be limited to recognizing that certain property is used or intended to be used for commercial purposes.<sup>334</sup> Such written clauses may be necessary inasmuch as it is not clear whether the conclusion of an arbitration agreement and participation in arbitral proceedings by the governmental entity constitutes an implied waiver of sovereign immunity from execution. At the international level, attempts have been made to come up with uniform rules and practices on sovereign immunity. Subsequently, with a view to enhancing the rule of law and legal certainty, particularly in

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<sup>333</sup> UNCITRAL (2000). Yearbook of the United Nations Commission on International Trade Law, 2000. *United Nations Commission On International Trade Law*, Vol 31, 171-74.

<sup>334</sup> UNCITRAL (1999), p370-71

dealings of States with natural or juridical persons, in order to contribute to the codification and development of international law and the harmonization of practice in this area, an international convention on the jurisdictional immunities of States and their property was adopted by the General Assembly of the United Nations on 2 December 2004.<sup>335</sup> The convention is yet to come into force.

**(ii) Effectiveness of the Arbitration Agreement And Enforceability Of The Award**

The effectiveness of an agreement to arbitrate depends on the legislative regime where the arbitration takes place. If the legislative regime for arbitration in the host country is seen as unsatisfactory, for instance, because it is found to pose unreasonable restrictions on party autonomy, a party might wish to agree on a place of arbitration outside the host country. It is therefore important for the host country to ensure that the domestic legislative regime for arbitration resolves the principal procedural issues in a manner appropriate for international arbitration cases. Such a regime is contained in the UNCITRAL Model Law on International Commercial Arbitration.<sup>336</sup>

If the arbitration takes place outside the host country or if an award rendered in the host country would need to be enforced abroad, the effectiveness of the arbitration agreement would also depend on legislation governing the recognition and enforcement of arbitral awards. The Convention on the Recognition and Enforcement of Foreign Arbitral Awards, *inter alia*, deals with the recognition of an arbitration agreement and the grounds on which the court may refuse to recognize or enforce an award. The Convention is

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<sup>335</sup> United Nations (2005). United Nations Convention on Jurisdictional Immunities of States and Their Property 2004. Adopted by the General Assembly of the United Nations on 2 December 2004; United Nations (2004). General Assembly resolution 59/38, *Official Records of the General Assembly, Fifty-ninth Session*, Supplement No. 49 (A/59/49).

<sup>336</sup> UNCITRAL (2000) p171-73.

generally regarded as providing an acceptable and balanced regime for the recognition and enforcement of arbitral awards. The fact that the host country is a party to the Convention is likely to be seen as a crucial element in assessing the legal certainty of binding commitments and of the reliability of arbitration as a method for solving disputes by arbitration with parties from the country. It would also facilitate the enforcement abroad of an arbitral award rendered in the host country.<sup>337</sup> Under Section of the Kenyan Arbitration Act, a domestic arbitral award, can be recognized as binding and, upon application in writing to the High Court, shall be enforced subject to the provisions of the section and section 37 and an international arbitration award can be recognised as binding and enforced in accordance to the provisions of the New York Convention or any other convention to which Kenya is signatory.<sup>338</sup>

#### **4.3.3 Expert Determination**

Expert determination on the other hand is considered attractive, largely because it is less expensive and is speedier. It avoids the rigorous of the application of the rules of evidence and procedure and offers finality which avoids delays, potential re-hearings and appeals, which is particularly suitable especially where an expert knowledge of the subject is required where the parties may have a continuing relationship.<sup>339</sup>

Expert determination is not governed by legislation; the adoption of Expert Determination is a consensual process by which the parties agree to take defined steps in

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<sup>337</sup> Ibid p173..

<sup>338</sup> Kenya Law Reports (2010). The Arbitration Act: Chapter 49, Revised Edition 2010 (1995). *Published by the National Council for Law Reporting*

<sup>339</sup> Kendall, J., Freedman, C., & Farrell, J. (2008). *Expert Determination*, 4th Ed. London: Sweet & Maxwell; Einstein J. (2002). *The Heart Research Institute Ltd v Psiron Ltd* [2002] NSWSC 646. *Award* July 25, 2002

resolving disputes. On a public policy level, the rationale behind supporting alternative dispute resolution includes:<sup>340</sup>

- (i) Harnessing the influence of the Courts to encourage the use of alternative dispute resolution as a way of overcoming the reluctance of litigants and lawyers;
- (ii) Making procedures more simple, and closer to normal business;
- (iii) Simplifying the work done in preparing disputes for the resolution process;
- (iv) Facilitating the resolution of disputes by allowing parties to choose an arbitrator or mediator with special knowledge or expertise;
- (v) Improving efficiency by finding earlier or more convenient dates for alternative dispute resolution that is permitted by court process;
- (vi) Reducing costs; and
- (vii) Achieving results which do not necessarily demand that one side wins and one loses.

In recent years, dispute resolution legislation and trends in resolving commercial disputes by alternative means have developed common themes and objectives including better case management, increased speed, and reduced expense, party autonomy and greater involvement by the parties themselves. It is notable as Einstein J in *The Heart Research Institute Ltd v Psiron Ltd* states that the concepts of public policy are not fixed but change according to developments in society.<sup>341</sup>

In some jurisdictions governments have advocated for standard approaches to PPP dispute resolution. In the Britain for example, there is **HM Treasury 2007, *Standardization of PFI Contracts*** which states that going through the courts may not be

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<sup>340</sup> Craig Darling (2007). Alternative Dispute Resolution in Entitlement Tribunals: A Policy Choice. *BC Tribunal Dispute Resolution Needs Assessment Project*, December 2007.

<sup>341</sup> Sweet & Maxwell; Einstein J. (2002). Para 84]

appropriate for the disputes that can arise under a PFI contract and that an alternative formal dispute resolution procedure may offer a more efficient and cost-effective method of resolving disputes.<sup>342</sup> It proposes a common form of dispute resolution involving a three stage process as follows;

- (i) the Authority and Contractor consult with each other for a fixed time period (possibly involving different levels of internal consultation) in an attempt to come to a mutually satisfactory agreement;
- (ii) if consultation fails, the parties may then (except in the case of certain types of dispute) put their case before an expert to decide. The expert is appointed from a panel (e.g. of construction or operation experts) whose appointment is regulated by the Contract. It may be appropriate in certain circumstances to substitute other forms of Alternative Dispute Resolution ("**ADR**") for this type of expert determination. Disputes relating to the mechanics of price variations may go to a financial expert agreed between the parties at the time; and,
- (iii) if either party is dissatisfied with the expert's decision, it may refer the matter either to arbitration (itself a form of ADR) or to the courts for a final and binding decision. The method of appointing the arbitrator should be set out in the Contract.<sup>343</sup>

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<sup>342</sup> HM Treasury, (2007). Standardization of PFI Contracts Version 4 (London: The Stationery Office), [www.h-m-treasury.gov.uk](http://www.h-m-treasury.gov.uk) <accessed on 29 July 2012>

<sup>343</sup> Ibid p13

#### 4.3.4 Other Methods for Preventing and Settling PPP Disputes

In Kenya, the Public Procurement and Disposal (Public Private Partnerships) Regulations, 2009 merely provides that a dispute resolution mechanism is one of the minimum contractual obligations that a PPP contract should clearly provide.<sup>344</sup>

However, the Kenyan Civil Procedure Act largely governs commercial disputes. The overriding objective is provided under section 1A as the facilitation of just, expeditious, proportionate and affordable resolution of civil disputes. For purposes of furthering this overriding objective, the Act provides for courts to incorporate arbitration and other alternative dispute resolution mechanisms in the determination of disputes.<sup>345</sup>

Order 46 of the Civil Procedure Rules provides that where in any suit all the parties interested who are not under disability agree that any matter in difference between them in such suit shall be referred to arbitration, they may, at any time before judgement is pronounced, apply to court for an order of reference to arbitration. Order 46 rule 20 of the said rules provides the court is not precluded from adopting and implementing, of its own motion or at the request of the parties, any other appropriate means of dispute resolution (including mediation) for the attainment of the overriding objective stated. It is further provided that the court may adopt an alternative dispute resolution and shall make such orders or issue such directions as may be necessary to facilitate such means of dispute resolution.<sup>346</sup>

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<sup>344</sup> European Commission (2003), p9

<sup>345</sup> Kariuki Muigua (2011). Alternative Dispute Resolution and Article 159 of the Constitution. *Centre for Advanced Studies in Environmental Law and Policy (CASELAP)*, September 3, 2012

<sup>346</sup> Ibid p3-5

At the international level, the United Nations Commission on International Trade Law has come up with a legislative guide on privately financed infrastructure projects.<sup>347</sup> It discusses commonly used methods of dispute prevention and settlement. It also sets out features of methods that can be used for preventing and settling disputes and considers their suitability for the various phases of large infrastructure projects, namely the construction phase, the operational phase, and post-termination phase. These methods range from early warning, partnering conciliation and mediation, facilitated negotiations, expert appraisal, review by independent experts, arbitration to judicial determination.

They are basically modelled along the three basic means of dispute resolution discussed above, namely, court determination, arbitration and expert determination. It is however important to note that the project agreement would usually provide for composite dispute prevention and dispute and dispute settlement mechanisms. It is common in modern commercial contracts for parts parties to provide for a graduated dispute resolution mechanism commencing with consultation to arbitration and ending with resort to courts.<sup>348</sup>

In line with the *Guide* the paragraphs below set out the essential features of methods that can be used for preventing and settling disputes and consider their suitability for the various phases of large infrastructure projects, namely, the construction phase, the operational phase and the post-termination phase.<sup>349</sup> Although the project agreement would usually provides for composite dispute prevention and dispute settlement

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<sup>347</sup> UNCITRAL (2001), p176-77

<sup>348</sup> Schwartz, David S. (2010). Mandatory Arbitration and Fairness. *84 Notre Dame L. Rev.* 1247, April 19, 2010)

<sup>349</sup> UNCITRAL (2000), p168-9.

mechanisms, it is desirable that care should be taken to avoid excessively complex procedures or to impose too many layers of different procedures.<sup>350</sup>

#### **4.3.4.1 Early Warning**

Early warning provisions are (are) discussed and considered as an important in the avoidance of disputes. Under these provisions, if one of the parties to a contract feels that events that have occurred, or claims that the party intends to make, have the potential to cause disputes, these events or claims should be brought to the attention of the other party as soon as possible.<sup>351</sup>

Delays in making these claims are a source of conflict because they are likely to surprise the other party and therefore create resentment and hostility. Furthermore, they render the claims more difficult to prove. Therefore, under early warning provisions, the claiming party is typically required to submit a quantified claim, along with the necessary proof, within an established time period. To make such a provision effective, a sanction can be included for non-compliance with the provision, such as the loss of the right to pursue the claim or an increased burden of proof. In infrastructure projects, early warning frequently refers to events that might adversely affect the quality of the works or the public services, increase their cost, cause delays or endanger the continuity of the service. These provisions are therefore useful throughout the duration of an infrastructure project.<sup>352</sup>

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<sup>350</sup> UNCITRAL (2001), p176

<sup>351</sup> UNCITRAL (2000), p168-70

<sup>352</sup> UNCITRAL (2001), p176-78



#### **4.3.4.2 Partnering**

Partnering serves to create, through mutually developed formal strategies and from the outset of a project, an environment of trust, teamwork and cooperation among all key parties involved in the project. Partnering may be useful in avoiding disputes and committing the parties to work efficiently to achieve the goals of the project. Parties may choose to sign a “partnering charter” (“Charter”), “memorandum of understanding” (“MOU”), project cooperation agreement (“PCA”) or a “joint venture agreement” (“JV”) signifying their commitment to work jointly towards the success of the project.<sup>353</sup> The Charter, MOU, PCA or JV agreement may include an issue resolution procedure designed to determine claims and resolve other problems, beginning at the lowest possible level of management and at the earliest possible opportunity. If a solution is not reached within a given time-frame, the issue is raised to the next level of management. Outsiders to the project are only called in if no agreement by the persons responsible for the project is achieved.<sup>354</sup>

#### **4.3.4.3 Facilitated Negotiations**

This procedure is aimed at assisting the parties in the negotiation process. The parties can appoint a facilitator at the commencement of the project. His/her function is to assist the parties in resolving any disputes, without providing subjective opinions on the issues, but rather coaxing them into analyzing thoroughly the merits of their cases.<sup>355</sup> This procedure is especially useful when and where there are numerous parties involved who would find it difficult to negotiate and coordinate all the differing opinions without such facilitation.

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<sup>353</sup> Ibid, p177

<sup>354</sup> Ibid, p178

<sup>355</sup> UNCITRAL (2000), p168

#### 4.3.4.4 Conciliation and Mediation

Conciliation broadly refers to proceedings in which a person or a panel assists the parties in an independent and impartial manner in their attempt to reach an amicable settlement of their dispute. Conciliation differs from negotiations between the parties in dispute (in which the parties would typically engage after the dispute has arisen) in that conciliation involves independent and impartial assistance to settle the dispute, whereas in settlement negotiations between the parties no third-person assistance is involved.<sup>356</sup>

Conciliation also differs from arbitration in that conciliation ends either in the settlement of the dispute agreed by the parties or it ends unsuccessfully; in arbitration, however, the arbitral tribunal imposes a binding decision on the parties, unless they have settled the dispute before the award is made.<sup>357</sup>

In practice, conciliation proceedings are referred to by various expressions, including “mediation”. However, the legal tradition of some countries may draw a distinction between conciliation and mediation to emphasize the fact that, in conciliation, a third party is trying to bring together the disputing parties to help them reconcile their differences, while mediation goes further by allowing the mediator to suggest terms for the resolution of the dispute. Nevertheless, the terms “conciliation” and “mediation” are used as synonyms more frequently than not.<sup>358</sup>

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<sup>356</sup> Ibid, p169

<sup>357</sup> Law Reform Commission (2010). *Alternative Dispute Resolution: Mediation And Conciliation. LRC 98-2010 First Published*, November 2010

<sup>358</sup> Tomás Kennedy-Grant. (2010). *Expert Determination and the Enforceability of ADR Generally. Paper presented to the Arbitrators and Mediators Institute of New Zealand Inc / Institute of Arbitrators and Mediators Australia Conference held in Christchurch, August 5-7, 2010*

The practice of conciliation has gained increase in use in various parts of the world. This trend is reflected, *inter alia*, in the establishment of a number of private and public bodies offering conciliation services to interested parties. At the international level, the value of conciliation as a method of amicably settling disputes has risen in the context of international commercial relations. This has created the need for the establishment of conciliation rules that are acceptable in countries with different legal, social and economic systems to significantly contribute to the development of harmonious international economic relations. The result was the adoption of the conciliation rules of the United Nations Commission on International Trade.<sup>359</sup>

The conciliation procedure is usually private, confidential, informal and easily pursued. It may also be quick and inexpensive. The conciliator may assume multiple roles and is in general more active than a facilitator. He or she may frequently challenge the parties' position to stress weaknesses that usually facilitate agreement and, if authorized, may suggest possible settlement scenarios. The procedure is generally non-binding and the conciliator's responsibility is to facilitate settlement by directing the parties' attention to the issues and possible solutions, rather than passing judgement. This procedure is particularly useful when there are many parties involved and it would therefore be difficult to achieve an agreement by direct negotiations.<sup>360</sup>

If the parties provide for conciliation in the project agreement, they will have to settle a number of procedural questions in order to increase the chance of a settlement. Settling such procedural questions is greatly facilitated by the incorporation into the contract, by

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<sup>359</sup> William K. Slate, Seth H. Lieberman, Joseph R. Weiner, & Marko Micanovic (2005). UNCITRAL: Its Workings In International Arbitration And A New Model Conciliation Law.

<sup>360</sup> UNCITRAL (2000), p169

reference, of a set of conciliation rules such as the UNCITRAL Conciliation Rules. There are other sets of conciliation rules have been prepared by various international and national organizations.<sup>361</sup>

#### **4.3.4.5 Non-Binding Expert Appraisal**

In this procedure a neutral third party can be charged with providing an appraisal on the merits of the dispute and suggested outcome. It can serve as a “reality check” showing the contesting parties what the possible outcome of the more expensive and usually slower binding procedures such as arbitration or court proceedings would be. This procedure can be useful where the parties have difficulty in communicating because their positions have become entrenched or where they do not see clearly the weaknesses of their positions or the strengths of the other party’s positions. A non-binding expert appraisal can be followed by negotiations, either direct or facilitated.<sup>362</sup>

#### **4.3.4.6 Review of Technical Disputes by Independent Experts**

In the case of disagreements relating to technical aspects of the construction of an infrastructure facility (for example, whether the works comply with contractual specifications or technical standards), the parties may wish to consider providing for certain types of dispute to be referred to an independent expert appointed by both parties. The parties may, for instance, appoint a structural engineer, design inspector or a consulting engineer, respectively, to review disagreements relating to the inspection and approval of the design, and the progress of construction works.<sup>363</sup> The independent

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<sup>361</sup> Ibid, p169

<sup>362</sup> UNCITRAL (2001), p178

<sup>363</sup> Yona Shamir (2003) Alternative Dispute Resolution Approaches And Their Application. UNESCO-IHP Publication, p11.

experts should have expertise in the designing and construction of similar projects. The powers of the independent expert (such as whether the independent expert makes recommendations or issues binding decisions), as well as the circumstances under which the independent expert's advice or decision may be sought by the parties, should be set forth in the project agreement.<sup>364</sup>

In some large infrastructure projects, for instance, the advice of the independent expert may be sought by the concessionaire whenever there is a disagreement between the concessionaire and the contracting authority as to whether certain aspects of the design or construction works are in conformity with the applicable specifications or contractual obligations. Referral of a matter to a design inspector or to a consulting or supervising engineer, as appropriate, may be particularly relevant in connection with provisions in the project agreement that require prior consent of the contracting authority for certain actions by the concessionaire, such as final authorization for operation of the infrastructure facility.<sup>365</sup>

Independent experts have often been used for the settlement of technical disputes under construction contracts, and the various mechanisms and procedures developed in the practice of the construction industry may be used, with the necessary changes, in connection with privately financed infrastructure projects.<sup>366</sup> However, it should be noted that the scope of disputes between the contracting authority and the concessionaire is not necessarily the same as would be the case for disputes that typically arise under a construction contract. This is so because the respective positions of the contracting

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<sup>364</sup> Kendall, J., Freedman, C., & Farrell, J. (2008), p34

<sup>365</sup> Kremenyuk, V. (1991). *International Negotiation: Analysis, Approaches, Issues*. Jossey- Bass.

<sup>366</sup> UNCITRAL (2001), p179

authority and the concessionaire under the project agreement are not fully comparable with those of the owner and the performer of works under a construction contract.

For instance, disputes concerning the amount of payment due to the contractor for the quantities of works actually performed, which are frequent in construction contracts, are not typical for the relations between contracting authority and concessionaire, since the latter does not usually receive payments from the contracting authority for the construction works performed.<sup>367</sup>

#### **4.3.4.7 Dispute Review Boards**

In some project agreements especially those for large infrastructure projects it is often established permanent boards composed of experts appointed by both parties, at times with the assistance of an appointing authority, for the purpose of assisting in the settlement of disputes that may arise during the construction and the operational phases (“dispute review boards”). Proceedings before a dispute review board can be informal and expeditious, and tailored to suit the characteristics of the dispute that it is called upon to settle.<sup>368</sup> The appointment of a dispute review board may prevent misunderstandings or differences between the parties from developing into formal disputes that would require settlement in arbitral or judicial proceedings. In fact, its effectiveness as a tool for avoiding disputes is one of the special strengths of this procedure, but a dispute review

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<sup>367</sup> Ibid., p180

<sup>368</sup> UNCITRAL (2001), p170; Chern, C, (2007). *Chern on Dispute Review Boards: Practice and Procedure*, 1 ed. Wiley-Blackwell Publication

board may also serve as a mechanism to resolve disputes, in particular when the board is given the power to render binding decisions.<sup>369</sup>

Under the dispute review board procedure, the parties may select, at the outset of the project at least three experts who are renowned for their knowledge in the field of the project to constitute the board. These experts may be replaced if the project comprises different stages that may require different expertise (that is, different expertise will be required during the construction of the facility and during the later administration of the public service), and in some large infrastructure projects more than one board can be established. For example, one dispute review board may deal exclusively with disputes regarding matters of a technical nature (e.g. engineering design, fitness of certain technology, compliance with environmental standards) whereas another board may deal with disputes of a contractual or financial nature (regarding, for instance, the amount of compensation due for delay in issuing licences or disagreements on the application of price adjustment formulas).<sup>370</sup>

Each board member should be experienced in the particular type of project, including experience in the interpretation and administration of project agreements, and should undertake to remain impartial and independent of the parties.<sup>371</sup> These persons may be furnished with periodic reports on the progress of construction or on the operation of the infrastructure facility, as appropriate, and may be informed immediately of differences arising between the parties. They may meet with the parties, either at regular intervals or

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<sup>369</sup> UNCITRAL (2000), p170

<sup>370</sup> Ibid., p171

<sup>371</sup> UNCITRAL (2001), p181

when the need arises, to consider differences that have arisen and to suggest possible ways of resolving those differences.

In their capacity as agents to avert disputes, the members of the board may make periodic visits to the project site, meet with the parties and be informed of the progress of the work. These meetings will help in identifying any potential conflicts early, before they start festering and turn into full-fledged disputes. When potential conflicts are detected, the board proposes solutions, which, given the expertise and standing of its members, are likely to be accepted by the parties.<sup>372</sup>

Referral of a dispute triggers an evaluation by the board, which is done in an informal manner, typically by discussion with the parties during a regular site visit. The board controls the discussion, but each party is given a full opportunity to state its views, and the dispute review board is free to ask questions and to request documents and other evidence.<sup>373</sup> The advantages of conducting hearings at the job site, soon after the events have occurred and before adversarial positions have hardened, are obvious. The board then meets privately and seeks to formulate a recommendation or a decision. If the parties do not accept these proposals and disputes do arise, the board, if authorized to do so by the parties, is in a unique position to solve them expeditiously because of its familiarity with the problems and contractual documents.

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<sup>372</sup> UNCITRAL (2000a). Privately financed infrastructure projects: draft chapters of a legislative guide on privately financed infrastructure projects. *Report of the Secretary-General, United Nations Commission on International Trade Law Thirty-third session*, New York, 12 June-7 July 2000

<sup>373</sup> UNCITRAL (2001), p181



#### 4.4 Conclusion

The proceedings in the cases discussed above like the *Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania* and *Malicorp Limited vs The Arab Republic of Egypt* discussed in the context of PPP disputes and the series of events culminating into the termination of the PPP agreements, demonstrate the complex and intensive nature of PPP disputes. The resource and time that can be applied to such disputes may be deterrent to any investor or to the government as the case may be. The very nature of these disputes clearly demand that in fostering the legal and regulatory framework for PPPs to encourage investment in infrastructure and achieve successful and sustainable PPP program, the PPP framework should not focus only on the institutional capacity of ministry of finance, and the line ministries, PPP law and regulation.<sup>374</sup>

A framework that will address key shortcomings in the fiancé infrastructure must include a policy that fosters the understanding of the nature and characteristics of PPP disputes coupled with processes and options that can best help to solve them at the different levels of the dispute hierarchy. These may include legal reforms, innovative approaches to risk mitigation and implementing good practice in procurement processes among other reforms. Innovative, fair and efficient dispute prevention and resolution practices form an integral part of this process.

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<sup>374</sup> European Investment Bank. (2011). Study on PPP Legal & Financial Frameworks in the Mediterranean Partner Countries. Best Practices and Lessons Learned: Selected Experiences from Other Countries. *Facility for Euro-Mediterranean Investment and Partnership (FEMIP)*, 3 – May 2011

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