Future of Water Privatisation Projects: an Emerging Economic View

Underlying Conditions for Successful Public/Private Partnerships in the Water Sector in Civil Law Africa

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In civil law Africa, the culture of public services, such as the supply of water, has traditional relationships with French culture. The central question is how to provide water services in the most efficient manner? The old answer to this question was to outsource the services, where possible, if there were sufficient guarantees of good 'public service' in the long run, but this tradition has been forgotten in recent times in Africa. The modern answer – a necessity of the times – is to outsource the services due to limited public resources and poor technical capability.

The current central question is whether a particular type of public/private partnership is acceptable in civil law Africa? If one looks at the projects under development, the answer is yes. Indeed, the equilibrium reached after more than a century of negotiation between private project companies and public authorities in France (or in Africa before the 1960s) is much more likely to be the starting point for any deal. This article will outline some basic principles from this culture.

Underlying principles of the African civil law culture

This article will only outline a few underlying principles which may also apply in other jurisdictions.

The water service is a 'natural monopoly' that every end user has to purchase without alternative. It is a capital and labour intensive local service which is among the most sensitive one to local voters. This is a very important factor which triggers many consequences, *inter alia*, the fact that the public authority cannot tolerate speculative margins for the project company or disruption to the service.

In its duty to serve the basic needs of the public, the public authority must be in a position to impose new investment and adaptation of the service on the project company. It is not realistic to impose on the project company a user's fee which is valid for many years under all circumstances, even if a proper escalation formula is used. It is impossible and inadvisable to record all the rights and obligations of the public authority and the project company in a contractual document for a venture which often lasts for decades.

If the project company performs well in all respects (good construction and maintenance, constant use of up-to-date technology, good operation of the service and sound commercial approach), it should receive a reasonable profit in the long run for the whole duration of the venture.

At the expiry of the venture (the length of which is calculated in such a way that the users' fees are acceptable to the public), the whole facility and system, which is deemed to belong to the public authority from the start, will be handed over to it in a good physical and operational state.

How to reconcile these potentially conflicting underlying factors?

Traditional French recipe for acceptable public/private partnership in water

The traditional French recipe is apparently complex but relatively easy to implement in practice. The recipe is made up of three ingredients: contract + underlying regulations + regulatory authority.

Types of contract

There are three types of contract : concession contract, leasing contract and management contract.

Taking the concession contract first, the key clauses are as follows:

- specifications: limited technical specifications and detailed 'functional specifications';
- public service obligations of the concessionaire: these obligations are very detailed;
- right of control and variation of the public authority: the public authority benefits from far-reaching rights based on three criteria: non-discrimination, continuity and adaptability of the service;
- remedy in case of default of the concessionaire: the public authority enjoys special rights to remedy the default quickly and efficiently (up to a right to use the equipment and personnel of the concessionaire) and the right to step in (which under certain circumstances may be assigned to third parties such as lenders);

- tariff: the tariff to be paid by the end users (*redevance*) must be calculated in such a way that the project company will eventually balance the concession costs and income and make reasonable profits taking into account both the industrial and financial amortisation of the concession assets and the financing costs. (This principle is a legal principle.) The tariff clause is rather detailed in relation to the parameters to be used for the calculation of the *redevance*, it also includes the conditions for tariff revision or formula if and when certain circumstances arise;
- renegotiation: the concession includes important clauses permitting the concession to be revisited at regular intervals and/or if certain circumstances arise;
- financial transparency: the concessionaire must file very detailed financial statements at regular intervals and present its account in accordance with a detailed accounting plan. The level of detail is often similar to that of traditional 'cost plus' or 'day works' contracts;
- hardship: several clauses, sometimes known as 'landscape clauses', often permit the concessionaire to be specially indemnified by the public authority should any substantial change in the conditions prevailing at the time of contracting arise;
- quantification of liability: the 'quantifications' principles, easy to reconcile with the financial statements, are rather detailed.

The above description of a few of the major clauses permits an understanding of the true nature of the public/private partnership created by the concession contract. It is mostly an instrument which is both very specific in relation to the various parameters guaranteeing a good service to be rendered in the long run by the concessionaire and able to adapt the rights and obligations of both parties to the actual needs of the 'public service'.

Against this background, an experienced project company will not be reluctant, for instance, to release the detailed financial statements required by the concession contract in order to document easily and with little risk of dispute the various situations where it is entitled to claim against the public authority in accordance with the terms of the concession contract (or the underlying regulations).

Another important element for the success of this venture (unusual in a traditional contracting approach) is the preference for an experienced project company to be a 'partner', being a public authority with strong negotiating and controlling skills able to agree easily on the many foreseeable future agreements to be reached on variations and renegotiations without having to present the matter as a formal claim leading to lengthy discussions. 'Partnering' in its more modern approach is indeed an integral part of such ventures and company law lawyers sometimes understand the scheme more clearly than project finance lawyers.

The leasing contract (*contrat d'affermage*) amounts in fact to a concession contract where the initial investment is not made by the concessionaire – the project company leases the bare infrastructure and network from the the public authority and it must then maintain and operate and sometimes rehabilitate the infrastructure. The renting price takes into account the scope and nature of investment that the 'farmer' would have undertaken in this contract. The length of the contract is shorter than the concession contract (typically ten to 15 years).

The management contract (*régie*) is a more traditional kind of service management contract with different possible consideration schemes: an interesting one is the *régie intéressée* where a part of the project company payment is proportional to the level of users' fees collected by the public authority.

Underlying regulations: a framework of 'equitable principles' deriving from administrative laws

When public interest and public service is at stake, the principles of the civil code relating, *inter alia*, to the sanctity of contract are set aside in order to give additional rights to the public authority and also to the project company.

Additional rights for the public authority include:

- the right to terminate the venture not only for default but also for convenience if it is in the public interest;
- the right to amend the terms of the agreement in order to adapt the services to support the public interest;
- the right to impose penalties and coercive measures as an interim remedy against the project company.

Additional rights for the project company include the following:

- when the public authority makes use of any of its rights affecting the sanctity of contract in the name of the public interest, the project company is entitled to be compensated for all losses incurred, including loss of profit (*damnum emergens* and *lucrum cessans*);
- when unforeseen physical conditions occur beyond certain limits, the project company is entitled to full compensation – this may include unforeseen environmental disasters;
- when the surrounding economic circumstances prevailing at the date of signature have substantially changed, the project company is entitled to indemnification even in the absence of a specific clause in the concession contract.

Regulatory authority

Even if the above framework of clauses and underlying principles defuse most of the potential conflicts between the public authority and the project company, there is still the need for an efficient regulatory authority able to quickly impose equitable solutions on both parties.

In France, this authority is vested in the Conseil d'Etat which is both an adviser of the State and a

court having authority over any dispute between a public authority and a project company managing a public service. The Conseil d'Etat is a highly respected forum and it may qualify as a 'regulator' since it has the authority to render its decisions on the basis of pure equity without being bound by a strict doctrine of precedent.

Additionnal requirements for the development of public/private partnerships for water projects in civil law Africa

Many contractual and legal similarities between France and civil law Africa are conducive to public/private partnerships based on the above-mentioned concession and *affermage* schemes. Indeed, most of the countries of civil law Africa have civil and administrative laws very similar to French laws in relation to the key issues of concession and *affermage*. In addition, most of these countries have experienced French concession and *affermage* at some point in the past; there is no need, therefore, to reinvent the wheel in relation to many of the clauses and underlying legal principles.

In particular, the necessity of special BOT laws is arguable for experienced players in the area (some recent BOT laws, eg in Guinée Conakry, may even be seen as a drawback in some respects). The feeling is that if some laws are necessary, they should mostly 'securitise' the principles outlined above.

However, if hardly any large-scale public/private partnerships have been entered into in the water sector in the region, one may question the interest of the concession and *affermage* systems as described above and may wonder if this kind of public/private partnership or other form of privatisation has any chance of being developed in the area in the near future.

Nowadays it is easy (and even fashionable in some circles) to be pessimistic about such matters and knowledgeable persons sometimes raise the issue of the difficulty of metering the consumption of water or the fact that end users are not used to paying for the full cost of the water service or cannot afford to pay. This, of course, has to be considered. However, taking into account the scarcity of public resources and the necessary role of public/private partnerships as a key feature of the economic development of civil law African countries, it is not only worthwhile but necessary to explore the various additional factors which could permit the development of water concession and *affermage* contracts in the area.

The response from lawyers to such a challenge is to make optimum use of the flexible public/private partnership principles deriving from the concession which are indeed very different from an outright privatisation, often perceived as inappropriate due to its rigidity. The concession could provide, for instance, for a progressive development of water services with respect to the quality and availability of water, as well as the location of the distribution point and the issue of subsidies from the public authority which could decrease (and be quantified through the detailed and transparent accounting scheme) if and when certain easy-to-control parameters are met.

In addition, legal practitioners will attempt to limit the collateral risks faced by investors in a practical manner, mostly taking advantage of the administrative law tradition of these countries which is often an unknown quantity which it is important to understand and/or rediscover in order to reach equitable legal solutions for long-term projects. Against this background, some template documents for concession contracts existing in the administrative law tradition could be used with great benefit, and additional reference to some key equitable principles could also be included in the contract or its annexes.

Another route rather common in civil law Africa for large projects and which has worked efficiently for decades to 'securitise' the project company is the pragmatic approach of ad hoc investment agreements (*convention d'etablissement*). Such a *convention d'etablissement* entered into between a state and a project company requires approval from the national assembly of the country involved. It will then have the status of a special law overriding any other national law to the contrary. In recent examples, these conventions can be rather detailed and are instrumental in securing many of the rights of the project company (for instance in terms of ownership, security, expropriation, currency convertibility and risk, trust account, tax treatment, legal stability, dispute avoidance and dispute resolution, indemnification principles, right to obtain permits, etc).

An additional impetus for the development of a successful project is the promotion of a regulating authority which could take the form of an authoritative body fully transparent and subject to judicial review and which could be entitled to rule *prima facie* (or, under certain circumstances, finally) on all problems arising between the parties – the draft BOT UNCITRAL legislative guide proposes very interesting developments on these matters. The time may be ripe to promote such an authority at a regional level, for instance within the framework of the current OHADA effort, involving the development of a full set of uniform business laws already applicable to most civil law countries in Central and Western Africa. Banking lawyers will be interested to explore for the same countries some new securitisation techniques deriving from the new OHADA Uniform Act. The IBA Conference which took place in Yaoundé, Cameroon, in December 1999 provided an interesting forum for discussion of this subject.

Conclusion

It is to some extent a paradox that major public/private partnerships in the water sector have not been developed to any substantial extent in African

civil law countries, since many of the legal instruments and legal framework have already been tested and are readily available in the region.

Of course, the economic factors may not be as favourable as those prevailing elsewhere but taking into account the level of development of some civil law African cities, the explanation for the lack of development may not lie there. Indeed, if the 'privatisation' is not presented as an outright privatisation but as a true public/private partnership through the very flexible and equitable concession approach (including its equitable underlying framework) outlined above, there is every reason to be optimistic.

However, while most of these countries are still on the road to improving their business and other laws, as well as their judiciary system and procedures, it remains likely that the largest projects (which often serve as the basis for other projects) will need some additional legal securitisation which could be obtained mainly through the *convention d'etablissement* route.

This article concludes that with a blend of knowledge of the concession scheme (made up of the three key elements described above), local laws and the practice of *convention d'etablissement*, the criteria for the legal and financial viability of some potential public/private partnerships in water in civil law Africa will stand a fair chance of being met, at least for large projects.

By pursuing this goal, the infrastructure lawyer will have the unexpected satisfaction of having participated in the fulfilment of a very basic need of many citizens in these countries, which is itself a substantial step towards economic development and better compliance with the rule of law.