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Reforming the BOT Law: a call of the times

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Recent experience with the implementation of the build-operate-transfer (BOT) Law indicates the need to address various issues, starting from the legal framework to the level of responsibilities of the government institutions that are involved in the project cycle, i.e., from entry level to implementation and completion. Improvements may be done at the level of both the legal and institutional frameworks, with the latter referring to the role of the oversight agencies and the implementing agencies.

Legal framework

On the whole, the BOT Law and its implementing rules and regulations (IRR) have to be reviewed. An indispensable condition for the successful implementation of the BOT Law is a legal environment where property rights and contractual agreements are protected and enforced. The present BOT Law's framework for private sector investment in infrastructure has to be clarified by a clear allocation of roles, functions, and duties across the spectrum of institutions.

At the minimum, an effective implementation of BOT projects hinges on the following: (i) a legal and economic environment that is conducive to a mutually beneficial partnership; (ii) clarity in articulating the duties and responsibilities of the parties to the contract; (iii) certainty of recovering investments and availability of mechanisms for dealing with risks and unforeseen events; and (iv) transparency and credibility of the government's processes for review and approval of proposed BOT projects and the associated contracts for implementation.

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This *Notes* draws from Dante B. Canlas and Gilberto M. Llanto, "A Proposed BOT Bill to Enhance Public-Private Partnership in Infrastructure Development," unpublished paper, 6 October 2006. The author is Senior Research Fellow at the Institute. The views expressed are those of the author and do not necessarily reflect those of PIDS or any of the study's sponsors.

A primary consideration is to be able to distinguish between the roles of the enabling legal framework (the BOT Law itself) and the IRR. The BOT law should provide the enabling framework and clearly allocate roles, functions, powers, duties, and rights among government agencies, namely, the oversight agencies and the implementing agencies involved in the project cycle. It is, after all, a primary statute that establishes government policy and the institutional framework for implementing that policy.

On the other hand, the IRR are normally technical or operational in nature. Thus, they should never be a verbatim copy of the enabling law. What we have now, however, is a BOT law that contains both the enabling policy framework and too many details that are technical or operational in nature. Ideally, the details should be in the IRR so that the government may have the flexibility to change any of them in view of rapid changes in technology, financial markets, and other factors that impact a BOT project. Because it is hard to anticipate such future changes, having a detailed BOT law may therefore not work in favor of the country inasmuch as the task of amending the law to respond to changes and innovations could be a complicated and time-consuming process.

Hence, it will be much more efficient to have a primary statute that clearly specifies state policy and assigns roles and functions to government institutions and an administrative procedure based on the IRR that may be amended from time to time as the need arises.

At the same time, the past experience with BOT implementation indicates the need to provide a clear legal and regulatory framework not only for BOT projects but also for public-private partnerships (PPP) in general in government infrastructure projects. Such framework must give enough flexibility to the implementing agencies and the oversight body to adjust the rules and regulations governing PPPs as may be required by the passage of time and specific circumstances.

It would thus be useful to revisit the BOT IRR from time to time to take into account financial innovations and advances in technology and engineering, among others, which may change the investment and implementation environment. Contract renegotiation may also be called for and should be provided for in the IRR. The IRR can usually be amended more easily by way of an administrative procedure, thereby avoiding delays that may arise from a usually lengthy and ponderous legislative process.

Institutional framework

In terms of the institutional set-up, project identification, review, and approval had traditionally gone through the screening process of the National Economic and Development Authority-Investment Coordinating Committee (NEDA-ICC) framework. Under this framework, the oversight agencies had the responsibility for project review and approval while line agencies were responsible for identifying and preparing project proposals.

The government, however, has recently proposed to change this framework—in response to some concerns from certain quarters that the approval process took so long—by assigning to line agencies the responsibility of identifying, selecting, and approving projects.[1] This clearly poses a conflict-of-interest role for these agencies because line agencies will now both identify, review, and approve projects submitted to the NEDA-ICC. Under the proposed amendment, the line agencies will prepare and submit their list of priority projects for approval by the NEDA-ICC. This reduces this oversight body into some sort of 'clearinghouse' for projects earlier identified as priority by line agencies. While the intent of the government was to facilitate the project approval process, what it did not realize was the conflict of interest situation to which the change has cast line agencies. This is bad public policy.

The government should therefore revert to the traditional process of giving the oversight agencies the responsibility for project review and approval and assigning line agencies the role of identifying and preparing project proposals. To shorten the approval process, the endorsement by the implementing agency of a BOT project should already constitute a "first pass" approval. ICC approval will be the "second pass," which will then mean the elevation of the project to the NEDA Board, chaired by the President, for final approval.

To further streamline the process, though, certain improvements need to be made in the overall ICC framework itself.

Aside from ensuring that the oversight agencies (to be composed of the NEDA as the primary agency responsible for overall policy coordination, the Department of Finance [DOF] and the Department of Budget and Management [DBM]) will be responsible for the review and approval of infrastructure projects, it is proposed that representation from the Department of Justice (DOJ) and the Bangko Sentral ng Pilipinas (BSP) be also retained to ensure that oversight decisions conform with the country's laws and regulations.

At the same time, the membership of the ICC has to be reformed by removing certain line agencies, e.g., Department of Agriculture (DA), Department of Energy (DOE), among others, from the committee. This will eliminate the conflict of interest situation where line agencies that are members of the ICC also propose projects for ICC approval from time to time.

An effective implementation of the BOT Law and, in general, public-private partnership requires more accountability on the part of the implementing agencies. Their officials should be accountable for the procurement contract as well as monitoring of the BOT

[1] Seven out of nine government agencies tasked to amend and improve the BOT IRR have already given their approval of this proposal. However, this amendment to the BOT IRR together with other amendments have yet to be published in newspapers of general circulation as required by law.

project. Monitoring requires vigilance over delivery by the private proponent of its contractual obligations.

The implementing agencies and the oversight agencies should observe transparency, from project identification to procurement to contract implementation. A copy of the signed contract should be available to the implementing agencies and the NEDA-ICC. BOT contracts are imbued with public interest and should likewise be accessible to the public.

The government should also allow the private proponent to levy user charges that provide a return commensurate to the opportunity cost of its invested funds. This will ensure project viability. The proper allocation of cost- and risk-sharing is likewise vital. Some risks are uninsurable. In this case, the partnership must allow for some form of co-insurance that provides for sharing of the identified risks.

Project quality at entry

Government agencies have found it difficult to move BOT projects from the identification to approval stage because of weak technical capacity, and insufficient legal and financial expertise. There are cases when a government agency cannot even put together a credible request for proposals, the first step for competitive bidding, because of weak capacities. What follows is the submission by the private sector of unsolicited proposals. This further burdens the ill-equipped government agency, which in the first place is not capable of identifying projects for competitive bidding. The government agency's inability to effectively evaluate unsolicited bids is the source of frustration on the part of legitimate investors; it provides as well a venue for nontransparent, back room negotiations over ill-prepared but politically vested projects submitted to the agency for approval.

The lack of project identification and preparation capacity has resulted in the inconsistent application of Section 4 (Priority Projects) in the BOT process and has opened up opportunities to crowd out projects in the priority list. This has created the incentive for the submission of unsolicited proposals—the exceptional case under the BOT law since there is policy preference for solicited proposals, which will be tendered for competition.

The NEDA-ICC has proposed the creation of a project preparation facility since the late 1990s. Although the DBM has been supportive, severe budgetary constraints have hampered the allocation of such funds to the budget of implementing agencies. It is timely to consider the provision of funding for a project development facility from budgetary resources or grant assistance from ODA donor-partners to jumpstart the process.

Contracts and regulation

Another difficult area is contract writing,

where implementing agencies must have a good understanding of the obligations of each party in a project; financial terms (including guarantees, subsidies, or equity to be provided if the project is eligible); and contractual provisions on risk allocation, including assisting the project secure financing and ensuring its financial viability and sustainability. Implementing agencies do not necessarily have the skills for contract writing.

The result is that during negotiations, the implementing agencies may not be adequately informed about the implications of the contractual provisions they have committed to the private partner. Obviously, the implementing agencies must develop capacity not only for contract writing but also for monitoring of contract implementation.

An example of a complex area is the provision on *Contract Termination*, a standard provision in contracts here and abroad. The language for the said provision should be thoroughly understood by the government agency concerned, reviewed and tailored to ensure that the government's (that is, public) interest is protected. The private investor interest will almost surely be protected given their access to the best legal advice that money can buy. On the other hand, creditors normally demand provisions on contract termination as a protection. They do not lend to projects unless such provisions are expressed with clarity and could be enforceable.

Unsolicited proposals

There is a need to review whether or not it is really useful to have a provision in the law on unsolicited proposals. These have been the source of controversy in many discussions because their inclusion leads to a situation where the element of competition gets missing, notwithstanding the so-called Swiss challenge that has been devised by legislators as a "cure" to the lack of competition. Building capacities in the implementing agencies for identifying projects for competitive bidding will minimize, if not eliminate, the need for a provision on unsolicited proposals.

Third party evaluation of projects

It will also be good to introduce as a norm the evaluation of projects during actual implementation or after a period of time following their review and approval. The idea is to assess whether actual project implementation delivers the development outputs envisaged during the proposal and approval stages or not. This should be done by independent organizations such as reputable research and academic institutions. Relatedly, implementing agencies should be compelled to share data to third party evaluators.

Proposed amendments to the BOT Law

In conclusion, it is proposed that RA 7718 be amended in pursuit of the goal of the government to enhance PPP in infrastructure development, in general, and to pro-

mote the use of the BOT scheme and its variants, in particular. The legal framework must be conducive to the protection and enforcement of property and contractual rights, backed by a substantive and very clear set of IRR. To make the IRR operationally efficient, some institutional reforms, as noted earlier, have to be made.

The main strategic approaches being proposed to strengthen PPP and the use of BOT are as follows:

- *Transforming RA 7718 into the principal legal framework for PPP in the Philippines*. The policy declaration in the law must explicitly say that PPP is a development strategy choice of the government. In this regard, the role of the NEDA Board as approving authority must be upheld.
- *Emphasizing that competitive bidding procedures remain the central tenet of government procurement policy*. Competitive bidding enables the government to get value for its money. The law should thus forthrightly express the government's preference for competitive bidding, and affirm that direct negotiation and unsolicited proposals remain the exception.
- *Asserting the sanctity of contract*. The law must affirm government's binding commitment to honor and defend contractual rights and obligations. The law must also counter ruinous attacks on contracts—especially after a relatively long period of time has elapsed since the contract was signed—by limiting options to annul contracts on procedural grounds. This includes providing for greater transparency with regard to the content of contracts.
- *Providing legal recognition to the importance of building PPP implementation capacity at all levels of government and raising overall project quality*. The entry point of the private sector in partnering with the government in an infrastructure project is at the level of the International Accounting Standard (IAS). In view of this, emphasis must be given on the importance of building and rebuilding capacity for project design and implementation within an implementing agency.
- *Ensuring the formulation of a substantive and operationally efficient set of IRR*. Granting that the desired legal framework has been set up, the IRR with the desired features follows as a matter of course. The operational details must facilitate smooth implementation with hardly any contractual dispute that requires court intervention emerging.
- Requiring an independent evaluation of the project during the implementation stage to assess whether it is delivering the envisaged development outputs or not.

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