

**The article under is presented to the UNECE Secretariat and to the UNECE Team of Specialists on PPP'S, by Dr. Wim A. Timmermans, Adv. (The Netherlands) and Mr. Assaf Behr, Adv. (Israel)**

## **Why an Independent UN Arbitration Tribunal for the Settlement of PPP Disputes is Necessary**

### **I. *PPP projects - Background***

Infrastructure construction can help kickstart a sluggish economy and sustain the growth of developing markets. But it can also be costly. Because such projects are typically priced over a hundred million USD, many governments choose Public-Private Partnership projects (PPP) whereby the private sector assumes a primary share of the risks with regard to design, planning, financing, construction, ensuring effective performance, as well as long-term maintenance.

Most PPP consortiums are comprised of companies from different disciplines, countries and cultures which adds another layer of unique challenges to an already complicated process. And when it compounds with opposing parties trying to exploit ambiguities in the contract, incomplete design information and conflicting interests, PPP projects can turn into very messy disputes that cost the industry millions of dollars each year, disrupt business operations, and take too much time to settle.

### **II. **Current Dispute Resolution Solutions****

Archaeology, relocation of utilities, obtaining work permits, and difficulties in expropriating land are just a few reasons that a project can become complicated and legal conflicts can arise. When this happens, both sides return to the contract to seek the dispute resolution forum stipulated in the original contract.

The current dispute resolution solutions are local courts, national arbitration, and international arbitration institutions. These different panels are sought for different reasons.

#### **i. **Local Courts****

Local courts are easily accessible and established and are therefore the preferred dispute resolution forum for PPP claims by governments. Local courts are also the forum governments usually seek to solve all of their legal disputes.

However, for PPP projects, local courts are not a good solution for either private companies or the government for the following reasons:

**a. It is often more difficult for foreign companies to fight the public sector in a local court**

Foreign companies entering PPP projects in countries where local courts are the preferred dispute resolution panel are at a disadvantage. They are not well-versed in the local laws, culture and language, and can end up losing a dispute more because of these factors than because of the claim itself.

**b. Bidding prices rise**

Foreign companies entering bids where local courts are the preferred dispute resolution forum may raise their bid prices because they fear that they are entering a bid with higher risks. If all companies entering a certain bid raise their bids, the project will become more expensive to execute. Rising bid prices can cause the public sector to cancel the project because of a lack of funds. Alternately, the public sector may be compelled to pay higher prices for no reason at all other than that the private sector's fear of executing the project.

**c. Foreign companies refrain from bidding**

Foreign companies that have experienced tremendous losses in countries where the public sector had turned to the local courts for dispute resolution may completely refrain from bidding in countries where dispute resolution will be handled by the local courts. While this may be understandable, both the private and public sector lose out. For the private sector this results in lost business. This affects the public sector which may find that project become more expensive or alternately it project becomes more difficult to execute since they have no bidders.

**d. Unfair advantage to the public sector**

When entering a dispute, the local public sector may have an advantage over the private sector since the public sector representatives have a deep understanding of the local legal court system and its culture. Also, in some countries, the judiciary cannot be considered totally independent. This may also put the foreign parties to a PPP project in an unfavorable position. The foreign company that is aware of its disadvantage may request an alternate dispute resolution mechanism to avoid the local courts, however, if this is refused, the foreign company may either raise its bid or avoid bidding altogether.

It is important to note that the unfair advantage of the public sector acts to its detriment in the long run. When local courts are the only dispute resolution forum a government is willing to consider, foreign companies will be reluctant and even refuse to work in places where they have reduced legal assurance. This can result in higher bids as less companies approach which especially harms all countries, especially developing ones.

## **ii. Local Arbitration and International Arbitration Institutions**

Instead of addressing local courts, both sides may seek to address local arbitration or international institutions as their dispute resolution panel. These panels are usually faster than local courts, provide both sides with the opportunity to select an arbitrator and are not bound to local procedures. This latter point enables the arbitrator to be more flexible in conducting hearings, selecting expert, hearing witnesses et al and gives both parties a better opportunity to leave the arbitrator with a lasting impression.

However despite the advantages these panels may have over local courts, they are far from being an ideal solution for dispute resolution for PPP projects for the following reasons:

### **a. Lack of PPP experience**

It is important to point out here that the environment of PPP is unique. In order to have a good grasp of the PPP world, it is vital that an arbitrator has relevant engineering, financial and legal understanding. Without insights into these disciplines as they apply to the PPP world, it is impossible for arbitrators to make knowledgeable and fair decisions in a reasonable time frame.

However arbitrators, whether from a local or an international arbitration institution, usually do not have the right background, knowledge or experience required to make crucial decisions. These arbitrators usually have experience only in the general practice of law and even if they have some experience in PPPs, which is rare, they do not have nearly as much experience as is necessary to judge fairly.

In both international and local arbitration, the sought-after arbitrator will most likely be a former judge or a lawyer. In many cases a former judge could have been handling criminal cases for his entire career and only in his very last years did he hear civil cases. Needless to say that these types of cases will not have provided him the right tools to make correct and fair judgement. In the event that the appointed arbitrator is a former civil judge or civil lawyer, the probability that he will have relevant experience is slim to none. A judge or a lawyer specializing in labor law, tax law or even commercial law will not be of any value to make a fair decision when analyzing a project delay or a value of a variation order (modification instruction) fairly.

#### **b. Potential Conflict of Interest**

When dealing with local arbitration, it is very often difficult to find an arbitrator who does not have a potential conflict of interest, especially when one party is the local state or if the country is small. As a result, the parties may find themselves settling for an arbitrator who has little or no experience in the field of PPPs or alternately may appoint someone who has a potential conflict of interest with either one of the parties. In the latter case, the parties will have to rely on the arbitrator's integrity and his ability to make a fair judgement despite a potential conflict of interest.

**International arbitration institutions** that aim to resolve international commercial disputes – addressing this mechanism (an international arbitration institution) has to be either specified in the contract or agreed upon later on – when the dispute arises - by both parties. However the problem with this is that the tools that these institutions use are very general to commercial disputes and do not take into consideration specific matters such as engineering practices, specific regulations and standards and financial models which are all essential in the process of decision making in PPP disputes.

**Local Arbitration** – is an attempt to reduce the fear of international companies from local courts, however it still has two major problems:

- i. Usually the arbitrators are local people i.e. former lawyers or judges – in which case there is not much difference between going to a local court or preferring national arbitration
- ii. The aforementioned arbitrators would rarely have experience in PPP projects therefore they would not know basic matters such as delay analysis, understanding schedules, understanding financial models, quantification of losses et al.

Existing international arbitration panels give the assurance of having no conflict of interest and having legal proceedings which are not bound to any local procedures, however, there is very little probability in finding arbitrators who have the right experience to handle the unique challenges derived from the special PPP environment, all as specified hereunder.

### **Why a Separate Arbitration Tribunal for the Settlement of PPP Disputes is Necessary**

As detailed above, the existing mechanisms do not provide an adequate solution to the unique challenges that disputes in the PPP world present. A new mechanism must be established and provide solutions to the aforementioned problems.

The PPP world is comprised of three pillars: the financial, technical (engineering), and legal (a sound understanding of the commercial/contractual world as well the dispute resolution world). In order to ensure that the arbitration panel is in fact a fair mechanism for both the public and private sectors and developed as well as developing countries, it is essential that the individuals sitting as the arbitration panel will have solid understanding and experience of these pillars.

In order to ensure that fair judgements are made and are based on a correct analysis of the PPP reality, arbitrators who judge PPP projects must be deeply familiar with the world of projects. Arbitrators sitting

on PPP cases must have many years of experience in the PPP world including familiarity with different types of contracts and broad familiarity with different judgements from all over the world as well as knowledge of common practice. These are necessary to enable arbitrators to exchange ideas, obtain fresh insights and combine the legal and contractual knowledge with deep financial and engineering experience in order to make fair judgements.

Arbitrators must also understand basic project management principles as well as engineering and commercial common practices. They must be familiar with such issues as, what constitutes reasonable risks that the parties should forecast, what a reasonable gross margin for the project should be, how to deduce from a contract if an activity is indeed a modification and not part of the original scope of work, et al.

The operation of a separate arbitration panel for the settlement of PPP disputes is also necessary in order to provide assurance to both parties (public and private) that a professional panel hears the case. This will enable the public sector to reduce the forecasted risk contingencies and will create cheaper price proposals to the public sector. The public sector will thus enjoy a project executed by leading professionals without the need to pay for unreasonable risks. In addition, this mechanism will provide developing countries with a more attractive business environment and will attract leading private sector companies to operate in those countries. It is clear that in order to judge correctly, arbitrators must have relevant education and perhaps more importantly, they must have relevant project experience, including a basic understanding of scheduling and delayed analysis. They do not need to know specific computer programs, but do need to understand how to read schedules, project budget documents and have a basic understanding of construction matters.

A unique PPP arbitration panel will ensure that all arbitrators are qualified to make the right decisions, having the education, knowledge and experience necessary to produce fair judgements. Such a panel is not only desirable, but vital to a successful PPP world.

### **Why the UN?**

The Charter of the United Nations, Chapter 1, Article 1 (3) and (4) state that one of the purposes of the United Nations is:

*to achieve international co-operation in solving international problems of an economic, social, cultural, or humanitarian character...and to be a centre for harmonizing the actions of nations in the attainment of these common ends.*

A PPP arbitration centre acting under the umbrella of the UN can provide a much needed solid mechanism to the area of PPP disputes. As a well-known and trusted institution it can provide both transparency and professionalism to all aspects of PPP disputes.

### **The UN's PPP Panel**

In order to establish a PPP arbitration centre, parties in the public and the private sectors need to agree to either include a relevant clause in the contracts or to refer a dispute to the PPP arbitration centre. Once a certain number of countries accept this revolutionary panel as its PPP dispute resolution panel, it will gradually become the main and accepted forum to rule on PPP disputes.

The UN's PPP Panel could provide the private sector assurance with respect to the dispute mechanism. If earlier we discussed the fear of lack of faith that the private sector has in pursuing a dispute resolution panel from either a local court or national arbitration, a separate panel that is an independent panel of experts under the umbrella of the United Nations, enjoying a totally independent, neutral attitude to any dispute or conflict between the parties, thus giving assurance to both parties that the people hearing the case will be the most suitable experts in the field with no preference to either party – their main goal is to judge professionally and independently according to standards – well known and recognized by both parties. The ability of instituting such an institution under the UN allows the PPP arbitration institution to select candidates from different countries and different nationalities in order to avoid any fear of prejudice by the arbitrators.

In this way the public sector also gains because it attracts foreign companies who would otherwise be afraid to invest in certain projects. This also might encourage companies to give more attractive proposals in their bids and both parties know that the dispute mechanism panel would have the best visibility in making a fair judgement should a dispute arise.

The arbitrators would be selected based on their background. They will be professionals familiar with the different methodologies relevant to the PPP world combining strong understanding in the financial aspects, engineering aspects and legal aspects.

**SOLUTION - We are of the opinion that an international dispute resolution forum, which specializes in PPPs and operating under the umbrella of the United Nations should be the right forum for every PPP project in order to provide the fairest resolution for both parties, whenever a dispute arises that cannot be solved amicably.**