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**Guidelines for Port Authorities and Governments on the
privatization of port facilities**

Report by the UNCTAD secretariat

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INTRODUCTORY REMARKS

(i) There are as many views on privatization as there are port assets that can be privatized. There are as many definitions of privatization as there are port practitioners and experts. In these circumstances, drafting "Guidelines for Port Authorities and Governments on the privatization of port facilities" is a challenge. The difficulty is compounded by the fact that port facilities are crucial tools for facilitating and promoting a country's external trade and, moreover, represent significant accumulated capital investments. Ports are thus extremely valuable assets for the national economy and hence any changes need to be considered carefully and cautiously. The latter requirement should, however, not be an excuse for inactivity or lack of adaptation; rather, it should be a reason for careful consideration of all options and their consequences. Guidelines for privatization are useful in that they provide a means of better evaluating the potential impact of various alternatives and deciding on the most appropriate procedures.

(ii) To guarantee minimum success for the drafting of guidelines, it is therefore necessary to take serious precautions, such as defining in advance what privatization is and is not, delimiting its scope and presenting a limited selection of acceptable forms of privatization. For any privatization scheme to be successful, it must be tailored to satisfy the specific conditions and characteristics of the port and its environment. Hence, the guidelines to be developed in this report can aim only to serve as a "checklist" for the privatization of port assets and as a reminder of the most crucial factors to be considered. They cannot be interpreted as an infallible recipe to be applied with or without the consent of the Government, the initiator of the scheme or the stakeholders in the assets that are being privatized. Moreover, they are neither the only way forward nor the exclusive road to the achievement of all goals.

(iii) To take fully into account the complexity of any privatization scheme and the controversial viewpoints that will inevitably be encountered, the present report uses a gradual approach, consisting of 10 interrelated topics, to develop the proposed guidelines. These topics are as follows:

1. definition of privatization and other critical notions and terms;
2. objectives pursued by privatization schemes;
3. scope of privatization schemes (the "object" of the schemes);
4. alternative modes of privatization;
5. determining factors in the conception and implementation of a privatization scheme;
6. the principles on which the guidelines are developed;
7. procedures for the tendering process;
8. clauses of leasehold licence and concession contracts;
9. financial performance measures to establish the true value of a leasehold licence or concession contract;
10. operational performance measures to allow adequate preparation of proposals and monitoring of performance after award of the concession.

(iv) The purpose of the first 4 topics is to clarify the precise context in which a privatization scheme is conceived and implemented. The second set of topics (5 to 7) endeavour to define the critical factors, principles and preconditions that will create the most favourable framework in which to conduct the privatization process. The final topics (8 to 10) detail the appropriate procedures and methodologies to carry through the privatization scheme until its full implementation. For each of those topics, there is a separate chapter in this report.

(v) The present report has been prepared in line with activities mandated under subprogramme 9.4.A.3 - "Economic impact of institutional and technological change in transport" of the biennium 1996/1997 - and the activity "Information technology and performance indicators in transport services", contained in the work

programme for the biennium 1998/1999. While the report mainly relates to the question of technological and institutional change, it also addresses the critical issues of financial and operational performance indicators, without which the privatization process could not be successfully concluded. The material in the report will be used in UNCTAD's technical cooperation programme to provide assistance for private sector participation in transport and related services.

Chapter 1

DEFINITION OF PRIVATIZATION AND OTHER CRITICAL NOTIONS AND TERMS

1. Defining "**privatization**" is a difficult, complex and controversial task. Many definitions have been proposed, often covering very different concepts and values, such as:

- ! Privatization is the act of reducing the role of government, or increasing the role of the private sector, in an activity or in the ownership of assets;
- ! Privatization means the opposite of nationalization: the objective of nationalization is for government to take over the ownership of private enterprise, while privatization means the transfer of government services to the private sector;
- ! Privatization means transferring the production of goods and services from the public to the private sector. It is not a policy but an approach, one which recognizes that the regulation which the market-place imposes on economic activity is superior to any regulation which can be devised and operated through law.

The diversity of definitions and the implied differences in nature, scope and coverage pose problems for the drafting of standard guidelines. There is therefore a need to agree first of all on an appropriate definition that is sufficiently precise to accurately reflect the concept of privatization and sufficiently broad to incorporate the specific characteristics of port assets and services in the majority of "privatization schemes" proposed in the ports industry - in the past, present and future.

2. For the purpose of drafting the "port privatization guidelines" the definition of privatization is as follows:

Privatization is the transfer of ownership of assets from the public to the private sector or the application of private capital to fund investments in port facilities, equipment and systems.

3. Without the notion of private ownership or the private funding of port assets or services, there can be no port privatization. Increased participation by the private sector in the delivery of port services, without private investment, is not privatization but *devolution*. Not surprisingly, devolution is often presented as privatization by those vested interests that oppose any enlargement of the financial stake of the private sector in ports. The same is true for *corporatization*. In its true sense this means giving a public sector organization the legal status of a private corporation or company, whilst the Government holds the shares. All the land and assets are then legally transferred to the newly established company or corporation, but they remain wholly within the public sector. Again, it has been suggested by some interest groups that corporatization is an improved form of privatization. This is clearly unjustified since there is neither a divestment of the Government's interests in favour of the private sector nor the inflow of fresh private capital.

4. Another popular term that is often used is *commercialization*. Although no standard definition has been suggested by its promoters, the concept presupposes at least a greater awareness by the public Port Authority of the needs of its private and public sector clients and the need to make it more accountable for its decisions, operational performance and financial results. It also presupposes no further interference by government or other public bodies, although this has rarely been verified in practice. Finally, confusion reigns supreme when, in the privatization debate, mention is made of *deregulation* of the transport sector. In essence, deregulation is the elimination or liberalization of rules and regulations initially introduced and enforced by government agencies and public authorities with a view to promoting safe, adequate, economic and efficient transport services, but which

are now felt to be unduly restrictive and burdensome. However, deregulation can have both positive and extremely negative effects. The elimination of restrictive port rules and regulations in order to liberalize the market and promote efficiency is no doubt a favourable development. But a minimum of regulations has to be in place, if only to ensure that the management and operation of the ports respects international codes, rules and regulations with regard to safety, security and employment. Examples of appropriate deregulation are the lifting of rules restricting entry into a business or on a transport route, the granting of freedom of pricing, thereby dispensing with an obligation to file rates, and the freedom for a transport operator to agree special contracts with large shippers, based on volume and service.

5. In the “privatization debate”, notions such as **concepts** and **modes** are frequently mixed up. Privatization, corporatization, commercialization and deregulation mostly refer to concepts promoting a greater private role in economic activities or a greater degree of freedom for the private sector. Realization of the concepts, however, requires the reliance on various alternative modes of privatization. These are specific **instruments** that ensure the implementation of the various concepts. The most common of these instruments are:

- ! licences and concessions;
- ! leasehold contracts;
- ! Build-Operate-Transfer (BOT), Build-Own-Operate (BOO) and Build-Own-Operate and Transfer (BOOT) arrangements.

6. These instruments will be discussed in more detail in chapter 4. It is, however, essential to emphasize from the start that various forms of privatization determine to a large extent the choice of privatization instruments and the specific procedures for actual implementation. The forms of privatization that can be distinguished are the following:

1. **Comprehensive privatization.** This is a scheme in which a successor company becomes the owner of all land and water areas as well as of all the assets within a port’s domain (this is equivalent to the sale of an entire port to a private or public/private company);
2. **Partial privatization.** This is a scheme whereby only part of the assets and activities of a public port body are transferred to the private sector (such as the sale of existing berths, the transfer of the pilotage or towage functions to the private sector or the concession granted by a public Port Authority to a private company to build and operate a terminal or a specialized port facility);
3. **Full privatization.** This signifies that the complete ownership of the facility or service provider is entirely in private hands (e.g. ownership of a specific terminal or storage facility, or of a tug-boat service, has been wholly transferred to a private company);
4. **Part privatization.** This signifies that part of the same facility or service provider is owned by the public body and part by the private sector, with public and private bodies thus effectively executing a **joint venture** agreement.

7. This means that it is possible to have comprehensive and full privatization, but also comprehensive and part privatization. Partial privatization can be in full or in part, depending on whether or not the public sector retains ownership.

8. In conclusion, it is appropriate to point out that no generally valid formulation of concepts and modes of privatization exists or has been embodied in an international convention. Rather, the opposite is the case, since national legislation and local practice often give a special meaning to the notions and terms explained above. It will therefore be necessary to verify whether in any given context, the definitions provided in this chapter, and on which the guidelines are developed, are consistent with the legal foundations of the national legal system and do not infringe international agreements.

Chapter 2

OBJECTIVES PURSUED BY PRIVATIZATION SCHEMES

9. The diversity of privatization schemes is matched only by the dissimilarity of the objectives pursued by these schemes. Governments opting for the privatization of their port facilities and services often pursue a cluster of objectives, some of which sharply contradict other aspects of government policy. When drafting guidelines for privatization, it is essential to be aware of the government's true intentions and what it hopes to accomplish through the proposed privatization scheme(s).

10. At least three paramount objectives underpin most major port privatization efforts:

1. improvement of the management capability of the port entities, such improvement often being narrowly defined as increased efficiency and upgraded operational productivity;
2. reduction of the financial demands on the public sector, in particular on central government, by employing private sector resources to replace those of the public sector by generating increased revenue for the government, or both;
3. enhancement of the service quality offered to users and a reduction of the price they have to pay for port services.

Additionally, other objectives are targeted by privatization schemes, such as:

- ! redistributing wealth or other social objectives (e.g. curbing the power of trade unions);
- ! attracting new or additional trade and business for the country and the port;
- ! sharing commercial, economic, technological or management risks between the public and the private sector;
- ! stimulating private entrepreneurs and investment in the economy;
- ! transferring technology in the form of advanced equipment deployment or the introduction of state-of-the-art management systems.

11. The objectives often reflect the perceived inherent advantages to be derived from port privatization schemes. What is not always apparent is which party or parties are expected to be the main beneficiaries. Table 1 groups the perceived inherent advantages and links them to the expected beneficiaries. It indicates that five parties can potentially benefit. The main beneficiaries are in particular the Port Authority, the terminal operator and the port customers. They gain in a varied number of ways. Another significant aspect brought out by the table is the distinction to be made between macroeconomic benefits (in general those generated at the level of the world economy, the national economy or the national Government) and microeconomic ones (typically the advantages accruing to the three main beneficiaries referred to above).

12. Again, the mode of privatization and the instruments used to privatize will to a large extent determine how many of the perceived advantages listed in table 1 can be obtained and by which of the parties listed. For example, if at the beginning of a privatization scheme the transfer of technology has been earmarked as a priority spin-off, the choice of the most suitable privatization instrument (long-term lease contract or BOT, BOO or BOOT arrangement) will need to be accompanied by the proper clauses in the concession or licensing contract. These clauses should not only be worded to allow the transfer of technology from the concessionaire to the Port Authority initiating the privatization scheme, but should also effectively encourage and facilitate such transfer.

Table 1**Perceived advantages and main beneficiaries of major privatization schemes**

Beneficiary	Perceived advantages
Port Authority	<ul style="list-style-type: none"> ! possibility to more readily define its priority corporate objectives, thanks to greater (or complete) freedom from government controls; ! greater freedom from public sector constraints, particularly with respect to personnel management, pricing, budget review and its sanction by higher authority, administrative impediments, and procurement of equipment and services; ! increased ability to define precise financial targets; ! increased accountability in line with set targets; ! greater transparency of costs, greater likelihood of tariffs being cost-related, reduced risk of cross-subsidization; ! a better distribution of port charges and dues particularly in the case of service ports, as these tend to undercharge the ship and overcharge the cargo; ! increased responsibility for the private investor with regard to the level of infrastructure investments necessary to carry on with his business;
Terminal operator	<ul style="list-style-type: none"> ! opportunity to bring into the country foreign management and technical expertise as required; ! greater potential for the diversification of activities; ! freedom to subcontract to third parties any activity the company does not want to pursue itself (or does less well); ! full accountability with respect to achieving the set operational and financial targets; ! cost transparency allowing for cost-related tariffs and a curb on the practice of cross-subsidization;
Port customers	<ul style="list-style-type: none"> ! availability of customer-tailored quality services; ! quicker, more effective response to users' service requirements; ! reduction in prices for port services, as competing units will make efforts to reduce costs and prices to attract traffic away from competing ports;
The world and the national economy	<ul style="list-style-type: none"> ! increased responsiveness to changes in market structures and demand; ! faster adaptation to changes in maritime transport technology and intermodal transport;
National government	<ul style="list-style-type: none"> ! reduction of the financial and administrative burden on the government ! creation of additional tax revenues for the Government as private operators pay their taxes (contrary to statutory port authorities, which often try to escape them) and the increase in business levels.

13. Clearly, privatization schemes have not only potential advantages, as listed in table 1, but also some potentially serious deficiencies and threats. The most notable of these are as follows:

- ! There is the increased risk that the statutory public service functions, with which a public port administration is generally entrusted, may be neglected, since private operators/investors will favour profit maximization and cost-cutting. Thus, they may be inclined to abandon facilities and services which although economically, socially or environmentally of essential value are less or not rewarding for the private operator or generate additional expenditures without providing significant revenue (which leads to the privatization of profits and the socialization of losses);
- ! Where no or limited competition exists, it is probable that a “public monopoly” will be turned into a “private” one, most ports having a certain degree of monopoly power because of a lack of “contestability”. Moreover, economies of scale resulting from the operation of modern port facilities are such that only large ports can have more than one of these (e.g. a container terminal, a mineral ores terminal, a grain terminal), and this further reinforces the natural monopoly power of ports and terminals;
- ! A division of responsibilities between the public and the private sector may hamper the necessary coordination of investments in complementary parts of the transport chain (e.g. highway and railway access to a private port terminal can be out of phase if both the public and the private sector have investment responsibilities in different sections of the transport chain);
- ! Logically, private operators will favour the business interests of their owner or holding company; and this may lead to the discriminatory treatment of outsiders (whether actual or potential customers) and to the exclusive use of the port facilities where initially a common-user arrangement was intended.

14. The potential disadvantages of privatization schemes can be tempered by a judicious choice of the mode of privatization, the instrument used and its modalities of application. Specifically, where governments and public administration have special duties to the public, the public interest necessitates that the privatization scheme is built on solid legal foundations. These should balance the interests of the public and the private operator, without reaching a level of regulation that would hamper effectiveness or efficiency.

Chapter 3

SCOPE OF PRIVATIZATION SCHEMES IN PORTS

15. At the start of any port privatization scheme is the selection of what port facilities or services will benefit from a transfer to the private sector. Not surprisingly, some are considered more amenable to privatization than others. Experience shows that the most frequently privatized are cargo-handling and storage facilities, which can be well defined and delimited and allow a reasonably accurate valuation acceptable to both the previous and the new owner. Port terminals for general and specialized cargoes are prime candidates for privatization. But often the process does not concern existing facilities but terminals yet to be built. This then raises the question of the precise “object” to be privatized and offers a range of possible alternative arrangements. Indeed, for a dedicated specialized terminal for example (containers, ore, liquid bulk, grain), the privatization of the full facility can be considered. The private sector would then be invited to invest in all the components that make up a terminal, such as the quay-wall, alongside dredging, land reclamation, pavement for the operational and open storage areas, buildings, gates, lighting, handling equipment and systems. The other extreme case would be to offer to the private sector the complete infra- and superstructure and invite proposals for provision of the handling equipment and systems. The privatization mode, as will be discussed in chapter 4, depends very much on the nature, scope and extent of the “object” that is offered for privatization.

16. The scope of privatization schemes in ports raises two important and complex issues:

- (i) the valuation of existing or projected facilities;
- (ii) the ownership and utilization of land.

(i) The valuation of existing or projected facilities can be done using:

- ! expected earnings projections;
- ! methods based on the value of the existing assets;
- ! market-based methods;
- ! port-industry-specific methods.

For existing facilities the expected earnings projections (see chapter 9) and asset-based methods are most frequently relied on. Market-based methods are generally irrelevant because the assets are not held by a company quoted on the stock exchange, but by a public body. Finally, the methods specific to the ports industry are at best very crude as they can be based only on annual throughput or past revenue. The most relevant basis for valuing a port’s business is therefore the earnings-based valuation method and particularly the discounted cash flow method. Problems specifically related to port valuation are the cost structure (heavily weighted towards labour costs, which makes it difficult to predict how the cost structure and labour cost level will change after privatization) and the determination of port capacity and traffic growth (the former fluctuates greatly and is most difficult to predict, while the latter depends to a large extent on international, regional and local economic conditions). In developing countries, port valuation is further complicated by the uncertainties surrounding the legal and regulatory framework, doubts regarding the convertibility and repatriation of profits, the risk that the private owner’s freedom to negotiate employment terms is “severely curtailed”, and last but not least, the level of political stability that is expected in the medium and long term.

(ii) The ownership and utilization of land is a highly critical issue because in most cases the public sector will make land available to the private sector on the assumption that optimal use will be made of it. Thus the question is ultimately one of ensuring that such optimal use is consistently and permanently guaranteed. Considerably more difficult is the question of whether land can be indefinitely made available (i.e. sold) to the

private sector. The answer to this question depends on the provisions of the applicable national legislation. In general terms, statutory corporations in charge of ports are forbidden to sell land without ministerial or Cabinet authorization because they are considered part of the public domain or because the public trust doctrine applies (i.e. navigable waters and adjacent land are held in trust by the sovereign for his or her subjects and should be used only for the benefit of the general public). Only in exceptional cases does a privatization scheme lead to the sale of the land, mainly where it is comprehensive and relates to a specialized port outside traditional port boundaries.

17. The ownership of the land has, however, significant consequences for the choice of the preferred mode of privatization and also implications for the ownership of the facilities that will be built on the land. Where the domain is immune, no liens and mortgages can be obtained or edifices built on it. If a mortgage has been obtained (despite the principle that it cannot be), the pledge is legally worthless. Port Authorities, however, have generally adapted the clauses of their leases to give more flexibility, although this again may not stand a judicial test. In fact, in some countries banks have accepted liens and mortgages based on the good faith of the parties involved. Clearly then, this is a major weakness of the lease and BOT modes and one that could be exploited by less scrupulous parties participating in such an arrangement.

Chapter 4

ALTERNATIVE MODES OF PRIVATIZATION

18. Port privatization schemes in port can be realized through a number of alternative modes of privatization. The most prominent of these include leasing, various BOT/ BOO and BOOT arrangements, the outright sale of port assets, joint ventures and stock market flotation.

19. Analysing these alternative modes is not a simple matter because of the confusion regarding the interpretation of the terms and the fact that some modes are superimposed (e.g. a joint venture being awarded a lease or BOT/ BOO/ BOOT contract). Meanings vary from one individual to another and from one authority to another. This chapter therefore sets out to present the most recent definitions and viewpoints on the privatization modes listed above. The “management contract” has not been included because it does not involve a transfer of ownership, although the role of the private sector definitely increases as the private sector is contracted to undertake the management and/or operation of public sector facilities. Management contracts (or farming-out contracts) do not imply any significant investment or pre-financing on the part of the management company, which may be a private or a mixed company or even a subsidiary of the public Port Authority. They often cover specific services (cargo-handling, pilotage) but also the management of a complete port.

4.1 Leases

20. A widely accepted definition of lease is that it is “**an agreement conveying the right to use an asset (land or equipment, or both) for an agreed period of time in return for a payment or a series of payments by the lessee to the lessor**”. This definition implies that depending on the required funding contribution of the lessee, leases may or may not be a mode of privatization. This depends on the “object” of the lease, as will become more evident with the example of the lease of a specialized port terminal such as a container terminal. Alternative “objects of the lease” can then be:

Option 1: the water frontage and quay-wall with the undeveloped land area behind the quay-wall;

Option 2: the water frontage and quay-wall with the developed and surfaced land behind the quay-wall;

Option 3: the water frontage and quay-wall with the developed and surfaced land area behind the quay-wall and ship-to-shore handling equipment;

Option 4: the fully equipped terminal including the water frontage and quay-wall with the developed and surfaced land area behind the quay-wall, ship-to-shore handling equipment, terminal handling equipment, offices, maintenance facilities and the gate complex.

21. The level of private capital investment is extremely high in option 1, whilst in option 4 it is virtually non-existent. Thus it is essential to determine in advance the exact “object” of the lease, as this will have significant consequences with regard not only to the funding requirements of the lessee but also to the legal implications and the duration of the lease. For option 4, standard leases can be used. The main disadvantage of option 4 is that the private operator has little incentive to use a terminal in which he did not heavily invest, although he may hold a monopoly (in cases where there is only one container terminal, as in many developing countries). The way out would be for the Port Authority to have the right to sub-lease parts of the terminal which the lessee does not use and to review the performance of the terminal to ensure that its use is optimal. But in that case the lease will be regulated by the public law concept of public interest rather than by common law contract only. As for the duration, because of the marginal investment to be made by the lessee, this type of leases will run only for periods

of between 10 and 15 years. A period of less than 10 years provides little or no continuity in the operations and can only remove the incentive for the lessee to develop sustainable systems and working methods. Leases of longer than 15 years will be likely to have the same effect for the lessee, as he is almost assured of continued management and operation of the facilities without any competition.

22. Options 1 to 3 equate with leases on more or less developed land. The erection of any permanent facility, equipment or installation by the lessee requires in most countries and legal systems a licence. Thus the facilities remain the lessee's property, whether the lease is on the public domain or not. Licences for lease of land with the obligation to invest in superstructure and equipment and the obligation to perform specific public-interest-inspired obligations have become a common mode of privatization, applicable to common user as well as dedicated port facilities. The duration of the licences for lease is dictated by the importance of the private investment. The time period agreed must satisfy the lessee in his efforts to secure an adequate return on his investment, but it should not be so long as to enable him to ignore the need to secure renewal of the lease by entering into a new contest (see R.O. Goss, "Economic policies and seaports: 4. Strategies for port authorities", *Maritime Policy and Management*, Cardiff, vol. 17, No. 4, 1990, pp. 273-287). The most common licence lease periods are therefore between 20 and 25 years.

23. Much has been written about the financial arrangements pertaining to leases, in particular the method for determining the rent that the lessee will have to pay to the lessor. There are two reasons for the rent:

1. to provide the lessor with an adequate return (mainly on the basis of the opportunity cost of the "object" of the lease);
2. to prevent rent-seeking from a monopolistic lessee, i.e. economic rent which the lessee would receive as the excess of total payments over and above the real earnings that the facilities would generate in employment in an open market and not within a monopoly (the latter are also referred to as "transfer earnings").

24. Rents can be determined as:

1. a flat rate whereby the use of a fixed asset is compensated for by a fixed amount of money during a specific period of time; as such, it provides a strong incentive to the lessee to generate a level of business as close as possible to the maximum capacity of the facilities;
2. a minimum-maximum rate whereby the owner and the lessee agree on a minimum and a maximum amount of rent, depending on the activity performed on the fixed asset; the bottom and ceiling amounts are then established in advance;
3. a shared revenue arrangement whereby the lessee pays a reasonable annual rental and the lessor shares with the lessee the benefits of additional cargo activity above an agreed bottom level but without setting a ceiling; in practice the shared revenue works as a royalty system with a fixed rental being increased by royalty payments calculated on extra activity (mostly throughput in tonnes or containers).

25. The lease mode does not imply control by the Port Authority or the Government over the tariffs that the lessee applies. But in reality the Government and Port Authority are very anxious to control the tariffs of private port operations. This is not justified unless there is a risk of monopoly and even then the solution will be for the lessee, at the time of bidding, to propose his charges (tariffs) and commit himself to keeping them at that level (given a reasonable escalation clause) during the lease period.

26. In the final analysis the licence to lease with provision of private infrastructure and equipment makes the lessee responsible for the costs of:

- ! initial pre-financing and ownership of facilities (mostly jointly with the port);
- ! financing and ownership of equipment (sometimes with the port);

- ! pre-financing of the replacement;
- ! financing of the current operations;
- ! maintenance of infrastructure and equipment (the former may be still entrusted to the port);
- ! employment of personnel;
- ! recruitment of personnel;
- ! liability for personnel, users and third parties.

Hence, most costs are for the lessee, with the port acting as landlord, providing the basic infrastructure and possibly (depending on the object of the lease, as pointed out previously) some main equipment items.

4.2 BOT/ BOO/ BOOT arrangements

27. Build-operate-transfer, build-own-operate and build-own-operate-transfer are all variants of the same mode of privatization. They are also referred to as “concessions” by legal experts, i.e. the grant of special privileges by government. In the latter sense, concessions are used as an equivalent of leases. However, in a strict sense a concession is a contract by which the grantor grants the grantee the right to finance, build and operate a facility or some equipment, for public use, for a stated period of time, after which the facility or the equipment will be transferred to the grantor.

28. As such, the concession, exactly like a lease, is not a permanent privatization, but only a temporary privatization. Legally, it is a technique for creating, delivering and operating a public service.¹ Although the concessionaire may be a public or mixed company, most BOT schemes and their variants have a private concessionaire. As rightly pointed out by Grosdidier de Matons,² there has been considerable discussion about whether BOT schemes and variants are only a contract or also a licence. Initially, they were considered to be simple contracts, but more recently they have generally been given a dual character, namely:

- a contract with respect to clauses that cannot be unilaterally modified (payments, duration, escalation, insurance, guarantees etc.);
- a licence with respect to the performance of the public service under the concession and which can thus be modified unilaterally by whoever has authority in that respect.

29. Some of the variants of the BOT schemes (such as Build-Own-Operate and Build-Own-Operate-Transfer) stipulate that ownership of the facilities belongs to the grantee and that it is transferred to the grantor at the end of the concession period. This, however, is not legally correct. Ownership of the facilities (including buildings) takes effect from the day the construction starts (because public works with a public interest and specially designed or arranged for the provision of a public service can belong only to the public domain). Thus the grantee is never the owner; this has serious implications with regard to bank guarantees and mortgages as it restricts the grantee’s capacity to work out a financing plan. This problem is mostly settled by the government’s giving its guarantee to any loan contracted by the grantee (a good solution and possibly better for bankers than a mortgage because the security on immovable port facilities is at best mediocre). Another solution is to stipulate in the concession contract that the “buildings and port facilities built on public property shall be considered the concessionaire’s property during the effective terms of the concession”.

30. Concessions with BOT, BOO and BOOT arrangements are of long duration and in proportion to the investment costs and depreciation periods. The scope of the concessions (the object of the concessions) is no

¹ In general terms a concession is a special right or privilege that is given to someone.

² J. Grosdidier de Matons, “Public port administration and private sector intervention in ports and in the ports industry”, paper presented at the Course on Advanced Port Management: Modern Principles and Methods, IPER, Le Havre, May 1995).

longer limited to equipment (as in earlier days) but now increasingly covers the construction of quay-walls, land reclamation, paving, erection of administrative buildings and workshops, and the installation of ship-to-shore handling equipment. The payments by the grantee to the grantor may be, as in the case of leases, either fixed or on a revenue-sharing basis. It is also possible for both parties to agree on a fixed amount, covering fixed costs, and then when the facility is well established to increase the concession fee with a share in the profits in the form of a royalty or a percentage on the net income from the concession.

31. Tariffs of the concessionaire should be established during the bidding phase, as bidders should make proposals for the tariffs to be applied in the event that they are awarded the concession (these tariff figures will then also form an input in the development of the business plan). As for the risk of giving the grantee a monopoly, this cannot be ruled out. The solution is then to control the tariff and establish maximum or ceiling rates. But the risk should not be exaggerated. Increasingly, competition is not between terminals in the same port but between terminals in a port range. The fierce competition between container terminals (which have a virtual monopoly in their respective countries) in most of the world's trading regions is a case in point.

32. The existence of various concession agreements has frequently confused both Governments and Port Authorities on the one hand and potential private operators on the other. It is therefore appropriate to define the distinction between the alternative concession agreements, notably:

BOT: This arrangement acknowledges the fact that the grantee never has ownership of the facilities, but that he has been granted the right to build and operate the facility for a specified (long) period, after whose expiration the grantor can lease out the facilities or, if the facilities have to be completely rehabilitated, can possibly grant another concession (but with a different “**object**”). As the grantee is not the owner he cannot expect at the end of the BOT arrangement to receive compensation for the transfer of the facilities.

BOO: The assumption in this type of scheme is that the concession granted gives the grantee two exceptional advantages: first, he is explicitly granted ownership of the facilities that he will build, and second, there is no specified duration, which implies that the facilities will not have to be transferred back at a specified time against an agreed level of compensation.

BOOT: This scheme is similar to the previous one, but provides for the return of the facilities, possibly against payment of a mutually agreed indemnification for the residual asset value.

33. Concessions under any of the three above-mentioned schemes, have intrinsic shortcomings, such as:

- ! a dominant position of the grantor;
- ! the risk that the grantee is mainly interested in special tax advantages or in real estate development;
- ! the likelihood that if the concession scheme operates at a deficit the grantee will be reluctant to finance new investments or properly maintain facilities;
- ! the danger that the grantee will reduce maintenance and investments to a minimum in the final years of the concession and leave behind a non-operational facility.

34. These shortcomings can, however, be tackled head on when negotiating the concession agreement and drafting the concession terms. They will require adapted clauses and careful wording, but as will be seen in chapter 8, should not constitute a major legal or operational obstacle.

4.3 Outright sale of port assets

35. Privatization through the outright sale of public sector assets to the private sector for continued management and operation can vary widely in extent. At the most basic level this type of privatization will

concern the sale of a bare site (in so far as the public body has the legal authority to sell land). At its most complex it becomes a MEBO (management, employee buy-out) of a service port.

36. The actual sale of assets is usually carried through by competitive tender, open to companies, consortia, joint ventures or (a) group(s) of management and employees. The advantage of the open and competitive tender is its low cost. But there is the risk, as in any sale, of a lack of control over who will ultimately be the purchaser and the amount of the ultimate proceeds. Moreover, there is the difficulty of establishing appropriate criteria to apply in the bid analysis and evaluation process (an impediment not limited to this privatization method, but equally prominent in the procedures for leasing and BOT-type schemes).

37. An alternative to sale by competitive tender is the “negotiated sale”: a sale is negotiated with a single purchaser, which may be a company, consortia, a joint venture or a MEBO. The Government (or Port Authority) is free to choose who the purchaser will be and the conditions are determined by negotiation. Clearly, this method carries the intrinsic danger that critics can always claim that the agreed purchase price was below market value. It is important, therefore, to get the valuation of the assets right.

38. If a negotiated sale is with a MEBO it is essential that the financial structure of the new company is secure. This means that care will need to be taken to balance the proportions of debt and equity in the new company. A situation of high capital gearing should be avoided, as this would result in the company being unable to service its debts.

4.4 Joint ventures

39. As port authorities are usually authorized by their statutes to invest in a business related to their main activity, the framework for private/public sector association exists and does not need to be created. In principle, a joint venture involves the setting up by two or more organizations (some public and some private) of a jointly owned, autonomous organization. This can be beneficial if all the parties involved have a mutual interest and the joint venture creates specialized subsidiaries:

- ! to broaden the private sector’s investment in publicly owned ports;
- ! to allow one side to gain technical expertise while the other gains, for example, access to different markets;
- ! to share the project risk by pooling public and private resources.

40. Joint ventures do, however, raise issues of divided loyalties since the Port Authority, when the mixed company holds either a licence or a concession, is both the controlling authority and party to the contract. Joint ventures are often popular in some Far Eastern countries (e.g. China) but much resisted in Africa. In the latter, there is great concern that foreign groups will take control of national assets.

4.5 Stock market flotation of shares

41. The stock market flotation of shares may entail the selling of all or a significant proportion of shares to the private sector. The result will be that the business is quoted on the stock exchange and the shares are traded openly. Under this method, it is also possible that the Government will sell the shares to the general public in large blocks, although applications from employees and institutional and small investors may be given preference. This method normally ensures a high (possibly the highest) price for the assets and in particular secures the widest possible share ownership. It can be used only by large businesses because of stock exchange requirements and the expense incurred in promotional costs and management fees. The major disadvantage, however, is that since the shares are freely traded the company could fall into the hands of competitors or of foreign-owned companies that already control a significant share of the market (e.g. more than 25 per cent).

Chapter 5

DETERMINING FACTORS IN THE CONCEPTION AND IMPLEMENTATION OF A PRIVATIZATION SCHEME

42. The previous chapters have presented the precise definition that will be used in the remainder of this document, the objectives that a privatization scheme is intended to achieve, the possible coverage or scope of a privatization scheme, and the alternative modes and various methods available for effecting privatization.

43. This chapter will present critical factors that will determine how a privatization scheme should be conceived and implemented. No two schemes are alike and any effort to privatize is arduous. Preparations and actual realization are extraordinarily complex and always time-consuming. It is therefore important that a privatization scheme and those called upon to execute it correctly identify and fully comprehend the implications of the key determining factors.

5.1 Need for labour reform

44. First and foremost, privatization is not a solution for solving major problems with respect to labour relations in port. It is a misconception that it will provide solutions to the range of manpower planning, employment and human resource development problems still affecting many ports. Outdated employment practices should preferably be tackled before a port privatization scheme is announced and labour reforms should have been realised well in advance of the private operator taking over the ownership, management and operations of the port facilities. The private sector should start its activities within a clearly defined, transparent and settled labour environment; otherwise privatization efforts will suffer as critics point to the negative impact of the labour reform measures which the private sector company will have to introduce immediately after taking over from the public sector. Numerous leasing contracts, BOT schemes and joint venture agreements have been flawed from the outset because of a complete disregard of the shortcomings/ inadequacies of the labour situation. A comprehensive and sustained reform programme should be introduced through close collaboration/consultation between government, port authorities, private sector companies and unions.

45. Such a programme should at a national level concentrate on:

1. the organization of labour;
2. sustainable employment levels;
3. streamlining of the workforce (through various schemes such as natural attrition, early retirement, voluntary redundancy, compulsory redundancy and job creation);
4. general contract conditions for employment;
5. general working practices;
6. negotiating machinery for reform of industrial relations;
7. general employment safeguards;
8. personnel and manpower development;
9. upgrading of the training capability;
10. a management strategy for the introduction and follow-up of the labour reform programme.

46. Privatization can of course reinforce the momentum of labour reforms and help to build further on the achievements of a government-led reform programme.

5.2 Political initiative and support

47. No privatization scheme will succeed without a major “trigger event” to start the process and without the continuing impetus during the process provided by patrons with strong political motives and connections. In the absence of such political leadership, preferably at the highest level, little or nothing will happen because too many vested interests are called in question and jeopardized by the efforts to privatize. Opposition to privatization of port facilities and services is likely to come from various groups, in particular from:

- ! officials from public organizations fearing a loss of prerequisites and financial advantages, and acting in the knowledge that they will see their power and job security significantly reduced; resistance from these officials is bound to be stronger the weaker the welfare system is and the lower the unemployment benefits are;
- ! labour and unions representing the staff of public port bodies, because these public organizations have often been used to provide employment and hence have generated large numbers of personnel in excess of requirements; for these people, privatization carries the risk not only of job loss but also possibly of termination of their organization’s activities or closure of activity centres;
- ! government officials and political decision-makers, since they fear a reduction of their control over the economy and society, coupled with a loss of patronage; additionally, they fear control of the new private port enterprises by foreign concerns and or possibly by ethnic or other groups.

5.3 Need for clear objectives and a rational action programme

48. Strong leadership and bold initiatives are essential ingredients in a privatization scheme, and so are clear objectives and a rational action programme. The initiator of the scheme must therefore state, in advance and unambiguously, the priority objectives and where possible and relevant, the proper criteria to measure the extent to which they are achieved. Because it is unrealistic to envisage a scheme with only winners, it is essential that the action programme anticipate the kind of measures that will be required in order to lessen the negative aspects of the scheme. Typically, a privatization effort is bound to substantially reduce the turnover as well as the cash flow of the public Port Authority. This advance knowledge should prompt the initiating body to take action to reduce the public Port Authority’s financial obligations and or to compensate for the expected loss in revenues (but this should not lead to subsidization or unwarranted monetary transfers from one government body to another). The action programme should avoid brusque and irrevocable decisions that would harm the port industry structure or the private companies operating within it (such as the abolition of the overseeing authority, cancelling reporting duties, excessive controls on private companies). The key issue here is to build trust between public and private players and alleviate fears on both sides that the other side will be the only beneficiary.

5.4 Dealing with policy issues

49. Privatization will be most successful if the Government and or the initiating body has an accurate and comprehensive idea of how a nation’s port or ports fit within the international trading system and the national transport network. This will allow easier decision-making on a multitude of policy issues which need a priori adequate solutions before the implementation of a scheme can proceed successfully. Critical amongst such issues are:

- ! What is the privatization scope aimed at (comprehensive, partial, full or part)?
- ! Will a monopoly or a near-monopoly situation be tolerated, and if so, under what conditions can this be tolerated and what counterchecks will have to be put in place?
- ! Will the port facilities be offered on an exclusive or common-user basis?
- ! Can the private operator of the privatized port facilities be a shipping line or a grouping (consortium/alliance) of lines?
- ! Does the Government want to retain a “golden share” and if so, what minimum guarantees should such a share offer?

- ! How does the Government intend to reconcile the need for a port to play its public service role with the private sector's legitimate but unidirectional objective of maximizing profits?
- ! How can the Government or initiating body prevent privatization schemes in the port(s) from being limited to the most lucrative parts (in terms of expected future returns) of the port domain?
- ! How to ensure that non-revenue-generating port services, which are deemed to be of public utility, are provided without their becoming a burden on the central or public Port Authority treasury?
- ! What performance levels will have to be set for the private sector operator, how will performance be measured and by whom?

50. A clear identification of the challenges that each of these issues will inevitably raise, as well as a critical evaluation of the implied consequences of alternative solutions, will permit the parties concerned to address difficult and controversial questions in a transparent manner. As a result, the probability that the scheme will fail because the real matters of contention were not mentioned, let alone dealt with from the outset, can be substantially reduced. In this respect, it has to be borne in mind that privatization is in any case an event synonymous with notable policy and regulatory reforms. Such reforms - the ineluctable result of fundamental shifts in the economy (because of globalization, concentration, economies of scale) - are rarely if ever willingly accepted by those in the front line. They are, however, necessary and unavoidable and have both to meet specific objectives and to satisfy a unique set of exigencies. Successful privatization schemes begin with full recognition of the importance of defining precisely objectives and demands.

5.5 Future Port Authority role

51. Opinions differ greatly with respect to the need for maintaining a Port Authority (or similar body) after the private sector becomes responsible for running most of a country's port facilities and services. Not surprisingly, private sector representatives are generally of the point of view that organizations of the "port authority type" merely constitute an additional layer of bureaucracy and consequently use a substantial amount of national economic resources without generating measurable output. Thus, they press for the abolition of Port Authorities and at best will accept the establishment of a landlord-type company which has a limited liability status, is profit-driven and remains solely responsible for managing the port's real estate. At the other extreme of the spectrum, one finds staunch defenders of a continuation of the public Port Authority, although it is understood that the actual running of operational activities such as cargo-handling, towage, mooring, pilotage, shipchandling and other specific services will be entrusted to private operators.

52. A smooth privatization process requires that the Government and possibly the initiators of the privatization scheme define their position at the outset. This will to a large extent then determine the mode and modalities of privatization. As a result, it will impact on the definition and wording of clauses in licence and concession agreements. The debate on whether or not a public port authority is still required has become one of political conviction if not political orthodoxy. In essence, however, what is needed in modern port management is the capacity to command and flexibility, which the private sector is well able to deliver, and at the same time control and long-term vision, which are the recognized strengths of public organizations. Hence, and contrary to preconceived ideas, a growing private involvement in ports is not synonymous with the redundancy of a port-authority-type organization.

53. What is absolutely clear is that privatization schemes will fundamentally change the mission and functions of the traditional Port Authority. Instead of acting as the omnipresent, omnipotent and autocratic body, responsible for everything but often highly ineffective in most of its endeavours, a modern Port Authority will essentially have to concentrate its efforts on the efficient provision and execution (directly or through subcontracting) of five fundamental functions:

1. the landlord function;
2. the policy-making and planning function;
3. the regulatory, supervisory and surveillance function;

4. the monitoring and promotion function;
5. the port training function.

1. The landlord function. Apart from the exceptional case where the entire port and all its assets are transferred to private interests (i.e. comprehensive and full privatization), a port privatization scheme will not substantially reduce the real estate holdings of a Port Authority. In fact, the contrary is more likely to happen (for example, with a BOT scheme the Port Authority's resources will at the end of the term be augmented by the newly created facilities), at least if the privatization of the port operational functions is successfully complemented by a well-conceived port development strategy. In the first instance then, the Port Authority will continue the management of the existing real estate portfolio in order to maintain its value and, when and where possible, enhance it. Ultimately, it will have to decide on the long-term deployment of the available land areas and their most appropriate utilization. The effective performance of the landlord function presupposes also the upkeep of channels, fairways, breakwaters, locks, turning basins, berths, access roads and other supporting infrastructure. Although the Port Authority remains responsible for the adequate maintenance of virtually all infrastructure works within its domain and most of the superstructures, the actual maintenance can be subcontracted to private and public firms. Through the granting of licences and concessions the Authority will generate revenues in order to cover the expenditures arising from its other functions and for which no or few specific revenues can be obtained.

2. The policy-making and planning function. Private companies are neither inclined nor equipped to take direct responsibility for long-term port development. Their horizon is too limited and too focused on direct commercial issues. The tasks of setting national macroeconomic targets for the ports, laying down a general long-to medium-term policy in coordination with the responsible government agencies, developing strategic master plans, obtaining funding for major infrastructure works and supervising their actual implementation will, by necessity, have to be carried out by a Port Authority. Inevitably, as these tasks are particularly sensitive to political influence and lobbying and concern major capital investments, they are bound to generate much controversy. Thus the Port Authority will also in future remain the main target for criticism from all sides, especially as it will continue to be identified as the strategic arm of a Government's ports policy. A well-thought-out and adequately structured privatization scheme will therefore provide for a review of the Port Authority's statutes and make sure that these as well as the Authority's organization are reinforced so that it can effectively fulfil its role as a policy-making body. Because privatization inherently causes fragmented decision-making, the need for an authoritative national port authority (or for decentralized port authorities, as the case may be) capable of mastering the long-term planning process and monitoring performance is greatly increased.

3. The regulatory, supervisory and surveillance function. Maintaining and improving the port's real estate portfolio requires supervision and surveillance, to make sure not only that the port's own assets are properly used, but also that all activities taking place within the port's boundaries and for which the port management is administratively and possibly legally responsible, are carried out according to existing laws, rules and regulations. Many, although not all, Port Authorities do in fact have regulatory powers in respect of private sector operators. Over the years, Port Authorities have had to cope with a more and more complex legal framework defined by supranational and national codes, conventions and decrees. Moreover, many ports have extensive police powers. All this has a considerable impact on the privatization process and explains why the statutory and regulatory aspects of port management are best entrusted to a public Port Authority. This argument is further reinforced by the fact that the private sector, even if it were empowered to exert the regulatory and surveillance function, ignores it or considers it irrelevant to achieving its primary management goals.

4. The monitoring and promotion function. The effective execution of the policy-making and planning function within the overall framework of a national ports plan requires the careful study of traffic developments worldwide and at regional and local levels. Additionally, it requires the monitoring of port performance and the follow-up of structural and technological developments. The Port Authority is therefore ideally placed to coordinate, in cooperation with the private sector, research into trade developments, prepare traffic projections, calculate available and required port capacities, and set trigger points for future infrastructure investments. A logical extension of such study, research and strategic development activities is the role of mastermind and coordinator of the port's marketing strategy and that of initiator of the resulting promotion

campaigns. The Port Authority should not substitute itself for the direct customer-oriented marketing of the private operators; rather, it should jointly with them promote and market projects abroad. Any port privatization effort should make the necessary amendments to allow for such interplay and the required joint initiatives to underpin this.

5. The port training function. The generally recognized significance of the human resources development function in ports has, in the past at least, been rarely translated into actions with adequate scope, depth and duration. Privatization is not going to improve this unfortunate state of affairs. Most private companies will provide some form of on-the-job training which is often pragmatic and quite effective. But this training can be considered only one of the many elements of a comprehensive programme of training that would need to include induction, vocational, management and ongoing training. Hence, there is a considerable need for developing and implementing long-term port training strategies after a careful and exhaustive training needs analysis. It is obvious from the preceding remarks that the organization and execution of such programmes cannot be entrusted to the private sector alone. Port Authorities could help in boosting training capabilities either directly or by supporting a Port Training Institute with a major structured training capability. Although it can be argued that privatization schemes have little or no relevance for the port training function, practice has shown that this function is crucial if the private sector is going to live up to expectations and outperform the public Port Authority as a service provider and operator.

5.6 Freedom to set prices

54. Without doubt one of the most controversial and least understood issues is that of freedom of pricing for the private operator. This is particularly true in countries where government has traditionally imposed pricing controls on the Port Authority, acting as a service port. The reasons generally given for the Government maintaining control over port pricing matters are invariably:

- ! the need for the Government to prevent discriminatory pricing practices;
- ! the defence of the interests of shippers and receivers;
- ! to avoid monopoly pricing abuses;
- ! to control excesses as a result of extreme inter-port competition.

55. None of the above-mentioned reasons withstands the test of serious scrutiny. As a matter of fact, freedom to price according to commercially and financially sound principles is a *sine qua non* for a successful privatization project. There are at least four major reasons why granting of pricing autonomy to the private port operator is a superior strategy:

- ! a greater probability that cost-based tariffs will apply and that operating expenses will effectively be paid for from operating revenue (and hence a greater chance that the operation will remain financially viable);
- ! a strong contraction of the practice of cross-subsidization;
- ! a greater probability that efficiency pricing will be implemented and that customers imposing higher costs will face higher tariffs;
- ! a stronger possibility of tariffs truly reflecting the real benefit that the services provided offer to users.

Chapter 6

THE PRINCIPLES UNDERLYING THE GUIDELINES

56. The guidelines to be developed in the remaining chapters of this report will, of necessity, have to be based on a set of clear and simple principles. This chapter presents those underlying principles and, where required, states their justification and/or underlying logic. The guidelines have been specifically developed for modes enabling true privatization of port cargo-handling facilities, such as terminals for the handling of liquid and solid bulk and of non-containerized and containerized general cargoes on the basis of a long-term (not less than 20 years) licence or concession. Guidelines for other port privatization objects (e.g. privatization of selected port services such as towage or pilotage), although similar, will require separate treatment.

1. The privatization scheme is open to competitive international bidding

57. The guidelines are intended to underpin the decision to privatize port facilities and services, with opportunities for introducing foreign expertise and/or external funding and/or employment of expatriate manpower. To achieve this aim fully, the first precondition is for the privatization scheme to be based on an international open, transparent, objective and non-discriminatory international bidding process. This will allow the scheme to attract the widest possible response and warrant the selection of the best proposal.

2. The privatization scheme has to be in line with government policy

58. The restructuring of the ports industry, through the privatization of infrastructures, should not be attempted if the Government's policies and/or strategies oppose or discourage private sector involvement in the transport sector in general and ports in particular. This is not a criticism of a Government's preference for public sector management and operation of transport services. It is merely a logical conclusion, i.e. that it will be impossible for any privatization scheme to achieve incontestable results if the political will is lacking. The political authorities should commit themselves clearly and unequivocally to port privatization and publicly articulate the objectives of their policy.

3. The Port Authority becomes the owner and manager of a "landlord port"

59. The future role of the Port Authority will be that of a "landlord". The Port Authority will no longer be involved in the actual operation of facilities or the provision of services, but will concentrate on maintaining and expanding the port's real estate holdings, on policy-making and planning, on regulatory, supervisory and surveillance functions, and additionally on performance monitoring, port promotion and training.

4. The effort to privatize port facilities is not a substitute for labour reforms

60. The privatization scheme, although it may be instrumental in achieving labour reforms, should not be conceived as an easy way out for the public sector to solve long-standing port labour problems. Labour arrangements must be reformed and new arrangements put in place as a prerequisite for further structural change and entrepreneurial port management. A related principle is that the private company is expected to offer employment conditions to current staff and labour on conditions which are not inferior to those previously offered by the Port Authority as a public operator.

5. The scheme will concern partial privatization in full or in part

61. The proposed privatization scheme does not concern the comprehensive sale of a port or the construction of a completely new port, but covers the partial transfer of port facilities to a private or public/ private sector enterprise (for the sake of simplicity, hereinafter also referred to as a private company) or the investment of a private or public/private sector enterprise in a well-defined new port facility.

6. The privatized facilities/services will be managed and operated on a common user, non-discriminatory basis

62. The facilities/services to be privatized, should be managed and operated on the basis of a common-user and non-discriminatory arrangement. The private company will handle business from any potential customer wishing to use the privatized facilities in accordance with the conditions set by the private operator. The latter is prohibited from offering actual or potential users different operational or financial conditions for similar requirements or identical operational or financial conditions for dissimilar requirements. Hence, the private company must give a guarantee that all users will receive equal treatment at all times, it being assumed that equal needs have to be satisfied.

7. The operator of the privatized facilities has to be experienced in the activities to be carried out

63. To be awarded the right to manage or operate the facilities, the private operator has to prove his qualifications, expertise and experience in similar port activities. This is a major criterion for selection. The private operator can be a specialized port handling company, a shipping line or group of shipping lines with port operating competence and experience, or a joint venture of a port handling company and shipping line. The award to a shipping line of a concession or license makes it more crucial that the previous principle (common-user, non-discriminatory service offer) is firmly adhered to.³

8. The private bidder selected will set up a new local operating company

64. After the bidding process, the successful bidder (which may or may not be a joint venture) should be required to set up locally a new operating company. This will facilitate cooperation and coordination between the Government/Port Authority and the winning bidder, and avoids further complications whenever the execution of the privatization agreement gives rise to arguments, disagreements, disputes and claims. Also, it helps to establish and maintain a direct link between the country privatizing its port facilities and the operating company(ies) selected to run them. The preferred legal form of the operating company would be that of a limited liability company: this is a familiar form and offers limited but clearly defined liability to the shareholders.

9. Land ownership remains with the Government or the public Port Authority

65. The ownership of and the resulting rights to use the land (possibly linked to the rights over the adjoining water) are an issue central to the development and management of any port facility and to the conception and execution of a national port policy. The latter would be unthinkable if ownership of the land were to be permanently transferred to an individual private company. The guidelines should therefore start from the premise that the ownership of and the resulting rights to use the land remain in public hands (Government/Port Authority),

³ A dedicated terminal licence or concession awarded to a shipping line (or group of lines) by smaller ports carries a great risk of monopolistic behaviour by the licensee or concessionaire since inter-port competition is virtually ruled out (the existence of similar facilities in the port is unlikely), and the possibility cannot be excluded that other shipping lines may be discriminated against in an insidious manner. It is therefore an alternative that should be considered only for large ports where numerous container facilities exist side by side and where there is much intra-port competition.

although these can be temporarily transferred through licences or concessions to the private company that successfully tendered for managing and operating facilities located on the land.

10. Management and operational autonomy of the private operating company

66. The award of a licence or concession to a private operating company is aimed at ensuring the most efficient management and operation of the port facilities concerned. This level of efficiency can be achieved only if the operating company has full management and operational autonomy within the normal limits of the law and is allowed to operate without interference by the Government or Port Authority in matters such as setting tariffs, selection of the type and quantity of equipment, configuration of port facilities, organizational structure and operational methods.

11. The evaluation of the technical content of the bids takes precedence over the financial evaluation

67. For a bid to be acceptable it must at least satisfy the technical requirements stated in the “notice inviting bids” and possibly exceed these. Thus the principle should be that, for the financial assessment, only those bids should be retained that meet the technical standards set by the authority initiating the privatization scheme. This implies that whatever proposal is ultimately selected, it will offer the necessary guarantees for the proper development, management and operation of the facilities.

12. Award of concession or licence on the basis of the highest present value

68. In the privatization process the interests of shippers/receivers (championed by the Ministry of Commerce) inevitably conflict with the interests of the Treasury (defended by the Ministries of Finance and Transport). The former will unconditionally defend the position that the winning bid should be awarded to the submission offering the lowest port tariffs. The latter will support the submission that proposes the highest price compensation for the facilities to be privatized or for the concession for building new facilities. The criterion of the lowest port tariffs is not a practical one, because it cannot be verified. Indeed, a great number of factors determine the ultimate price to be paid, and it is virtually impossible to define future activity levels with any accuracy. The only true and valid criterion to be applied should therefore be that of the highest present value of aggregated rents, royalties and any other additional compensations offered by the bidder. There is another reason why the latter principle should apply: it is only fair that the private sector should properly reward the Government/Port Authority for the licence or concession which it will be granted and which will allow it to benefit financially. Thus the price compensation should approximate as closely as possible on the one hand the advantages that the bidder expects to be able to gain from the concession and on the other hand the opportunity cost of the facilities/concession. Logically, the most attractive financial package should be declared the winning bid because it will most accurately reflect both anticipated gains by the bidder and opportunity forgone by the Port Authority (assuming that the content of the proposal satisfies the technical requirements, as stated in the previous principle).

13. A priority objective of the privatization scheme is to boost performance levels

69. A priority objective of the privatization scheme is to boost the operational performance level of either the existing facilities or the facilities to be built. Performance levels can be expressed in many ways, depending on the particular goal. For the privatization of handling facilities the key indicators on which performance should be judged may include throughput (on an annual basis), gross productivity per main production subunit (e.g. a gantry crane, a ro/ro gang, a conventional cargo gang), output per ship on a 24 hours per day basis and the “effective working time to berth time” ratio.

14. Another priority objective is the private funding of the extension of existing facilities or the construction of new facilities

70. True privatization assumes the actual transfer of ownership of assets from the public to the private sector or the application of private capital to fund investments in new facilities, equipment and systems. The guidelines should therefore incorporate the principle that the Government/Port Authority relies on privatization as an alternative means of funding port investments, thereby reducing the burden on the national Treasury. This principle implies, however, that the necessary deregulatory measures have been taken by the Government to create transparency and limit institutional risks as perceived by potential investors.

15. The private operator enjoys pricing freedom

71. The private operator should be given the right to autonomously set the tariffs for the services offered, assuming that no de facto monopoly exists (if such a monopoly would be created, maximum or “ceiling rates” should be set by the Government on the basis of the tariff proposals presented by the private company in its bid). This principle implies the obligation of the private operator to meet all legal and fiscal requirements, including the payment to the Government of taxes on corporate profits.

Chapter 7

PROCEDURES FOR THE TENDERING PROCESS

72. A successful privatization programme starts with well-conceived rules and procedures:

- ! for inviting potential investors and operators (the “candidates”) to tender;
- ! for the processing of the proposals received as a result of the invitation to tender.

73. This chapter will present and discuss the main elements to be included in the bidding documents (assuming that a pre-qualification process has already been completed) and the rules that should apply when selecting the winning bid. It assumes that an existing terminal will be transferred to the private sector. However, the bidding documents for the construction of a new port facility by private sector interests would follow a similar approach and identical rules would apply. Only certain specific stipulations would need to be drafted with the BOT approach in mind. “Port Authority” in this chapter refers to the public port body that will carry on with the landlord function and be responsible for seeing the privatization process through; it therefore acts for and in the name of the Government.

74. The four major steps in the tendering process are:

1. drafting and publication of a “general notice inviting bids” and of the bidding procedures;
2. drafting and issuance of the bidding documents;
3. evaluation of the proposals received and selection of the winning bid;
4. negotiation and award of the licence or concession.

7.1 Drafting and publication of a general notice inviting bids and drafting and issuance of the bidding documents

75. The first phase in the tendering process usually comprises two activities:

- ! the drafting and publication of a “**background document**” serving as an introduction to the privatization scheme;
- ! the drafting of detailed “**bidding procedures**” that will have to be followed in the tendering process;

76. These two activities will be considered in turn and attention will be drawn to crucial elements and particular concerns.

7.1.1 The “Background document”

77. In its first section, the “background document” will discuss the economic and political context in which the privatization process is carried on. For example, it will state that the process is in response to the needs of international trade and that the Government has embarked on economic liberalization by opening up various sectors of the economy to private investments, through measures of decontrol and the abolition of restrictive rules and regulations.

78. Also in the first section, the port in which the facilities are to be privatized or to be built, is presented. The importance of the port is indicated by referring to significant indicators of its activity (such as annual port

throughput, number of people employed and value added). An indication of future activity is also given (e.g. in terms of expected traffic and/or throughput growth).

79. Finally, the first section of the “background document” will state the Government’s intentions, the legal basis for them and the Government’s expectations:

Example

To handle the forecast substantial growth in traffic, to allow for rapid modernization and to meet the demands of technological innovation the Government, in accordance with Section ... of the Ports Act of ..., proposes to license the management and operation of terminal ABC and has decided to transfer the ownership of this facility to the private sector.

80. The second section of the “background document” presents the wording chosen for inviting bids. It will state the period for which a licence or concession will be awarded and the physical limits of the facility:

Example

The present documents are issued to invite bids for the grant of a 30-year licence to manage, operate and maintain the ABC terminal and ancillary facilities and for the sale of the existing terminal equipment.

81. An additional paragraph could cover future development steps and the strategy that will be followed:

Example

With anticipated growth, the Port Authority will, at an appropriate time, initiate development plans for the extension of the ABC type facilities. This will be subject to a separate concession to be tendered for at an appropriate time as decided by the Government.

7.1.2 The “Bidding procedures”

82. The “bidding procedures” referred to in the general notice inviting bids can be subdivided into five sections (apart from an introductory section presenting explanatory definitions of the most important terms used). The sections cover:

- ! the purchase of the general bidding documents;
- ! the conditions governing the submission of bids;
- ! a schedule for submission and review;
- ! selection criteria;
- ! award of the licence or concession.

7.1.2.1 The purchase of the general bidding documents

83. The first question to be addressed *is the place where bidding documents can be obtained and under what conditions*. Normally, each pre-qualified bidder will be issued with one set of bidding documents against payment of a non-refundable fee. The level of fee is often a subject of controversy. A good rule for setting the amount is that a significant part of the administration costs entailed by the bid invitation procedure should be recovered, but it is not the intention to recover the full cost of the bidding and selection procedure. The objective is not to use the bidding exercise to generate a profit. An excessive price for the bidding documents would not

necessarily discourage potential candidates but would certainly do little to create a climate of trust between potential future partners (Port Authority and licensee/concessionaire).

84. Next comes the possible *obligation to register* which carries the right to participate in the bidding, subject to the conditions set forth in the invitation to bid. To this end, the candidate has to fill out, sign and return an “acknowledgement of receipt of bidding documents”.

85. A standard procedure is to allow for a *pre-bid visit* to the facilities to be privatized and the organization of a pre-bid conference. Frequently, the visit to the facilities and attendance at the pre-bid conference are mandatory in order to ensure that potential candidates are fully aware of the site location, the state of the facilities and the prevailing operational conditions.

86. Another stipulation may set a *deadline for receiving inquiries* concerning the bidding documents. The Port Authority will generally reserve the right to amend the bidding documents (at its own initiative or in response to clarifications requested by any of the potential candidates), but such amendments will have to be notified to all registered bidders (i.e. those that have returned the signed “acknowledgement of receipt of bidding documents”). An amendment may or may not lead to an extension of the deadline for the submission of the proposal. This is left to the discretion of the Port Authority.

7.1.2.2 The conditions governing the submission of bids

87. This is an important section, as it will stipulate how bids will be processed and what limiting factors apply.

88. In most tenders the candidates are limited to a *single technical and financial bid*, although it is generally accepted that a bid can be *submitted by a consortium*. The latter will, however, have to follow strict rules, such as:

- ! the obligation to designate one or more persons (authorized to perform all tasks) to represent the group of companies in its dealings with the Port Authority;
- ! each member of the group of companies to submit a signed letter with the proposal, which states that it has reviewed the entire proposal and is in agreement with each key element and with the choice of the person(s) who will represent the group of companies.

89. Conditions with respect to the *validity of bids* usually indicate a maximum period for the bids to remain valid, counted from the date of submission of the proposal. Validity periods of six months to a year are quite common.

90. Rules concerning *sealing and marking of the proposals* must be precise and clear in order to avoid possible fraudulent manipulation of the proposals. The number of original proposals to be submitted will need to be indicated. Preferably a limited number will be specified, typically three or four sets, as this will reduce the risk of leaks or infractions. The proposals should preferably be addressed to the most senior officer in the organization responsible for the bidding procedure, usually the Chairman of the Board of the Port Authority or the Chairman of the Privatization Committee (or its equivalent). It is common practice to work with a two-envelope system (an inner and an outer envelope, the former containing two separate proposals again in two separate envelopes, one for the technical and one for the financial bid), as this allows the proposal to be returned unopened in case it is declared late or there are other procedural errors or shortcomings.

91. It is customary for the potential candidates to bear all *costs associated with the preparation of the proposals* and their participation in the negotiation process, and it is therefore suggested that a provision such as the following be added:

Example

The ... Port Authority shall not be responsible or in any way liable for costs associated with the preparation of the proposal or the contract negotiation, regardless of the conduct or outcome of the bidding process.

92. In order to ensure the bidder's good faith and determination to go ahead with the offer submitted, he is requested to submit with his proposal an *earnest money deposit* in the form of a certified cheque or demand draft payable to the Port Authority. This deposit is returned to all unsuccessful bidders. The deposit of the successful candidate will commonly be used towards the required development security (see chapter 8). The amount should be sufficient to discourage unmotivated candidates from submitting a proposal, but not excessive so as to dishearten serious contenders. Typically, an earnest money deposit will be somewhere between US\$ 25,000 and US\$ 50,000.

93. The opening of proposals is stipulated at a specific time (set out in the "schedule of submission and review") and place (most often the headquarters of the Port Authority) in the presence of those bidders wishing to be there in order to know the number of proposals ultimately submitted and the names of the competing bidders also present (as these will have to sign a register evidencing their attendance).

94. Finally, the section dealing with the conditions governing the submission of bids will have to state which events would result in the rejection of a bid. Usually, four main reasons are invoked:

- ! any effort by a bidder to influence in any way the Port Authority in the process of examination, clarification, evaluation and comparison of the proposals or to influence the Port Authority's decisions concerning the award of the contract;
- ! any false or misleading statements and evidence of any fraud in the proposal submitted by a bidder;
- ! the fact of giving or offering illegal compensation or other advantages to officers, employees or agents of the Port Authority (often extended to include Ministry of Transport officials and personnel);
- ! the non-responsiveness of the bid (the non-conformity of the proposal).

7.1.2.3 The schedule of submission and review

95. The schedule of submission and review will be established by the Port Authority as a milestone for the accomplishment of the various tasks that will ultimately lead to the signing of a licence or concession agreement. The following essential tasks should be included in such a schedule:

- ! announcement of the privatization scheme;
- ! issuance of the bidding documents;
- ! review of bidding documents by potential bidders;
- ! possibility for bidders to seek clarifications or raise specific queries;
- ! pre-bid visit and pre-bid meeting;
- ! submission of proposals;
- ! evaluation of proposals, including separate phases for:
 - ! the notification of rejection of proposals or their acceptance for further consideration;
 - ! notification to registered bidders of either rejection of their technical proposals or their selection for further consideration of the financial proposal;
 - ! verification of remaining bids and ranking after consideration of financial proposals;
 - ! negotiations with selected bidder;

! signing of the licence or concession agreement.

96. The total time provided, from the announcement of the bidding process to the final signing of the agreement, is highly variable and differs from one scheme to another. It is difficult to indicate any generally appropriate duration for the process. A realistic period needs to be set and its optimal length will depend on the complexity of the scheme, the necessary amount of data gathering and the required detail of the proposal. Too short a period makes it difficult for potential candidates to properly consider the proposed privatization scheme, participate in the pre-bid visit and meeting, and duly prepare the requested documentation and schedules. Moreover, it will create the impression that “a short fuse” was deliberately inserted so that a particular bidder, in possession of advance information by design or by accident, is allowed to take advantage of this. Too long a period will inevitably result in a drawn-out procedure which may make the process less transparent and more open to manoeuvring and unfair practices. Also, once a decision on the privatization of a facility or service has been taken, it is highly detrimental from both a commercial and an operational point of view to prolong the transition from public to private sector ownership and management. It can be stated, as a rule of thumb, that for a major scheme it will be well nigh impossible to complete the process in less than a year. But even for major privatization deals, the period should preferably not exceed between 18 and 24 months from initial publication of the general notice to the final signing of all the legal papers.

7.1.2.4 Criteria for selection

97. Both in the background document and in the detailed bidding procedures considerable attention should be paid to describing the evaluation process. Although rules concerning this process vary greatly, most frequently a three-stage procedure is followed: first, the bids are scrutinized in order to eliminate all non-responsive bids; secondly, the technical content of the proposals is evaluated; and finally, the remaining bids are assessed on the basis of the financial conditions offered.

Non-responsive bids

98. In the first phase non-responsive bids will be eliminated. These are proposals that do not meet the requirements of the tender. Subject to rejection are, for example, proposals that:

- ! were not received by the date and time specified;
- ! were not accompanied by the earnest money deposit;
- ! were not submitted in the required formats;
- ! do not contain the minimum technical and financial information;
- ! are not valid for the period specified in the “conditions governing the submission of bids”;
- ! do not carry the required signatures or seals;
- ! reveal significant inconsistencies between the proposal itself and the supporting documents.

Evaluation of the technical proposals

99. In the second stage the technical proposals will be evaluated. The conditions for selection and the evaluation criteria are best described in an annex to the bidding documents. The most effective method is to set a minimum acceptable overall score (say 80 marks out of 100) and also a minimum score for each of the main headings (say 70 marks out of 100). Bidders whose proposals have scored less than the minimum required (overall or on individual headings) are eliminated and will no longer be considered for the financial evaluation. It is important that the technical evaluation be comprehensive and cover all major aspects regarding the future management and operation of the facilities (a listing of possible criteria is given in the part dealing with the various bidding documents). Experience from past privatization schemes shows that a superficial or incomplete

technical assessment results in much controversy with respect to the winning proposal, particularly if the latter proves to be technically rather weak but financially attractive.⁴

Evaluation of the financial conditions

100. In the third and final stage, the separate envelopes containing the financial proposals of the bidders that successfully passed the technical evaluation will be opened. The proposals will be ranked according to a predetermined evaluation methodology. This should normally deem to be the best scheme the one that offers the highest total present-value cash flow, calculated over the life of the licence or concession period. Once the top-ranked proposal has been identified, negotiations will start with the bidder that submitted the most advantageous proposal. If these do not result in a contractual agreement within a specified period, the Port Authority may begin negotiations with the bidder that submitted the second best proposal.

7.1.2.5 Award of the licence or concession

101. Once the bid evaluation result, as substantiated by the Chairman of the Bid Evaluation Committee, is announced it becomes irreversible. To avoid endless disputes and discussions regarding the result, it is recommended that there be inserted in the "conditions governing the submission of the bids" a clause stating that:

"the bidders, when submitting their proposals, implicitly accept the Bid Evaluation Committee's decision and refrain from any action in recourse."

102. The award of the licence or concession implies on the part of the winning bidder the incorporation of a company under the Companies Act (or equivalent instrument) of the country in which the privatized facilities are located. The contracts will then be entered into by the Port Authority and the new corporate entity.

7.2 Drafting and issuance of the bidding documents

103. The drafting and issuance of the bidding documents constitutes a major effort on the part of the privatizing authority. It is a critical step since it will shape the future ownership, management and operation of the facilities. Also, the complete set of bidding documents is the key to a successful conclusion of the privatization effort.

104. The set of bidding documents to be drawn up for privatizing existing port facilities should include all of the following:

- ! description of the business;
- ! prevailing General Conditions for the licence or concession;
- ! content of the bid proposal;
- ! basic licence or concession agreement terms;
- ! criteria for the technical evaluation;
- ! criteria for the evaluation of the financial proposals;
- ! a set of standard forms for presenting the proposals.

⁴ In such a eventuality it is unlikely that the bidder will be capable of keeping his financial promises, since by definition the technically weak proposal will not generate the required returns to sustain such promises. As a result, such a proposal will invariably lead to substantial tariff increases, which means that the user must pay for the bidder's financial promises that cannot be supported by an efficient operation.

7.2.1 Description of the business

105. The description of the business is inevitably determined by the location and characteristics of the facilities to be privatized. The bidding documents should therefore present detailed plans with respect to the location of the facilities, meteorological information, berth and terminal layout, and type and quantity of equipment. It is essential to provide a detailed specification of the facilities (and equipment) that will be made available and the amount of traffic that has been handled in the past five to ten years. Also, the present shipping lines and other services using the facilities should be listed, together with their share in the total throughput of the facilities.⁵

7.2.2 Prevailing general conditions

106. The section on prevailing general conditions should give full details of the framework in which the privatization scheme is to be executed, the bid proposal formulated and the licence and lease conditions (or the concession and BOT conditions).

107. Typically, all of the following will be covered:

- ! the *services to be provided* by the private company (the licensee or concessionaire), e.g. to operate and maintain terminal ABC and to control the business for the period indicated in the bidding document;
- ! the need for the licensee or concessionaire to *carry on the business in a manner conducive to the interests of the port and the country* (as a counterweight to the purely commercial interest of the licensee or concessionaire);
- ! the *obligation of the licensee or concessionaire to efficiently manage and operate terminal ABC* and make available all necessary resources, including **investments** for construction, extension or enhancement of the facilities and equipment, to achieve this goal (these provisions making this an invitation for a genuine privatization scheme);
- ! *required equipment and spare parts acquisition* by the licensee. Here it is useful to stipulate that the private entity will have to provide at its own expense equipment and spare parts necessary for operating the facilities and handling the projected traffic and throughput volumes in line with the agreed standards of performance; hence the bidder in his bid proposal will have to make provisions for this requirement;
- ! that the *land and or premises described and licensed or given in concession shall be taken in its or their present condition* by the licensee, without the Port Authority (licensor) having an obligation to make any changes or improvements but allowing the former to make such improvements on condition that approval for the plans is secured in writing from the latter (thus not making the licensor liable for any loss or damage or expense whatsoever which the private company may suffer arising directly or indirectly from the improvement works);
- ! that the *ownership of the facilities* is to remain at all times that of the licensor but the equipment is to remain the property of the licensee;⁶
- ! that the *limitations on the use of the assets* are stipulated and the type of activities that can be carried out on the facilities without prejudice to the other activities of the port are defined (e.g. what the activities are which violate the initial intended use);

⁵ If a new facility is to be built (e.g. with respect to a lease on vacant land or a BOT-type arrangement) the site conditions should be clearly and succinctly specified and bathymetric, topographic, meteorological, oceanographic and geotechnical data provided. In addition, information on environmental impact and water properties should be made available.

⁶ In BOT-type arrangements, different agreements may be concluded.

- ! that the licensee is expected to *promote the activities of the facilities* (existing or planned) so that optimum utilization is achieved (this is in line with good business practices and constitutes a guarantee for the licensor that the facilities will be properly used);
- ! that the *common-user and non-discriminatory aspect of the licence* is to be embedded in the proposals, making the facilities open to any shipping lines, shippers and receivers that may be suitably handled at the terminal;
- ! that the respective responsibility for the *maintenance of the facilities* is determined; ideally, the licensee should be responsible for carrying out and paying for all necessary repairs and maintenance work, but this may in most licences entail subcontracting (against proper compensation) of the maintenance of quay-walls, fenders and dredged depth to the Port Authority, as it is unlikely that the licensee will have the necessary qualifications or staff;⁷
- ! that the *inspection and acceptance of the existing property* has to be arranged in order to establish the condition of the facilities at the time of transfer from the licensor to the licensee, whereby the latter accepts the premises as being suitable for the purposes for which they are licensed; the licensee will need to accept the “rights of ingress and egress”;
- ! that a clear *division of responsibilities* is defined between the licensor and licensee (or the grantor and concessionaire) with respect to scheduling of entry and berthing of vessels, pilotage and towage, maintenance of the entrance channel and general port structures, operation and maintenance of fire safety installations, waterside safety, provision and maintenance of adequate road and rail access, supply and maintenance of electrical power, water supply, sewage disposal, etc.; the appropriate settlements and formulation will to a large extent depend on local conditions (e.g. who is providing utilities in the country and how reliable is the service offered?, who is carrying out the pilotage or towage activities in the port?) although in general terms the Port Authority will mostly remain responsible for all activities/services that create the overall setting in which private companies can manage and operate specific facilities;⁸
- ! that it is expected that the *transfer of labour* from the Port Authority to the licensee is guaranteed and that the general *terms of employment* for all personnel employed by the licensee are stated. Again, the particular stipulations will dictate the content of the bid proposal; although they are heavily influenced by conditions prevailing at the port, a generally accepted principle is that the licensee shall employ such personnel whose service has been formally terminated by the Port Authority and who have been working on the facility intended to be licensed, provided that they desire to work for the licensee. Overall, it is expected that the new private operator will offer conditions of employment which are the same as or better than those of the Port Authority (these will comprise medical benefits, social security schemes, pensions, housing, etc.);
- ! that the *responsibility for setting prices and collecting revenues related to the facilities* is properly determined, whereby preferably the principle should prevail that the licensee or concessionaire has the freedom to set his tariffs in line with the charges proposed in the business plan included in his bid proposal and collect the resulting revenues;
- ! that the *right of exclusivity* will be linked to the possibility for the Port Authority or the licensee to construct additional facilities if traffic or throughput exceed predetermined trigger point levels;
- ! that *minimum standards of performance* are set according to which the licensee’s managerial and operational achievements will be judged; these need to be proposed in the technical bid proposal and will include a minimum throughput level, year after year, for say the first 10 years

⁷ It is up to the bidder to formulate specific proposals in this respect.

⁸ The bidder will have to properly assess the implications of the proposed division of responsibilities when preparing his proposal.

of the licence period and such quality of service standards as average gross output per hour (per vessel) and per 24 hours (per vessel) for the first five years of operation;

- ! that the respective *liabilities of the Port Authority and the licensee or concessionaire* with regard to property and people are clearly determined; this will have consequences for the necessary insurance cover to be taken out by both parties and will have financial implications that need to be given due consideration in the bid proposal;
- ! that the *tax responsibility* of the licensee or concessionaire will be stipulated in advance and incorporated in the final contracts, in terms of both obligations and allowances.

7.2.3 Contents of the bid

108. The bidding documents will provide for a detailed brief, stating the obligatory content of the bids to be submitted. These have to be scrupulously followed and thus determine the shape of the proposals. The instructions should cover a number of crucial elements that will allow a accurate and non-biased appraisal of the bid proposals. The more significant of these are:

! *Details of the bidder*

109. The bidder or group of companies making up the bidding consortium should provide full information with regard to their companies, in particular the corporate domicile, place and date of incorporation, copies of the articles of incorporation for each of the constituent companies and a summary of their primary business activities. It is customary to provide forms for entering the requested details and insist that a firm of chartered accountants verify the accuracy of the stated share ownership.

110. The reporting of the relevant experience of the bidder or group of bidding companies in managing and operating port facilities and services in the world and its or their experience with respect to working and operating in the country offering the licence or concession is equally important.

111. For the Port Authority to be able to assess the financial standing of the bidder or group of companies making up the bidding consortium, copies of the audited financial statements (certified by chartered accountants) for the company or for each company for the last three financial years will have to be presented; these statements will normally include the balance sheet, income and expense statement and cash flow statement, as well as the corresponding exhibits and auditor's notes.

112. Most significant for the evaluation of the bidder's future financial capabilities is the information that will be provided under this heading concerning the financial resources available to the bidder for investment in facilities and equipment in the medium and long term.

! *Corporate structure of the bidder*

113. If the bidder submits his proposal in association, in a joint venture or in any form of grouping with other companies, he will have to complete a special form providing for:

- ! the written commitment by all constituent companies to establish a locally registered company for the specific purpose of carrying out the licence or concession agreement;
- ! a copy of the memorandum of understanding between the constituent companies regarding participation in the bid and provision of the paid-in capital for the new company to be established;
- ! the statement of the level of participation in the paid-in capital and the decision-making of each of the constituent companies;

- ! the representation of the constituent companies and outsiders on the board of directors of the company to be established;
- ! a chart setting out the corporate structure of the constituent companies and their interrelationship with other companies and holdings;
- ! an organization chart showing key management and operations positions in the new company.

! ***Proposed corporate structure of the licensee or concessionaire***

114. The Port Authority will expect the licensee or concessionaire to show his ability to provide the facilities and/or services required under the bid, by furnishing proof of experience in managing and operating comparable enterprises. The licensee or concessionaire will also have to present the corporate structure of the local business entity that will be established, the résumés of senior executives and full biographical data on key personnel proposed for carrying through the project (at headquarters and on site), and possibly the available mechanisms for transfer of know-how and technology.

! ***The business plan***

115. The proposed business plan is **the key** element in the technical proposal. It should allow the Port Authority to assess the scope and viability of the bidder's proposal with respect to the expected development of the business. A model business plan should cover, for example, all of the following:

! *An introductory statement*

This statement should present the facilities and services which are the subject of the proposed licence or concession agreement, set out the mission of the new company, formulate its priority objectives, summarize the phased developments that are proposed, and define the economic and social benefits of the project proposal for the country and the operational and financial advantages for the Port Authority.

! *The marketing strategy*

The proposed marketing strategy should essentially concentrate on the mission and objectives of the new entity, the marketing strategy of the main potential users (shipping lines, shippers and receivers) and the marketing concepts that will be implemented. It will need to consider carefully the competitive position as input for vessel, cargo and activity forecasts. Also, it should provide a substantiated account of the reasonable potential which the bidder will offer for attracting new business.

! *Vessel, cargo and activity forecasts*

As preparation for the development, operational, capital investment and acquisition and financial plans it is crucial to prepare vessel, cargo and activity forecasts for alternative scenarios. These should be based on past performance, expected economic developments, the expected outcome of the marketing strategy and foreseeable structural and technological changes.

! *The development plan*

The development plan should set out the phased master plan for the duration of the licence or concession agreement, stipulate the trigger point for further expansion, present the design criteria where appropriate (e.g. for BOT-type agreements) and discuss any environmental issues that may arise. The development plan may have to give due consideration to ways of incorporating the different results obtained in carrying out the alternative activity forecasts (e.g. through appropriate phasing and selection of suitable trigger mechanisms).

! *The operations plan*

The operations plan should discuss the arrangements to be put in place during the subsequent phases of implementation of the project. It could discuss alternative operational designs and procedures to maximize efficiency and cover such aspects as response to customer requirements, relations with third-party suppliers, quality assurance, safety, insurance cover and security. For an existing terminal the plan could formulate constructive proposals on how to solve observed operational problems. In addition, the operations plan should indicate the guaranteed performance levels in terms of throughput, output, utilization and quality of service.

! *Human resources development plan*

The personnel policies and procedures should be detailed in the human resources development plan. The organizational structure of the new entity should be explained and the general labour arrangements defined. Recruitment, promotion policies and motivational measures should be explained and career development opportunities demonstrated. Training requirements should likewise be clarified (with an indication of the number of workers and staff concerned, the frequency of the proposed programmes and the substantive coverage). The social coverage should be detailed and would include medical care, housing arrangements and fringe benefits. Furthermore the extent to which expatriate experts will be used should be specified (their numbers, functions, job specifications and duration of employment), as well as the expected level of new expertise that they can bring to the terminal.

! *Information systems and EDI plan*

The chapter of the business plan dealing with information systems and electronic data interchange (EDI) should concentrate on the application of information technology to the facilities to be licensed or given in concession (what systems would be introduced for which functions and with what timing). A brief but accurate systems description should be provided and the operational principles of the proposed systems defined (including the extent of the systems' coverage). For an existing facility, an outline could be given of the improvements suggested to the existing computer and communication systems.

! *Capital investment and acquisition plan*

For the duration of the licence or concession period, on the basis of distinct expected activity levels, a year-by-year estimate of the required capital investment should be prepared for a comprehensive acquisition plan covering land, quay-walls, civil works, equipment and systems.

! *Financial plans and funding arrangements*

The concluding section in the business plan should synthesize the preceding activity forecasts, operational and investment projections and acquisition plans into a financial model providing alternative cash flow projections and profit and loss statements for the different development scenarios considered in the business plan. The proposed funding arrangements should be detailed, including a clear division between equity and borrowing. For the latter the expected or boundary financial conditions and repayment terms should be specified.

! *Financial qualifications of the bidder*

116. To limit the financial risks for the Port Authority, the brief setting out the required content of the bid proposal should specify what information has to be supplied with regard to the financial qualifications of the bidder. It is worth while to consider including, for example, minimum requirements for the paid-up capital of the

bidder's (or bidders') companies and the minimum average annual turnover for the past three years (the sums to be stipulated should be proportional to the required investments and the annual cash flow generated by the project under consideration). If the bidder represents a group of companies, the minimum average turnover for this purpose could be that of the group, on condition that a corporate guarantee is provided for the performance of the bidder.

! Terms of the financial offer

117. A critical part of the brief will concern the components of the financial offer. Here the bidder should be given explicit and accurate directives with respect to the structuring of his financial proposal and information on the evaluation methodology that will apply. The components of a financial offer could include:

- ! an initial lump sum payment at the time the licence or concession agreement is signed;
- ! an annual licence or concession fee to be paid as the basic rental for the use of existing facilities or the right to expand or build a new facility; alternative payment modalities exist, such as payment in advance or at the end of a period and payment on an annual basis or monthly instalments;
- ! a royalty fee to be paid at the end of every year, based on the recorded activity level for the year; usually a minimum activity level is stipulated on which the lower ceiling of the royalty is based (depending on the type of agreement, there may be a higher level or no limitation at all);⁹
- ! a schedule of payments for the acquisition of equipment and/or systems that are in place and will have to be transferred from the Port Authority to the winning bidder;
- ! proposed schemes for taking into account inflation (indexing scheme) and currency devaluation (possibly licence rental payments in a basket of currencies or in a specified hard currency).

118. To harmonize and facilitate the completion of the financial offer, it is customary for the Port Authority to include in the brief a compulsory format for the bidder to complete. An example of such a format will be presented in chapter 9, which covers the financial performance measures and methodologies for evaluating financial proposals.

7.2.4 Basic licence or concession agreement terms

119. The package of bidding documents should contain, in addition to the note on "Prevailing general conditions for the licence or concession", the basic clauses of the licence contract for a leaseholding or of the BOT-type concession agreement (whichever may be the case) that the Port Authority has the intention of negotiating and signing with the winning bidder. Because of their importance, the detailed content and the implications of various clauses, to be incorporated into these two documents, will be further discussed in chapter 8.

7.2.5 Criteria for the technical evaluation

120. The criteria for the technical evaluation will be determined by the type of facility offered and the operation that the Port Authority intends to promote. They have therefore to be specifically developed for each privatization project. It is, however, possible to present a general framework that can be used as a basis but needs adaptation and adjustment to make the criteria project-oriented. This model, applicable to tendering for a leasehold licence for existing port facilities, is summarized in table 2. It covers the essential elements that need to be scrutinized when considering the technical adequacy of a proposal.

⁹ A royalty assumes that the lease or concession is not based on the flat rate but on a minimax or a revenue-sharing formula.

121. The model criteria for the technical evaluation need each to be given a proper weighting. As this is dependent on the objectives set for each privatization scheme, it is not possible to present a generally valid weighting scheme. The following is, however, a characteristic marking formula for a tender relative to a major cargo-handling facility such as a container terminal:

Out of a total of a 1,000 marks:

1. bidder's corporate and financial corporate profile: 150 marks;
2. proposed business plan: 250 marks;
3. proposed corporate structure: 100 marks;
4. operating plan for the terminal: 150 marks;
5. capacity for investment in additional facilities, equipment and systems: 150 marks;
6. employment plan and mechanisms for transfer of know-how and technology: 200 marks.

122. Bids that pass the technical evaluation should score at least 800 marks in total and on each of the six headings not less than 70 per cent of the possible marks to be obtained. This is a solid safeguard that the proposal which is finally selected will adequately satisfy all operational and financial conditions. Furthermore, it is an effective safeguard that financial proposals that are artificially boosted but technically inappropriate cannot be declared the preferred submission (as unfortunately occurred in the case of a number of recent tenders).

123. Weights should be given in advance to main criteria, and to secondary and tertiary criteria as well. They can then be included in the "Conditions governing the submission of bids".

Table 2

Criteria for technical evaluation

Main Criteria	Secondary Criteria	Tertiary Criteria
1. Registered bidder's corporate and financial profile	1.1 Experience in managing and operating port facilities and services	1.1.1 Number of terminals
		1.1.2 Types of services
		1.1.3 Years of experience
		1.1.4 Shareholding in management and operating company
		1.1.5 Total throughput volumes handled in past three years
		1.1.6 Annual turnover
	1.2 Experience in other port management, operations and advisory projects	1.2.1 Number of terminals and projects
		1.2.2 Years of experience
		1.2.3 Share in operating company
		1.2.4 Total throughput volume handled in past three years
		1.2.5 Annual turnover
	1.3 Experience in the country inviting tenders for the project	1.3.1 Number of terminals and projects
		1.3.2 Years of experience
		1.3.3 Share in operating company
		1.3.4 Total throughput volume handled in past three years
		1.3.5 Annual turnover
1.4 Ongoing business world-wide	1.4.1 Number of terminals and projects	
	1.4.2 Countries/locations	
	1.4.3 Total throughput volume handled in past three years	
	1.4.4 Annual turnover	

Table 2 (continued)

Main Criteria	Secondary Criteria	Tertiary Criteria
	1.5 Share ownership	1.5.1 Adequacy of corporate structure 1.5.2 Main shareholders: ! nationality ! main line of business ! public/private ! local/foreign 1.5.3 Share of main shareholders in equity capital
	1.6 Participation of port users in corporation	1.6.1 Number and name of major shipping lines 1.6.2 Degree of participation of shipping lines in management 1.6.3 Number and name of major shippers 1.6.4 Degree of participation of major shippers in management 1.6.5 Number and name of multi-modal operators 1.6.6 Degree of participation of major multimodal operators in management
	1.7 Current financial position of bidder	1.7.1 Total equity 1.7.2 Total turnover 1.7.3 Net worth 1.7.4 Working capital 1.7.5 Cash flow in past three financial years 1.7.6 Net profit margin in past three financial years 1.7.7 Dividends paid out in previous three years 1.7.8 Invested amounts or participation in equity in past five financial years
2. Proposed business plan	2.1 Quality of proposed business plan	2.1.1 Level of realism in assumptions used 2.1.2 Level of substantiation 2.1.3 Guarantees provided and data confirmed 2.1.4 Degree of reliability 2.1.5 Time period covered 2.1.6 Level of technical and quantified detail
	2.2 Adequacy of stated management objectives	2.2.1 Degree of satisfaction of shipping lines' requirements 2.2.2 Degree of satisfaction of cargo owners' requirements 2.2.3 Degree of satisfaction of national transport needs
	2.3 Reliability of market demand forecast	2.3.1 Substantiation of vessel traffic forecast 2.3.2 Substantiation of cargo traffic forecast 2.3.3 Substantiation of predicted activity levels in facilities' handling systems
	2.4 Potential for attracting new business	2.4.1 Type and amount of expected new business 2.4.2 Significance of new business in terms of scale increase and use of available capacity 2.4.3 Guarantees of achieving expectations
	2.5 Expected financial performance	2.5.1 Soundness of cash inflow projections and revenue forecasts 2.5.2 Soundness of cash outflow projections and expenditures forecasts 2.5.3 Soundness of financing and funding plan 2.5.4 Soundness of financial performance prognosis

Table 2 (continued)

Main Criteria	Secondary Criteria	Tertiary Criteria		
3. Proposed corporate structure	3.1	Level of autonomy		
	3.2	Proposed degree of subcontracting		
	3.3	Functionality of the proposed structure		
	3.4	Capability of generating new initiatives		
	3.5	Capability of monitoring performance		
	3.6	Qualifications of proposed senior executives and key terminal personnel		
		3.6.1 Age		
		3.6.2 Education and degree		
		3.6.3 Relevant management and technical experience		
		3.6.4 Experience in similar projects		
		3.6.5 Experience in the country inviting tenders		
4. Operating plan for the facilities	4.1	Adequacy of operational arrangements	4.1.1	Overall operational arrangements for different types of port facilities (liquid bulk, solid bulk, neo-bulk, containers, ro-ro, non-containerized general cargo)
			4.1.2	Appraisal per facility of ship-to-shore, horizontal transfer, storage system and port-to-inland transport interface
	4.2	Scope for capacity upgrading	4.2.1	Additional equipment allocation
			4.2.2	Development of new management systems and controls
			4.2.3	Reorganization of labour and staff deployment
	4.3	Effectiveness of proposals to solve current problems	4.3.1	Quality of analysis of current situation
			4.3.2	Rationality of proposed improvements
			4.3.3	Reliability of envisaged results
	4.4	Upgrading of computerized systems	4.4.1	Quality of proposals for streamlining present system
			4.4.2	Scope of proposed extension of computerized system
			4.4.3	Effectiveness and timing of computer applications and EDI system
	5. Capacity for investment in additional facilities, equipment and systems	5.1	Evidence of financing capacity	5.1.1
5.1.2				Weight of local financial resources
5.2		Extent and quality of proposed investment	5.2.1	Scope of investment programme
			5.2.2	Standards proposed for new facilities and equipment
			5.2.3	Projected investment
			5.2.4	Investment period and timing
5.3		Proposed funding package	5.3.1	Proposed sources of funding
			5.3.2	Foreign exchange contribution
			5.3.3	Financial conditions for funding package
			5.3.4	Other conditions attached to proposed funding arrangements

Table 2 (continued)

Main Criteria	Secondary Criteria	Tertiary Criteria
6. Employment plan and proposed mechanisms for transfer of know-how and technology	6.1 General employment conditions	6.1.1 Wage and salary levels
		6.1.2 Career development prospects
		6.1.3 Bonuses, incentives and other fringe benefits
		6.1.4 Social security and medical coverage
		6.1.5 Proposals for streamlining workforce
	6.2 Coverage of human resources development schemes	6.2.1 Extent of coverage
		6.2.2 Numbers of staff and workers concerned
		6.2.3 Frequency of proposed training schemes
		6.2.4 Recruitment and promotion policies
		6.2.5 Career development schemes
	6.3 Employment of expatriate experts	6.3.1 Number and level of experts
		6.3.2 Duration and scope of assignments
		6.3.3 Expected contribution from foreign experts
		6.3.4 Probability of transfer of know-how
	6.4 Supplementary schemes	6.4.1 Number and duration
		6.4.2 Type and coverage
6.4.3 Expected outputs		

7.2.6 Criteria for the evaluation of the financial proposals

124. As in the case of the technical content, it is important for bidders to know how their financial proposals will be rated. The recommended procedure is therefore to explain, in the bidding documents, the intention of the Port Authority with respect to the financial proposals submitted. Chapter 9 will discuss the choice of criteria for these and possible alternative ways of assessing the merit of proposals that will generate revenue and expenditure flows at different times and in different amounts. It will also present a worked-out example of how to determine the true value of a licence or concession contract.

7.2.7 A set of standard forms for presenting the proposals

125. It is common practice to include as an attachment to the main bidding documents (or sometimes as part of the main documents) a set of standard forms to be completed by bidders. This practice has the advantage of standardizing the responses, clarifying and illustrating the instructions and facilitating the evaluation. Suggested standard forms include a special format for the following:

- ! acknowledgement of receipt of bidding documents;
- ! form for presenting the bidder's corporate profile;
- ! form for presenting the corporate profile of companies participating in a consortium bid;
- ! form for résumés of key personnel for the new company;
- ! form for presenting traffic and throughput forecast developed for and used in the business plan;
- ! form for the bidder's financial offer.

7.3 Evaluation of the proposals received and selection of the winning bid

126. The principal elements of the evaluation process have been discussed in previous sections dealing with selection criteria (section 7.1.2.4), criteria for the technical evaluation (section 7.2.5) and criteria for the evaluation of the financial proposals (section 7.2.6). The evaluation of the proposals submitted should proceed in a totally impartial, unprejudiced and unbiased manner. Because of the high stakes involved in major port privatization schemes (approximating the earning capacity of the facilities over the proposed licence or concession period) it is inevitable that the ultimate award decision and the proposal of the bidder selected will be scrutinized in detail. Apart from the precaution of including the clause quoted in section 7.1.2.5, whereby bidders implicitly accept the decisions of the Bid Evaluation Committee and pledge to refrain from any action in recourse, a transparent set of structured criteria and a sensible marking system will considerably reduce the risk of major disagreements and disputes.

127. The composition of the Bid Evaluation Committee is another contentious issue. Ideally, the committee should have a restricted membership. It should not have more than five or six members who amongst them share the necessary port management, terminal operation, civil and mechanical engineering and financial expertise to properly judge the qualities and insufficiencies of the various submissions. These subject-matter experts can come either from the Port Authority or from other national bodies responsible for port development matters in the country. There is great merit in appointing one or two expatriate experts to serve as benchmark evaluators. Although some Governments refuse this type of arrangement, it helps to dispel suspicions concerning the possibly biased viewpoint of experts who have too many links with the political authorities, and to eliminate the risk that partisan decisions will be made.

7.4 Negotiation and award of the licence

128. The last step in the tendering process consists of the negotiation phase and the final award of the licence. This is a highly critical period as the Port Authority and the bidder submitting the top-ranked proposal sit around the table and start the business of combining the Port Authority's stated minimum requirements for awarding the management and operation of the designated facilities with the bidder's proposed conditions into a balanced licence or concession agreement supported by the indispensable technical, financial and legal schedules. The negotiations will have a greater chance of a successful conclusion if, from the start, both parties accept that the agreement that should ultimately be signed by them, is the basis of a long-term partnership and is not a contract of submission between a dominant party and a submissive one.

129. Because of the nature and complexity of negotiations aimed at formalizing a leasehold licence or BOT-type concession, it is recommended that legal advisers and technical experts be present. Negotiation sessions should be short (possibly not more than one or two hours over a two- or maximum three-day period). The process is considerably facilitated if in advance of the negotiations:

- ! a time-table is established and approved by both parties; and
- ! for each meeting a detailed agenda is prepared and complied with.

130. In order to avoid indecision, procrastination and the danger of reopening issues previously agreed, the total time provided for concluding the negotiations should not extend beyond a period of three months. If the period is longer, there is a risk - in addition to the risks just mentioned - that the second highest bidder will lose interest or insist on a change in the terms initially proposed.

131. When the negotiations are finally concluded, both parties should jointly announce the outcome and publicly present the main terms of the agreement reached. This will greatly improve the transparency of the overall tendering process and, more significantly, give the right signals to major stakeholders (labour, Port Authority personnel, shipping lines, shippers and receivers) in the privatization process, of which the tender is an integral component.

Chapter 8

CLAUSES OF LEASEHOLD LICENCE AND CONCESSION CONTRACTS

132. The main outcome of the negotiation process will be the signing by the Port Authority and the successful bidder of a contract that will delineate the rights and duties of both with respect to a leasehold or BOT-type arrangement. This chapter will discuss the most relevant and critical clauses pertaining to a licence for a leasehold or to a concession for a BOT-type contract. For the principal clauses in these contracts it will consider their purpose and the strategic issues they raise. Where appropriate, sample clauses will be proposed. The first part of this chapter will concentrate on a licence for a capital leaseholding contract relating to an existing facility in which the bidder pledges to make new investments in the extension of the physical infrastructure and the provision of additional equipment and improved systems. In the second and final part of this chapter, clauses which are specifically relevant for concessions awarded on a BOT-type arrangement will be reviewed. Crucial for the proper understanding of the proposed clauses is that the principles, set out in chapter 6, will apply for both contract types.

8.1 Clauses of a licence contract for a capital leasehold

8.1.1 Preamble

133. In addition to identifying the parties to the agreement, the preamble provides a summary of the aims and objectives to be achieved through the agreement. It normally states:

- ! the date(s) on which the agreement is signed;
- ! the place of signing by both parties;
- ! the names of the parties to the agreement and any terms or expressions that will be used to refer to them in the contract;
- ! the general purpose of the agreement.

134. The *strategic issues* relate to the extent to which the aims and objectives of the agreement are specified as well as its scope. A *sample clause* will state that:

This Licence is made and entered into this ... day of ... of 19... . The [name of licensee and corporate status] (hereinafter the Licensee) agrees to use the ...[name of the facility], including leasing of certain premises and improvements as hereinafter more fully described, for the purpose of [general list of activities]. The [name of licensor and corporate status] (hereinafter the Licensor) for the consideration and on the terms hereinafter set forth does agree to furnish said [name of the facility] and provide certain services as hereinafter more fully described to the Licensee for the duration of this Licence Agreement . This agreement is made ... [purposes and objectives]..

8.1.2 Period of agreement and possible basis for renewals

135. The section dealing with the period of agreement states the date on which the agreement will take effect and the normal period for which it will be in effect (i.e. the duration of the leasehold licence). It is good practice to specify the various options that exist for the renewal of the agreement, indicating for each:

- ! the period of the renewed agreement;
- ! the number of times that the agreement can be renewed;
- ! which party has the option to renew the agreement;

- ! what sections or clauses of the agreement will be renegotiable or must be renegotiated at the time of renewal.

136. The principal strategic issue at stake here is the basic choice that is offered between a relatively short-term leasehold licence with options for renewal or a long-term agreement. The former is to be preferred if the required investment from the licensee is relatively small, as it then allows both parties to adjust their commitments to the realities of the markets they serve or wish to serve. Longer periods are not only justified but also indispensable where the licensee has to make substantial capital investments (i.e. where the level of privatization is very high). Such extended periods give the licensee sufficient time to recover the cost of the investment. Thus, in the latter case, periods of 25 to 35 years are quite commonly stipulated, although some experts have pointed out that these may be excessively long and that the private sector should and will recover its capital investment more quickly. Another argument in favour of somewhat shorter lease periods (e.g. 15 to 20 years) is that port facilities cannot easily be dedicated to a specific trade or business activity for very long periods of time.

Sample clauses

The leasehold licence is awarded and entered into for a term of [...] years, commencing on the ... day of ... in 19... and terminating at midnight on the ... day of ... in 19... .

The licensee shall hold a leasehold for a period of ... years. The effective date of this licence shall be on the first day of the first month immediately following the occurrence of the following events:

- *signing of the leasehold licence agreement by both parties*
- *signing of the lending documents for funding of the ... [nature of investment].by licensee and lending institution(s).*

Options are hereby granted to the licensee to extend this licence for ... successive and separate additional periods of ... years each after the expiration of the original term of this leasehold licence.

The options shall be exercised by written notice to the licensor at least ... months before the expiration of the original term or any extended term.

After receipt of the notice for renewal the parties agree to renegotiation in good faith with respect to the rental, royalty and other agreed payments.

If the parties are unable to agree within ... months after such notice then the option to renew this leasehold licence shall cease.

8.1.3 Financial and reporting obligations of the parties

137. The section defining the financial obligations of the two parties will specifically define the payments to be made by the licensee to the licensor. This section will usually include the licence fee itself, the schedule of rental and royalty payments, as proposed in the submission of the licensee's winning bid, as well as the amounts to be paid for the transfer of equipment and systems from the licensor to the licensee. Provisions for indexing and the type of index to be used will likewise be specified (e.g. the consumer price index or a labour cost index). The form in which and time at which payment must be received will also be specified. Because critical data with respect to the execution of the financial obligations (e.g. monthly or annual throughput) will be available only to the licensee, a special clause should be included stating the reporting requirement of the operator/licensee.

138. Various formats of the basic rental charge to be paid by the licensee to the licensor can be distinguished:

- ! a fixed annual amount;

- ! a schedule of escalating annual rental payments, but not linked to activity;
- ! a percentage of the licensee's gross earnings;

Additionally, a royalty schedule can be agreed on the basis of an increment for additional throughput, either with or without maximum throughput compensation (resulting in minimax leaseholds or revenue-sharing leaseholds).

139. Furthermore, this section will specify the liability of the licensee for payment of taxes associated with the licensed facility and its operation. If the Port Authority is required to pay taxes on the licensed property, the licence should clearly state what portion, if any, the licensee has to pay of these.

140. Four strategic issues come into play. First and foremost, there is the sharing of business risk incorporated in the rental and royalty structure. A fixed rental places all of the business risk squarely on the shoulders of the licensee, at least if the stated amount fully covers the total fixed and variable costs associated with making the facility available. A combined rental and royalty charge based on activity will allow for the sharing of the business risk between the licensee and licensor.

141. A second strategic issue is whether the activity charge will be levied through a charge specified in the agreement or as a percentage of the revenues collected under the agreed tariff. The former may present the opportunity for the licensor to receive an equal amount per extra ton or container handled or for the licensee to incorporate a declining handling rate, while the latter will automatically provide for any volume discounts that the licensee may offer his leading customers. In any event, the arrangement incorporated in the leasehold licence agreement should fully reflect the conditions of the licensee's winning bid.

142. The third strategic issue concerns the allotment of the financial obligations relating to the facilities (e.g. business taxes, property taxes and in some cases utility charges). Some of these should be borne by the licensor and others by the licensee. In order to avoid unnecessary wrangling during the licence period, it is important to specify in the agreement what distribution key will apply for allotting these charges.

143. The fourth and final strategic issue relates to the procedure for adjusting the rental charge and/or the royalties. For short-term agreements (up to five years) this may not be relevant, but leasehold licences are mostly long-term. Thus a procedure for escalation is required. The escalation is not only to counteract inflation but also to account for any changes, over time, in the value of the assets being licensed to the licensee and the changing value of the business which is transferred under the licence to the private sector.

Sample clauses with respect to the rental and royalty fees

The licensor shall bill and the licensee shall pay the following charges: the sum of ... yearly as rent for ... [facility].

or

The licensor shall bill and the licensee shall pay the sum of ... yearly as rent for ... [facility] and ... per cent of the estimated cost of rehabilitation.

or

The licensor shall bill and the licensee shall pay in accordance with the following schedule: up to ... [monetary units] for an activity level of ... [activity units].

or

The licensor shall bill and the licensee shall pay in accordance with the following schedule: ... [monetary units] in the first year, ... [monetary units] in the second year, ... [monetary units] in the third year [etc.].

or

The licensor shall bill and the licensee shall pay in accordance with the following schedule: the sum of ... [monetary units] as base rent and ... [monetary units] per [activity unit] per year as royalty.

or

The parties agree that the rates for the items specified above shall be adjusted by the licensee after each period of ... years of this licence on the basis of the change during the said period in the published price index and the appraised variance in the value of the licence.

Sample clauses with respect to payment schedule

All fees (rents) shall be payable by the licensee in equal instalments [quarterly, semi-annually] in advance, on the first day of the month, without prior written notice or demand, at ... [location for payment].

and

Failure to remit the above fees on their respective due dates shall render the licensee liable to the payment of interest on the due amounts at the rate of ... per cent for every month of delay and an additional penalty charge of ...

Sample clause with respect to reporting requirements

The licensee shall submit to the licensor within ... days following the close of each month a report setting forth ... [all data describing the level of activity and required to calculate the sums due].

Sample clause on taxes

If by reason of this licence, or if by reason of the use of the licensor's premises by the licensee as provided in this leasehold licence agreement, ... [specifically named taxes] should accrue against any land or buildings or improvements on the licensed facilities, then the licensee shall pay any and all such taxes prior to the same becoming delinquent.

or

The licensee shall pay, as additional rent, before the same becomes delinquent, any ... [specifically named taxes] that may hereinafter be imposed, during the term of this licence. Such payments are to be, at the licensor's option within ... days of receipt of the bill or directly to the appropriate agency or other authority imposing the same.

8.1.4 Location and type of assets

144. This section describes the area allocated to the licensee and the number and type of assets to be transferred to the latter for the period of the agreement. This section will be accompanied by drawings indicating the area being licensed, the exact location of the facilities, any other assets and a list of equipment to be transferred

to or to be operated by the licensee. A separate agreement (licence/purchase, sales/purchase) would have to accompany the licence agreement if assets such as equipment were to be transferred permanently to the licensee (e.g. sale of gantry cranes).

145. This section should, moreover, specify whether the licensee can build any new structures or modify existing structures on the site allocated to the licensee. Furthermore, it would assign responsibility for any additional assets to be acquired during the period of the agreement. This could become a complex matter to word if in the case of new structures or site development, the section covers the responsibilities for the design, approval of the design, construction and construction supervision (see in this respect the relevant references in the second part of this chapter dealing with BOT-type arrangements).

146. This section is central to the whole leasehold licence contract and brings up a major strategic issue: the extent to which the licensee will be responsible for any modifications, improvements and/or extensions to the site being licensed to him. As these developments will have an impact on the value and future utilization of the site, the licensor can insist on maintaining some level of control over design and implementation. How much control will be accepted by the licensee will depend to a large extent on the level of financial responsibility assumed by either party. If the licence is being used as a tool for privatization, it is to be expected that most of the funding will be coming from the licensee. The key issue then becomes “who is the owner during the leasehold period and at the termination of the leasehold licence?”

Sample clause on description

It is the intention of the parties that the licensee will be provided with a tract of land of hectares, hereinafter known as the “premises”, all as defined, described and indicated in the attached drawing marked “Exhibit No. ...” made a part hereof. The licensee accepts the premises as they are as of ... day of ... in 19... .

Sample clause on options for additional assets

The parties further understand and agree that if the ... hectares currently under leasehold licence to a third party should become available, the licensee shall have the right of first refusal of such new space, provided that the licensee gives notice of his intent to exercise the said right of first refusal within ... days after the said premises become vacant.

Sample clauses with respect to extensions or improvements

The licensee may make, or cause to be made, on the herein licensed premises such improvements as may be necessary or appropriate for carrying on his business, provided that no such work on the said licensed premises shall be undertaken without the licensee first having submitted the plans and specifications thereof to the licensor or securing the written approval of the licensor.

Sample clause with respect to funding of extensions or improvements

The parties agree that as a condition of the leasehold licence the total cost of any approved improvements and extensions will be fully paid by the licensee.

Sample clauses with respect to ownership of extensions

The parties further understand and agree that the ownership of the property and all extensions will at all times remain that of the licensor.

or

The aforementioned improvements and extensions that the licensee erects upon the leasehold premises in furtherance of the licensee's aforementioned business shall be and remain the property of the licensee, except as hereinafter provided; and have been constructed and installed without any claim for or right of reimbursement from the licensor for the cost or value thereof.

8.1.5 Limitation on the use of the facilities

147. This section will define the activities that can be performed on the licensed facilities and the type of services the licensee is expected to provide within the licensed area. Activities other than those directly related to the operation of the facilities (e.g. ship-to-shore cargo-handling, long-term or short-term storage, distribution activities) may be restricted so as to ensure the appropriate use of the land. For example, it would be preferable to insert a prohibition on the use of the facilities to construct and operate a shopping centre or a theme park. Also, certain types of cargo or services may be excluded from the facility. This may be in order to limit excessive direct competition by the new facility with the port's similar established facilities (which may have received an exclusivity right for a defined period of time). Alternatively, this may be in order to avoid the handling of certain products which are considered undesirable because they are too polluting, too dangerous or to be handled in specially reserved areas of the port. This section will also cover the requirement for a common-user and non-discriminatory treatment of the users of the licensed facilities.

148. The strategic issue at the heart of this section is encouragement of the proper use of the facilities and protection from inappropriate use or from the creation of port activities outside the intended scope of the agreement. Caution should, however, be exercised by both parties in drawing up this section, so as not to make it too restrictive. If it was made too restrictive, this could prevent the licensee from taking advantage of new and legitimate business opportunities. At the same time the commitment of the licensee with respect to open and equal treatment of all users likely to be served at his licensed facilities will need to be clearly stated.

Sample clauses on the type of activity

Under this leasehold licence agreement, the licensee shall provide coordinated port services within the licensed area (e.g. stevedoring, shore-handling, consolidation, warehousing) without prejudice to the other activities of the port or other port operators.

and

It is an essential condition of this leasehold licence that the said premises shall be used predominantly for [listing of specific functions] at all times.

or

The licensee shall use the premises only for [listing of specific functions] and operations supplemental thereto and shall not use the premises for any unlawful purposes.

Sample clause with respect to the promotion of the activities

The licensee understands and agrees to use his best efforts to promote and develop the business at the licensed facilities in order to achieve their maximum utilization as a [type of facility] and that he shall at all time give foremost consideration to this objective, consistent with sound business practices, in the manner of managing and operating the facilities and services, in the systems and methods being put in place and in establishing rates and charges.

8.1.6 Maintenance of facilities

149. The section dealing with the maintenance of the facilities will delineate the responsibilities of the Port Authority as licensor and of the operator as licensee for maintenance of the licensed facilities, including infrastructures, equipment and utilities. It will determine the responsibility for all planned maintenance and for remedial repairs and renewals. In most leasehold licence agreements, it is the licensee who is responsible for general housekeeping and for repairs where damage was caused by the licensee's negligence. With increasing levels of privatization, the maintenance and renewal of equipment becomes almost exclusively the responsibility of the licensee. In order to prevent careless behaviour or outright dismantling of the facilities, leasehold licence agreements will normally include a statement regarding the condition in which the facilities must be at the time of termination of the agreement. Furthermore, this section will contain a statement giving the licensor the right of access to the licensed property for the purposes of inspecting the condition of the facilities. A major maintenance activity to be included in this section is maintenance dredging alongside the berth and maintenance of the quay-wall structure. In the case of basic port structures and long-life assets the Port Authority often assumes responsibility for maintenance, because these assets will normally outlast the licence agreement period and will then become "the object" of another licence contract. In recent licence contracts the responsibility for these two maintenance activities is more frequently given to the licensee. He may, however, not have the experienced workforce or the necessary equipment and materials to carry out these tasks. The solution is then for the licensee to assume the responsibility but to subcontract these maintenance activities to the Port Authority, which is generally well equipped and has the competent staff to carry them out.

150. The primary strategic issue is to ensure that the party responsible for the maintenance has, at all times, an incentive for maintaining the facilities. To achieve this, it is best to assign the maintenance responsibility to the operating party, i.e. the licensee, because he is the first beneficiary of good programmed maintenance and safe operator behaviour.

Sample clauses with respect to the responsibility for maintenance

The licensee shall at all times keep the premises neat, clean and orderly. The licensor shall be responsible for all repairs and maintenance necessary to keep all structures and improvements upon the premises in good condition. The licensee will repair any damages caused by negligent or intentional acts or omissions of the licensee, his employees, agents or invitees.

or

The licensee, from the time of his occupancy of the facilities and until they are vacated by him, shall assume sole responsibility for the condition of the leased premises, as well as of any building and other improvements which may be constructed or placed on the premises during the term of this agreement.

or

The licensor shall have no responsibility whatsoever to perform any maintenance work on the herein licensed premises, except, however, for the remedying of any latent defects in construction which seriously impair the licensee's use of the said premises.

Sample clauses with respect to the cost allocation of the maintenance activities

The licensee shall repair, replace, rebuild and paint all or any part of the premises or of the facility which may be damaged or destroyed by the acts or omissions of the licensee or by those of his officers or employees, or of other persons on or at the premises with the consent of the licensee.

or

The licensee agrees to be responsible for and shall, at his own costs, risk and expense, perform and pay all costs of maintenance, repairs, renewals and replacements, whether attributable to use and operations or to the deterioration of materials, of the herein licensed premises and any equipment and facilities situated or to be situated thereon, so that at the termination of this licence and at all times during this licence, the same will be in as good condition as at the commencement of the licence, normal wear and tear excepted.

Sample clause with respect to the acceptance of property

The licensee acknowledges that his agents and employees have fully inspected the licensed premises and, on the basis of such inspection, the licensee accepts the licensed premises in their present condition as being suitable for the purposes for which they are hereby licensed.

Sample clause with respect to licensor's inspection of the property

In order that the licensor may carry out the obligations imposed by this licence agreement, by law, or otherwise, and to ascertain whether or not the licensee's covenants herein are being observed, the licensee agrees that the licensor shall have the right at all reasonable times to enter upon and inspect the therein licensed premises.

8.1.7 Responsibilities of the Port Authority with regard to the licensee

151. This section defines the responsibilities of the Port Authority as a party to the leasehold licence in addition to those stipulated with respect to maintenance. These will include overlapping responsibilities with regard to the movement of vessels and cargoes through the port as well as the provision of complementary general services and infrastructures such as construction and maintenance of breakwater(s), dredging of the entrance channel to the appropriate draught, provision of utilities, drainage, fencing, control of access, security and fire fighting. In addition, peaceful possession and the right of ingress and egress will be specified here.

Sample clause with respect to the provision of utilities

The licensor shall furnish and sell [water, natural gas, electricity] to the licensee in quantities adequate for the conduct of the licensee's business on the licensed properties and for other facilities, such as lighting, heating, fire protection or other purposes, provided the rates and charges therefor shall not exceed the lowest rates and charges furnished by the [public or private water, gas or electricity utility] for such quantities or at the lowest rates and charges at which the Port Authority as licensor shall furnish [water, natural gas, electricity] to any other user in the port.

Sample clause pertaining to peaceful possession

The licensor binds himself to cause the licensee to be maintained in peaceful possession of the above described premises during the licence period. Should the licensee be disturbed by any person or persons pretending to have a right to the licensed premises, or should the licensee be cited to appear before a court of justice having jurisdiction over the area in which the licensed premises are located to answer to the complaint of any person or persons claiming the whole or any part of the said licensed premises, the licensee shall call upon the licensor to defend him against such claims and the licensee hereby obligates himself to defend any such action at his cost, provided that this section shall not apply to trespassers.

Sample clauses pertaining to right of ingress and egress

The licensee shall have the right of ingress and egress between the premises and the city street outside the facility. Such right shall be exercised by means of such pedestrian and vehicular ways, to be used in common with others having rights of passage within the facility, as may from time to time be designated by the Port Authority for the use of the public.

or

The licensee agrees and understands that the licensor shall have the right of ingress and egress to the licensed premises for all business purposes. The licensee agrees that the [specified name of third parties], their employees and invitees, and all other persons authorized by the licensor shall have right of access across the licensed premises to [a stated location]. The licensee and licensor agree that where common-use tracks, roadways and channels are situated on the licensed premises, the licensee will maintain a [n]-metre right of way from the centre line on each side of the said track, roadway and channel to permit free and unencumbered passage.

8.1.8 Responsibility for setting prices and collecting revenues from port users

152. The section on the responsibility for setting prices and collecting revenues from the port users will determine on what basis the licensee will be allowed to charge the port users for the services he provides. The basic options are:

- ! The licensee is required to charge according to the published port tariff, a copy of which is then attached to the agreement; this is an option that should be ruled out because it inevitably leads to rate protection and rent taking;
- ! The licensee will charge the user a maximum as specified in the rates set out in the published port tariff but will be allowed to offer rebates and discounts; the rationality of this option depends on the reasons for and the basis upon which the rebates and discounts are calculated;
- ! The licensee is permitted (if he accepts certain rules to avoid monopoly pricing) to negotiate directly with individual port users (mainly the shipping lines) for setting specific charges.

153. This section will also determine the division of responsibility between the Port Authority and the licensee for collection of the charges billed to port users and for the allocation of revenues between the two parties.

154. This section thus deals with one of the most important strategic issues in the licence agreement, since it has a direct impact on the demand for port services. As a matter of fact, the basic choice is one between allowing the licensee to set his own price in competition with other providers (within the same port or within the same port range) of the same type of port services and regulating the prices set by the Port Authority or the Government to protect users from predatory pricing. The former approach is the only preferred one in a free market environment. It allows the licensee to be responsive to conditions in the market-place and to change the quality and type of service according to the price that the user is willing to pay. The licensee should, however, not be allowed to take advantage of any monopolistic powers and flagrantly raise the prices to be paid by the port users to exorbitant levels. The licensor can provide a simple protection against this risk by stipulating in the licence that the tariff rates as presented in the business plan will be the ceiling levels that can be charged (ex inflation).

155. If the licensee is allowed to set his own prices, another issue that can be raised is whether he will be allowed to use discriminatory and/or negotiated pricing or whether he will have to operate under a published tariff. Again the former is recommendable for the same reasons and arguments as those advanced to give him pricing freedom. In any event, the latitude given to the licensee for setting tariffs will also affect the value of the business. Since the value of the business is initially calculated on the basis of extrapolated revenues, based on proposed

tariff levels in the business plan, it is very much determined by the proposed prices and anticipated throughput levels. Likewise, it is determined by the process to be put in place for price adjustments as suggested in the business plan for that purpose.

Sample clause with respect to the setting of prices

The licensee agrees that the charges for his services rendered in connection with his operations on the licensed premises shall be competitive within the port and other competing ports having such facilities and services. The licensor shall, at all times, have the right to increase or decrease such charges and modify such rules and regulations, in accordance with sound business practices and provided that at all times, the charges shall not be more than the charges [stated by the licensee in the business plan of the submitted and selected proposal] or [published in licensee's tariff].

Sample clauses with respect to price regulation and review

The prescribed rates and charges collectable by the licensor for the services provided at the licensed property shall be subject to adjustment in accordance with the proposed pricing policy of the licensee, provided, however, that such changes or proposed increases in rates shall be considered only when the following conditions are present:

- ! when the adjustment is proposed after the first [n] years of the contract;*
- ! when the rate of the increase in the [consumer cost index, other index] has increased by more than [y] per cent;*
- ! when the last increase in rates was made more than [m] years prior to the proposed increase.*

and

In the event the licensor receives a charge or charges of discrimination on the part of the licensee in the operation of the licensed premises and the licensor, in his sole discretion, concludes after investigation that there are reasonable grounds to believe that discrimination has been practised by the licensee, then the licensee, upon written notice to him by the licensor, shall cease and desist from such practices and activities.

8.1.9 Exclusivity or right of franchise

156. This section indicates whether the licensee will be granted any protection from competition in the provision of specific services or the right to service specific markets, or whether he will possibly benefit from an exclusivity on the operation of the facility for a predetermined period of time. By limiting the rights on franchise or by not awarding an exclusivity, the licensor may be able to reduce the opportunities for monopolistic behaviour on the part of the licensee. Alternatively, the licensor can grant protection to the licensee from potentially destructive competition for a sufficient period of time to allow the licensee to recover aggregated investments made in the licensed facility (i.e. to give him the prospect of a reasonable pay-back).

Sample clauses with respect to rights of franchise and exclusivity

The licensee agrees that he shall not have the sole and exclusive right to maintain and operate a [specified port business] and to provide [specified port services] therefor in the port. The licensee acknowledges and agrees that the licensor has reserved and shall always have the right to grant, at the licensor's sole discretion, permits and assignments relating to other licensor-owned or administered lands and facilities to any other persons, corporations or firms.

or

The licensee shall be granted the exclusive right to [manage and operate a specified business] within the port for a period of [n] years beginning with the signing of this contract. Thereafter the licensor shall have the right to grant, at the licensor's sole discretion, licence permits and assignments relating to other licensor-owned or administered lands and facilities to any other persons, corporations or firms.

8.1.10 Standards of performance

157. This section will specify the performance requirements and raises the question how the licensor can avoid being too rigid or too vague in setting minimum performance standards. Because of the significance of the selected performance standards for the execution of the leasehold licence contract¹⁰ and the quality of the management, operation and maintenance of the licensed premises, chapter 10 will consider this issue in greater detail.

8.1.11 Liabilities of the Port Authority as licensor and of the operator as licensee

158. The section on liabilities of the Port Authority as licensor and of the operator as licensee will state the respective liabilities associated with the occupancy and use of the licensed site. These liabilities will mainly include:

- ! the cost of repair and replacement in the case of damage or loss to structures, equipment and systems located on the licensed site whether owned by the Port Authority or the licensee, caused by the negligence of either party;
- ! compensation for loss or damage to the cargo and damage to the vessels being served alongside the licensed site;
- ! the costs of compensation in the case of death or injury to employees of the licensee or the Port Authority resulting from activities at the licensed site;
- ! fines or clean-up costs because of pollution resulting from activities at the licensed site.

159. This section is also likely to state a minimum required insurance cover that the licensee must maintain to insure the Port Authority's facilities, equipment and systems against damage caused by the licensee as well as against other potential liabilities of the licensee as a result of the leasehold licence agreement. It will also consider the issue of insolvency and the need for the lessee to provide a performance bond.

160. The strategic issue here is the division of responsibility for liability in view of various relevant factors. One of these is the ownership of the assets that were damaged. The licensor, for example, can waive responsibility if the assets affected are owned by or provided as improvements to the site by the licensee. As pointed out earlier, with leasehold licences it is, however, unlikely that there will be a transfer of ownership from the Port Authority to the licensee. What is essential is that the licensor makes sure that he transfers the existing liabilities to the licensee for all those events over which he no longer has control, and moreover that he ensures full protection of his interests.

Sample clause pertaining to the repair of damage and destruction

The licensee agrees that he shall, at his own cost, risk and expense, promptly and with due diligence, repair, replace or restore or cause to repair, replace or restore any and all such property licensed

¹⁰ And also for the execution of the BOT-type arrangements.

herein which may become the subject of loss, damage or destruction, however caused and whether such loss, damage or destruction be partial or total.

Sample clause pertaining to liabilities to persons on licensed premises

The licensor shall not be liable to the licensee's employees, patrons or visitors or to any other persons for any damage to person or property caused by an act, omission or negligence of the licensee or his agents, employees or assigns; and the licensee agrees to indemnify and hold the licensor exempt from all claims; the licensee binds and obligates himself to undertake and provide, for and on behalf of the licensor, a proper defence of all such claims, whether asserted by suit or otherwise, at licensee's costs.

Sample clause pertaining to indemnification

The licensee agrees to indemnify, protect and hold exempt the licensor, his agents and employees, from and against all suits, actions, claims, demands, damages, losses, expenses and costs of every kind or description to which the licensor, his agents or employees may be subjected by reason of injury to persons, including death, loss or damage to property or any person, corporation or firm whatsoever in a manner due to, growing out of or connected with the occupation and use of the licensed premises by the licensee, his agents, employees, contractors, subcontractors and invitees, under this licence, unless caused by the negligence of the licensor, regardless of whether such suits, actions, claims, damages, losses, expenses and costs be against or sustained by the licensor, his agents or employees, or be against or sustained by others to whom the licensor, his agents or employees may become liable. Upon request of the licensor, the licensee shall undertake to defend, at his costs and expense, any and all suits brought against the licensor in connection with the matters specified herein.

Sample clauses pertaining to insurance

For the duration of this licence, the licensee shall at his own expense insure the installations existing or to be constructed thereon in favour of the licensor against loss or damages by fire in an amount not less than the total value of the improvements on the licensed premises.

or

The licensee shall procure and maintain throughout the term hereof, at his sole cost and expense, the following insurance policies with not less than the limits specified for each policy:

- ! general liability insurance issued by a responsible company and in such form as is satisfactory to the licensor for the protection of the licensee against any claims, suits, demands or judgements by reason of personal injury, including death, and for any claims of damage or losses occurring on the licensed premises or arising out of or as a result of the occupancy thereof by the licensee (the limit of liability shall be not less than [yyy] per occurrence for bodily injury and [www] per occurrence for property damage);*
- ! the operator's liability insurance shall be for the amount of at least [zzz] per occurrence;*
- ! other insurance as required by the law of [specified country].*

and

Proceeds from such insurance coverage shall be utilized to repair or reconstruct the installations damaged or destroyed with a view to having them restored to their condition immediately prior to the event which occasioned the loss or damage.

and

In the event that the licensee at any time refuses, neglects or fails to secure and maintain in full force and effect any and all of the insurance required under the terms and provisions of this licence, the licensor may if he so wishes procure or renew such insurance, and all amounts of money expended by the licensor in connection therewith shall be paid by the licensee.

8.1.12 Right to sublicense and subcontract

161. Another critical issue is the degree of freedom given by the licensor to the licensee to transfer the Port Authority assets to a third party under a sublicense. If this right is granted, for which the justification is generally complex, this section should indicate the conditions under which the licensor would approve such a sublicense.

162. Furthermore, a distinction should be made between sublicensing and subcontracting. Although most solicitations for the former are met by a refusal, the latter are generally accepted. Such acceptance is, however, conditional on the pledge by the licensee that he will remain the ultimate responsible party for the activities and/or services carried out by a third party but which the licensee is required to fulfil because they are obligations resulting from the leasehold licence agreement. The main purpose and justification of subcontracting is the need for the licensee to bring in expertise for activities where he feels another entity could be more efficient or competent. The licensor should therefore admit the possibility of subcontracting but may wish to incorporate in the licence agreement a safeguard by incorporating a clause to the effect that he has to approve the choice of major subcontractors and to attach the subcontracts as annex(es) to the licence agreement.

Sample clause with respect to the permission to sublicense

The term of this licence shall inure to the exclusive benefit of and be binding upon the successors and assigns of the licensee and licensor. The licensee may not assign or transfer this licence or any rights hereunder without the prior written consent of the licensor.

8.1.13 Additional laws and regulations

163. The section on additional laws and regulations is used to identify specific laws, by-laws and regulations for which it is desirable to clarify the licensee's responsibilities. The strategic issue here is whether by identifying the applicable laws and regulations to which the licensee is subject, the Port Authority will avoid liability for the actions of the licensee in violation of such laws and regulations.

Sample clause with regard to the legal jurisdiction

The parties agree that this licence was entered into in the [city, province, State] of [relevant country name] and that the laws of [name of country in which city, province, State are located] shall govern its interpretation and application.

Sample clauses with regard to the applicable laws

The licensee shall at all times conduct his business on the licensed premises in full compliance with local, provincial and national laws.

and

The licensee agrees to demand adherence to all of the above-mentioned laws, ordinances, rules and regulations with reference both to employees of the licensee and to all other persons entering the premises, who derive their right to be thereon from the licensee.

8.1.14 Early termination and penalties for possible contract violations

164. This is another substantial section, since it specifies the conditions under which the licensee shall be considered to be in violation of the fundamental terms of the agreement so that termination is justified. These conditions would include non-payment of rentals and royalties, bankruptcy, transfer of ownership of the licensee and consistent failure to meet performance criteria. The section would self-evidently include penalties which can be levied by the Port Authority on the licensee for violation of the terms of the agreement together with the procedure for collecting these amounts. This section could also specify the conditions under which an early termination of the licence agreement will be permitted by mutual agreement, including the possibility for the licensor to buy back the licence through a combination of payments and/or exchange of the premises with comparable facilities.

165. Several strategic issues come to the fore with respect to this section. Effectively, the best protection against contract violations is the careful design of the licence agreement so as to ensure that both parties are well served by the terms and conditions, and that the potential exists to renegotiate whenever external market conditions so demand. Although penalty clauses are usually incorporated in a licence agreement, they are difficult to apply and the amounts are expensive to collect because of the delays and the cost associated with litigation. Where violations occur the licensee is often no longer in a position to pay the penalties. In all cases, it is therefore preferable to have a mechanism built into the licence agreement that will allow both the termination of the licence, if deemed inevitable by either party, without excessive waste of time and effort, and the payment of the penalty (for the latter, for example, the payment of a performance bond). The section dealing with default will also specify a series of clauses dealing with specific legal aspects, such as the “cumulative remedies clause”, “condemnation clause” and “insolvency clause”. Much attention is generally focused on specifying the responsibilities (or lack of) in case of *force majeure*.

Sample clauses pertaining to default

This licence is made upon the condition that the licensee shall perform each and every one of the covenants and agreements herein set forth to be performed by him; and/or the licensor upon giving [n] days' notice in writing of any default, and if such default or lack of payment be not fully rectified within [m] days following the mailing of such notice, then at any time thereafter and without any further notice or demand, shall declare all or any part of the remaining instalments of rent to be paid as herein agreed to be immediately due and payable.

and

Upon termination of this licence in the event of default, the licensor shall have the right to enter upon the licensed premises and take possession thereof, and to bring suit for and collect any rents or other payments or obligations which may have accrued up to the time of such termination and re-entry.

Sample clause pertaining to events constituting default

The following shall constitute events of default hereunder:

- ! if at any time any rental and royalty payment, charge, lien, penalty or damage herein specified to be paid by the licensee, or any portion thereof, shall be in arrears and unpaid for a period of [n weeks, months];
- ! the licensee shall fail to perform any of the covenants or agreements herein provided to be carried out or performed by the licensee, other than the payment of monies as aforesaid, for a period of [n weeks, months];
- ! if the licensee shall be adjudicated bankrupt or shall be insolvent;
- ! if the licensee assigns or sublicenses the premises or any portion thereof without the written consent of the licensor;
- ! if the licensee fails to provide the necessary repairs and maintenance commitments as provided herein;
- ! overcharging of rates or collection of fees other than those prescribed and authorized herein;
- ! change of control arising from the sale, assignment, transfer or other disposition of capital stock by the licensee;
- ! repeated failure by the licensee to provide adequate port services in conformity with the performance standards provided herein;
- ! if the licensee through any of his corporate officers and officials and/or employees, by taking advantage of their free access to port premises and the vessels calling at the port, engages in or knowingly fails to take action to prevent [listing of specific illegal activities].

Sample clauses with respect to penalties

The parties understand and agree that in the event the licensee prematurely cancels this licence then and in such event, the licensee will be liable and will pay licensor [amount of penalty, such as one or several months of rental]. In case it becomes necessary for the licensor to employ an attorney at law for the purpose of collecting any of the rent or royalties stipulated in this licence or to enforce any of the provisions hereof, the licensee agrees to pay a reasonable attorney's fee, whether suit be filed or not.

or

The licensee agrees to pay the licensor liquidated damages not exceeding one year's licence fee in the event of violation or of non-compliance with the terms of the licence agreement that results in the cancellation or early termination of the agreement.

Sample clauses pertaining to force majeure

Neither the Port Authority, the licensor, nor the licensee shall be deemed to be in violation of this agreement if they are prevented from performing any of their obligations hereunder by reason of strikes, boycotts, labour disputes, embargoes, shortages of material, acts of God, acts of the public enemy, acts of superior governmental authority, weather conditions, tides, riots, rebellion, sabotage or any other circumstances for which they are not responsible and which are not within their control, provided, however, that this provision shall not apply to failures by the licensee to pay the rentals specified in this agreement and shall not apply to any other charges or money payments.

or

Except for strike, riot, act of God or any act or state of war or public emergency or government regulations, no abatement, diminution or reduction of the rent or other charges payable by the

licensee shall be claimed by or allowed to the licensee for any inconvenience, interruption, cessation or loss of business or other loss caused, directly or indirectly by any present law, rule, requirement, ordinance or regulation.

and

The licensee or licensor (whoever claims force majeure) shall bear the burden of proof that force majeure was not caused or contributed to by negligent or wrongful acts, loss and/or omissions of the licensee or licensor.

Sample clauses with respect to a performance bond

The licensee will provide a bank guarantee or letter of credit conditioned to guarantee performance of all of the terms hereof and in a form acceptable to the licensor, in the amount of [to be specified]. The bond amount will be changed as a result of rental adjustments provided for herein.

or

The licensee shall within [n] days from the signing of this licence submit a Performance Bond in the amount equivalent to [x] per cent of the [annual rent or other fees] which shall answer for and guarantee the full and faithful compliance by the licensee with each and every condition of the licence stated herein. The Performance Bond shall not, however, preclude the licensor from recovering the full value of the damages, losses or injuries the licensor may sustain as a result of the non-performance by the licensee.

8.1.15 Conditions for normal termination

166. The section on conditions for normal termination will specify the disposition of assets to be transferred to the licensee at the time of the termination of the agreement. This may typically include a requirement that the site be returned to the port in its original form, in which case the licensee shall be responsible for removing and demolishing any structures added to the site. With respect to equipment, this section may specify who has the right to retain each of the major pieces of equipment.

167. The key strategic issue here is to decide how the assets can be best used following termination of the licence agreement. This is not an easy task, and the longer the duration of the agreement the more difficult it is. It is now standard practice for equipment to stay with the licensee at the termination of the contract (it avoids the problem of the licensee running down the equipment during the final years of the licence). Basic infrastructures will be returned to the Port Authority in their original condition or possibly with improvements. The latter makes sense, as the facilities may have realized an added operational value and it would cost an inordinate amount of money to restore the facility to its initial but inferior condition. In addition, this section will contain clauses providing for a final survey and a right of seizure if upon termination the licensee or any of his officials or employees continues to occupy the premises.

Samples clause for right of ownership and condition of property surrendered

The parties understand and agree that unless otherwise agreed to in writing, the licensor retains all rights, title and interest in any improvement that has been made by the licensee to the premises.

and

Licensee shall surrender the premises (and all structures and improvements thereon) in good condition and repair at the end of term in the same good order and condition less normal wear and tear as when originally received from licensor at the commencement of this licence.

8.1.16 Contract enforcement and arbitration

168. The final section of the licence agreement sets out the conditions under which waivers and amendments can be introduced. Other clauses in this section may determine the general role of the licence document and the licensor's notification requirements with regard to matters relating to the licence. In addition, this section will specify the procedures for arbitration of disputes and identify who will be called on to mediate disagreements regarding the terms and conditions of the agreement.

169. No agreement is perfect and the longer the agreement is in force, the less suitable it will be for prevailing conditions. A licence agreement is rarely signed for a short term. Most licences, as explained in previous chapters, will have a duration well in excess of ten years. It is therefore advisable to allow for a limited number of modifications to accommodate changes in the market-place and the changing role of the port in this market-place. Of course, it is necessary for any allowances for amendments and waivers to be drafted in such a way that no self-serving or trivial changes are introduced. As for the method for enforcement and arbitration, this should be a mechanism not only for enforcing the contract but also for avoiding early termination or unsatisfactory performance by the licensee. Hence, the process should be fair, impartial, simple and quick so that the activities performed under the licence agreement will continue with as little disruption as possible. Finally, the licence agreement commonly concludes with two precautionary clauses: one with respect to "illegality" and one concerning the "entire agreement".

Sample clauses with respect to arbitration

In the event of a dispute between the parties as to payment or other charges or other matters arising out of this licence, the parties may appoint a mutually agreed upon arbitrator to resolve the dispute. The parties agree to abide by the final decision of the said arbitrator.

or

If any dispute or difference shall arise between the licensor and licensee touching on any matter or thing whatsoever herein contained or in any way connected with this licence or the rights, duties or liabilities of any party arising hereunder then and in every such case the dispute shall be referred to arbitration in the city of [to be named] within 30 days of the receipt of notice of any dispute and the arbitration will be conducted by three arbitrators, one to be appointed by each party and the third to be appointed by the two arbitrators appointed by the parties.

Sample clause regarding amendments

The licence may be amended from time to time provided the licensor and licensee mutually agree to such amendment and the amendment is stated in writing, executed by both parties and attached to the original executed copies of this licence.

Sample clauses pertaining to waivers

Any waiver at any time by either party of any of the terms, covenants, provisions and conditions of this licence or these general licence conditions shall not be construed to be a waiver of any other terms, covenants, provisions and conditions hereof or a waiver of any breach or default other than that specifically waived.

and

The licensor's failure at any time to compel a fulfilment of any one or more covenants or agreements contained in, or to exercise any one or more of its rights or remedies under this licence shall not be construed to be a waiver of the licensor's right thereafter to enforce any such covenant or agreement, or to exercise any such right or remedy.

and

No waiver by the licensor shall be deemed to have been made unless expressed in writing and signed by the licensor.

Sample clause on "illegality"

If any provision of this licence is held to be illegal or invalid under present or future laws or regulations effective and applicable during the term of this licence, such provisions shall be fully separable and this licence shall be construed as if such illegal and invalid provision had never comprised a part of this licence and the remaining provisions of this licence shall remain in full force and effect and shall not be affected by the illegal or invalid provision or by its severance from this licence.

Sample clause stipulating the "entire agreement"

This licence contains the entire agreement and understanding between the licensor and the licensee as to the subject matter thereof and merges and supersedes all prior agreements, commitments, representations, writings and discussions between them. This contract may not be changed, modified or supplemented in any way except by an instrument in writing executed by the licensor and the licensee.

8.2 Clauses of a BOT-type concession agreement

8.2.1 General considerations

170. Concession contracts to underpin BOT-type agreements will normally contain a number of clauses which are virtually identical to those constituting the framework of a leasehold licence contract. Others will be similar but will have to be adapted to suit the specific conditions created by a BOT scheme and satisfy the particular requirements which this type of arrangement imposes. Finally, a third group of clauses in a BOT concession contract are designed to adequately deal with the unique understanding between grantor and grantee concerning the two essential components of a such a arrangement: "building" the facilities and transferring them at the end of term of the contract.

171. Typical of a BOT agreement are also the numerous appended schedules which contain the detailed arrangements for the construction, operation and transfer of the facilities to be managed under the concession.

172. The first group of clauses are those identical to the ones in the leasehold licence contract. They will of course still need to be drafted with the characteristic circumstances of the BOT agreement and the distinctive location and nature of the facilities in mind. They normally cover the following issues:

- !** **liabilities of the Port Authority as grantor and of the private operator as grantee** with special emphasis on peaceful possession, right of ingress and egress and provision of utilities;
- !** **insurance** identified in the BOT agreement and detailed in an appended schedule;

- ! **force majeure** with respect to the grantor and grantee as affected parties;
- ! **applicable law and dispute resolution** with possible provisions for conciliation, arbitration, expert determination and continued performance during negotiations to resolve the dispute.

173. The second group of clauses, although similar to the clauses in leasehold licences, will require careful consideration in view of the adaptation required. Such adaptation needs to reflect the characteristic attributes of the BOT project and concerns in particular relating to the following:

- ! **terminal and/or port services** that are provided by the grantee (i.e. the enumeration of all functions and services to be made available by the latter) and are often broader than in a standard leasehold licence;
- ! **performance measuring and monitoring**, which is likely to be on a macro level but may, in the event of a lack of corrective action or failure to remedy the inadequate performance, have far-reaching consequences, including the early termination of the concession (and the resulting difficulty for the grantor in ensuring under the best possible conditions continuity of the activity);
- ! **responsibility for tariff setting and collecting revenues**, providing for full tariff setting autonomy under specified anti-monopoly conditions and mostly full revenue collecting responsibility for the grantee;
- ! **financial obligations, in particular the payment of rents and royalties** with levels adjusted to take full account of the considerable initial investments by the grantee;
- ! **right or refusal to subcontract** the concession to a third party (in most contracts the grantor will stipulate the unacceptability of the grantee's subcontracting his concession rights);
- ! **duration of the agreement and renewal**, specifying terms of 25 years and over (possibly offering periods of in excess of 35 years if the base investment level is huge - e.g. in excess of US\$ 100 million) and including the provision of basic common port infrastructures (such as breakwaters and channel dredging), not allowing in general a renewal of the concession but rather conversion into a leasehold;
- ! **exclusivity rule**, which will tend to offer a greater guarantee to the concessionaire than under a leasehold agreement by stipulating for example that the grantor will refrain from having an interest as a promoter or having some significant ownership or financial capacity (as a developer or as a provider of management) in any facility in the port or outside that would be a competitive threat to the grantee's facility provided under the BOT concession. This restriction will generally apply until precisely described events occur, such as the lapse of a defined period of time or the attainment of a mutually agreed occupancy or utilization level;
- ! **limitation on the use of the facilities**, which needs to be specially construed in order to avoid the risk (greater than in the case of a leasehold) that the vacant land given in concession will be used for other than intended purposes;
- ! **employment conditions** specifying protective measures in favour of the currently employed grantor's labour and staff and/or minimum conditions of employment;
- ! **maintenance levels**; these will tend to be similar to those in a leasehold licence but will possibly include more stringent terms to respond to the effects of the longer-term nature of the agreement, the fact that the responsibility for building has been that of the grantee and that the grantor will expect to operate the facility for a number of years after the transfer at the end of the concession;
- ! **early termination clauses and procedures**; these will cover occurrences leading to early termination by the grantor or the grantee and possible termination compensation. The effects of early termination in the case of a BOT project are bound to be very serious (even more serious than in the case of a leasehold licence) and the concession contract should therefore clearly spell out the termination procedure and clarify the accessory effects concerning the ceasing of rights, the transfer of assets and the payment of employees.

8.2.2 Clauses specific to a BOT-type arrangement

174. The BOT-type concession agreements will principally differ from leasehold licences with respect to five major topics:

- ! scope of the project;
- ! asset transferral;
- ! design and construction;
- ! lenders' security;
- ! hand-back or transfer at normal termination.

175. In this section these topics will be considered in turn, the resulting strategic issues discussed and sample clause(s) proposed.

8.2.2.1 Scope of the project

176. In the preamble to the concession contract, the scope of the project and the related aims and objectives need to be clearly specified. What are the exact rights awarded by the grantor to the grantee and what obligations does the latter take on? Because of the numerous strategic implications of these clauses, their wording will inevitably determine the substance and the particulars of the concession.

Sample clause of a concession

Subject to the provisions of this BOT contract, the concessionaire shall have the right and the obligation to finance, design, construct, equip, test, commission, operate and maintain the [name of site/facility and/or description of the facilities].

8.2.2.2 Asset transferral

177. The characteristic that distinguishes BOT-type arrangements from any other privatization schemes is the provision of facilities to be financed and constructed by the concessionaire. But this also leaves the possibility that assets, mainly land but also existing infrastructures or equipment, will be transferred by the grantor. Hence, the clauses regarding asset transferral are of particular importance. Moreover, they will establish the right of the grantor to collect a rent (because a site lease will then be agreed) or receive a compensation (for the take-over of the existing infrastructures and equipment). For the grantee the clause is significant, as he will expect to develop the BOT project on whatever asset transferral is agreed. Thus he needs the pledge that the agreed and mostly indispensable assets (such as the land) will be provided by the grantor and that he will have the required access.

Sample clause regarding the provision of "land"

On the effective date of the BOT contract:

- (a) *the Port Authority as grantor and land owner and the private operating company as concessionaire shall enter into the "Land Lease" (the lease of the land constituting the concession area)*
- (b) *the Port Authority and the concessionaire shall enter into the "Terminal Access Agreement".*

Sample clause regarding the transfer of existing infrastructure and/or equipment

On the effective date of the BOT contract, the Port Authority as grantor shall transfer, and the operating company as concessionaire shall accept the transfer, of [specify the infrastructure and/or

equipment currently located at or on the site of the proposed BOT development project] on the following terms and conditions:

- (a) *the price for the [infrastructure and/or equipment] will be its [replacement value, market value or any other retained value] at the date of transfer, determined by an expert, in the absence of a mutually satisfactory agreement by the parties within 60 days preceding the anticipated date for the start of the first phase of the construction works;*
- (b) *the [infrastructure and/or equipment] shall be transferred to the concessionaire in its current state and condition, without any express or implied terms, conditions or other assurances as to merchant ability and fitness for purpose;*
- (c) *title to the [infrastructure and or equipment] shall be transferred by the grantor for the concession period;*
- (d) *responsibility for any transfer taxes shall be for [as agreed either grantor or concessionaire].*

8.2.2.3 Design and construction

Functional requirements and design solution

178. In a BOT concession contract, the clauses regarding the design and construction of the facilities are of supreme significance. Indeed, they will have to satisfy the grantor (and the political interests backing the scheme) that the facilities to be built will meet the functional criteria and will be designed and constructed in full accordance with the best practices of the day and meet internationally agreed standards and codes of practice. The BOT facilities should serve their purpose not only during the concession period, but also within a specified life period for which they are supposedly designed (and which in most BOT projects exceeds the concession term).

179. The principal strategic issue at stake here is the choice left to the grantor between two extreme positions with respect to the responsibility for design and construction. On the one hand, he can extensively specify in detail the nature, type and extent of the civil works; on the other hand, he can be satisfied by nominating performance levels of specification only. If the grantor was the developer, procuring the civil works, the detailed designs and specifications would without question be prepared. Alternatively the grantor could go for construct or turnkey methods of procuring facilities. In the case of a BOT it is as if the grantor awards such a turnkey project to the concessionaire, although it is embodied within a complex BOT agreement. From the foregoing, it may thus be concluded that a performance-level brief could be fully satisfactory, assuming that a clear statement of purpose of the facilities is given, together with a framework of best practice for design, materials and workmanship codes. The situation regarding plant procurement in a BOT project is quite different and generally much simpler. In most cases this procurement will proceed on the basis of a highly detailed performance specification only. The main reason for this is that advanced port handling equipment is now almost always built to order. Only smaller equipment is bought “off the shelf”. Thus a major effort will be required, on the part of the concessionaire, to write the detailed specifications for interested manufacturers and subsequently evaluate the equipment tenders submitted.

Sample clauses for functional requirements

*The concessionaire shall design and construct the facilities to comply with the functional requirements of the grantor set out in schedule No. x (the “**Functional Requirements**”).*

or

The principal objective of the facilities to be constructed at [proposed location] is that they will be recognized by potential users over the next three decades as a world-class modern port terminal, the main function of which is to be a nodal point in an international transport structure for [indication

of type of traffic, e.g. liquid bulk, solid bulk, containers, ro-ro]. It is expected that such status will be achieved and maintained by virtue of state-of-the-art infrastructure and plant.

Sample clause with respect to the design solution

Without affecting the concessionaire's obligation under the preceding provision regarding the functional requirements, the concessionaire shall comply with the design and construction methods described in schedule No. y (the "Design Solution") and the concessionaire represents, warrants and undertakes that:

- (a) *the design solution satisfies the functional requirements;*
- (b) *each item of the facilities (including fixtures, plant and other assets) will be fit for its respective purposes.*

Sample clause with respect to the design development

The concessionaire shall complete the detailed design for the facilities so as to comply with the construction programme as established in the time-table for design completion.

Design of the interface(s) and other aspects of design

180. Of particular importance in the design solution are the provisions for the **design of the interface(s)**. This is another critical strategic issue. Indeed, interface design problems are likely to arise with neighbouring developments and operations (most likely between the Port Authority as landlord of the neighbouring facilities and the concessionaire of the BOT scheme). It is therefore essential to try to incorporate within the concession contract instruments to promote compatible and harmonious coexistence. The interface design problems that thus need to be solved may include:

- ! near-boundary constructions which may adversely affect the neighbouring activities and therefore require prior consultation (for example, with respect to paving levels, drainage, fencing, incompatible activities, obligations for maintenance of the interface);
- ! design and routing of aboveground and underground utilities;
- ! replacement or reallocation of existing infrastructure currently within the concession area;
- ! access to and through the facilities of the neighbouring parties.

181. The most appropriate way of solving the above problems is to include a clause in the BOT contract that will ensure the full briefing of the Port Authority in its capacity as grantor of the interface designs. Because the construction responsibility falls on the concessionaire, the grantor's approval is in most BOT contracts not required.

Sample clauses with respect to interface design

*The concessionaire shall submit to the grantor, for review, **all interface design data** (i.e. data concerning the parts linking the facilities with the rest of the port), including all calculations, designs, design information, specifications, plans, programmes, computer software, drawings, graphs, sketches, models, samples and mock-ups.*

and

If in the grantor's opinion, any interface design data do not comply with the requirements of this contract, he shall be entitled to require the concessionaire to amend the relevant interface design data

so as to comply with those requirements, and the concessionaire shall make those amendments as soon as possible, and in any event so as to comply with the construction programme. Any dispute whether the interface design data comply with these provisions shall be determined by an external expert

Sample clause with respect to other aspects of the design

The grantor shall be entitled to monitor the development of other aspects of the design for facilities and the concessionaire shall provide him with all relevant design data promptly on request and consult with the grantor concerning such design data and answer all the relevant questions concerning the design data. The concessionaire shall not be obliged to obtain the grantor's approval of any such design data, but the concessionaire shall give due consideration to any comments which the grantor may make. Any comment or approval which the grantor may give concerning the design data shall not affect the concessionaire's responsibility to comply with the provisions concerning functional requirements as stipulated in this contract.

Design flaws

182. Another difficult issue is the possible occurrence of design flaws and the resulting non-execution and non-respect of the construction schedule. The grantor needs to be protected from the consequences of such an event and should therefore insist on including in the BOT contract pertinent clauses to neutralize, alleviate or remedy the effects of design flaws.

Sample clause with respect to design flaws

If the concessionaire becomes aware of any failure to comply with the provisions regarding the design and construction of the facilities, he shall

- (a) immediately notify the grantor of the fact and provide reasonable details of the breach;*
- (b) as soon as reasonably practicable, provide the grantor with a written statement:

 - (1) giving a full explanation for the reasons for the breach and, if appropriate, for any delay in providing notification;*
 - (2) describing in full the measures which the concessionaire proposes to adopt in order to rectify the breach and/or to prevent or mitigate the consequences of it (if any);*
 - (3) assessing the effect of the breach on the construction programme;**
- (c) where the concessionaire considers that it is impossible for him to comply with the provisions of clauses regarding design and construction, a full statement of his proposed variation to those provisions, including detailed specifications, cost estimates and effect on the construction programme.*

Variations in the requirements

183. It is quite possible that after approval of the design of the facilities and the signing of the BOT contract, the concessionaire will request variations or alterations to the submitted construction plans. It is recommended that in such an event the grantor have the power to accept or refuse the proposed changes.

Sample clause with respect to proposed variations in the requirements

The grantor shall have an absolute discretion to decide whether to accept any application for a variation in the requirements of this contract, and any acceptance may be made conditionally or unconditionally.

184. Permits for construction will undoubtedly need to be obtained. The difficulty here is that it may not be a simple matter to identify which permits are required. In some cases, permits are created as a way of ensuring the necessary spin-offs to local administrations or other agencies issuing permits. Although it is customary for the grantor to assign full responsibility for identifying and obtaining permits to the concessionaire, there is a good reason to opt for an alternative solution. This could be one in which the grantor is responsible for identifying the permits needed and the concessionaire for obtaining them.

Permits

Sample clause with respect to permitting

It is the sole responsibility of the concessionaire to identify, obtain and maintain all consents.

or

It is the responsibility of the grantor to identify the required permits and for the concessionaire to obtain them and maintain all consents.

185. In accordance with the principle that in a BOT scheme the responsibility for design and construction lies solely with the concessionaire, it is good practice for the grantor to include a series of clauses aimed at clearly defining the obligations of the former with respect to the preliminary inspection of the concession area in order to ascertain the condition of the area, the adequacy of rights of ingress and egress, the risk of interference by third parties and the need for precautionary measures.

Concession area conditions

Sample clause with respect to concession area conditions

The concessionaire shall be deemed to have inspected the concession area and its surroundings, including the land which is subject to the "Terminal Access Agreement" (and, where applicable, any existing structures or works on, over or under the concession area and its surroundings), and to have satisfied himself as to:

- (a) the nature and extent of the conditions of or affecting the concession area (including climatic, hydrological, ecological, environmental, geo-technical, seismic and archaeological conditions), the ground and the subsoil, the seabed, the geographical area and nature of the concession area and the risk of injury or damage to property affecting the concession area, the nature of the materials (whether natural or artificial) to be excavated, and the nature and extent of the design, work and materials necessary for the execution of the works;*
- (b) the adequacy of the rights of access and egress to and from the concession area and movement within the concession area and any accommodation he may require for the purpose of fulfilling its obligations under this contract, including the need for any additional land or buildings outside the concession area;*
- (c) the possibility of interference by persons of any description whatsoever (other than the grantor) with access to or use of, or rights concerning, the concession area and its surroundings, including adjacent land owners;*
- (d) the precautions, times and methods of working necessary to prevent any nuisance or interference, whether public or private, being caused to any persons whose interests may be affected by the performance of the concessionaire's obligations under this contract.*

Building contract

186. The autonomy and full responsibility of the concessionaire are as a matter of course applicable with respect to the building contract. The grantor will insist on giving his approval only with respect to any stipulation that relates to the assignment of the facilities to the grantor at the end of the concession or to the implementation of the “Collateral Warranty” provisions (given as development security).

Sample clause with respect to the building contract

The concessionaire shall have the right to, and responsibility for, selecting the builder and agreeing the provisions of the building contract, without the approval of the grantor, except that the grantor’s approval shall be required for:

- (a) *the provisions of the building contract;*
 - (i) *enabling its assignment to the grantor upon termination of this contract; and*
 - (ii) *enabling the implementation of the “Collateral Warranty” (warranty from the builder in favour of the grantor)*
- (b) *the provisions of the “Collateral Warranty” from the builder.*

Not surprisingly, the grantor will place much emphasis on the faithful and timely execution of the construction programme and to all intents and purposes will take the necessary precautions in the BOT contract to ensure that the milestones as defined in the construction schedule are maintained, even if this requires the implementation of contingency plans.

Construction programme

187. The clauses pertaining to the construction programme will usually impose an obligation on the concessionaire to proceed with the works so as to meet each milestone date. If it will not be possible to comply with the established construction programme, clauses will be inserted in the contract to oblige the concessionaire to inform the grantor and give the reasons for the delay as well as set out possible contingency plans.

Sample clauses with respect to the construction programme

The concessionaire shall ensure that the works are carried out:

- (a) *according to the construction programme; and*
- (b) *so that the achievement date for each milestone shall occur by the relevant milestone target date.*

and

The construction programme may not be varied without the prior approval of the grantor. Any such approval shall be without prejudice to his other rights under this contract.

and

If the actual progress of the works is not in accordance with the construction programme, then the grantor shall be entitled to require the concessionaire either:

- (a) *to submit to him a report identifying the reasons for the delay; and/or*

- (b) *to prepare and submit to him proposals for a revised construction programme, showing the manner in which the works shall be carried out and the time necessary to ensure that each milestone achievement date shall be achieved by the relevant milestone date.*

Progress reviews

188. Proper control of the progress of construction is essential for the grantor to ensure that the quality of the works is consistent with the agreed specifications and standards, and that milestone target dates are maintained. The most effective way of controlling progress is to provide in the concession contract the obligation on the part of the concessionaire to submit “progress reviews” and to nominate a “construction observer” (i.e. a person or corporate entity specializing in the business of port civil engineering construction supervision). The principal duty of such an observer is to safeguard the interests of the grantor. But for the “construction observer” to act as a certifier of compliance, the assent of the concessionaire will be required for his appointment. This should be not likely to be withheld and is not often a serious obstacle (engineers also often act as design adviser for a client and contractually as construction engineer).

Sample clause with respect to “progress reviews”

Throughout the period from the effective date of this agreement until the actual commissioning date for the last of the planned facilities, the concessionaire shall keep the grantor fully informed about the progress of the works and, in particular:

1. *The concessionaire shall provide the grantor with monthly progress reports, in such form, and containing such information, as the grantor may reasonably require from time to time;*
2. *The concessionaire and the grantor shall hold regular progress meetings to review performance of the works, and discuss any coordination issues;*
3. *The concessionaire shall cooperate fully with the “construction observer”, who shall be entitled to be present at any time during the performance of the works and to have reasonable access to all parts of the concession area and to all records and materials of the concessionaire concerning the works, including attendance at the concessionaire meetings to review progress of the works. The “construction observer” shall be entitled to disclose all such information to the grantor and his advisers. The grantor shall instruct the “construction observer” to comply with any reasonable requirements of the concessionaire concerning the concession area safety, and to use all reasonable efforts to minimize disruption to the orderly and cost-effective performance of the works, but the grantor shall not be responsible for any delay, loss, cost or expense incurred by the concessionaire as a result of any act, or failure to act, of the “construction observer”.*

Extension events

189. Under specific conditions the grantor may accept an extension of the construction period if “extension events” occur. These are either breaches of obligations by the grantor himself or events that can be deemed to be *force majeure*. The concession contract then needs to specify how the milestone target dates will be affected by such events, what will be the duties of the concessionaire and if any compensation needs to be paid by the grantor.

Sample clauses with respect to extension events

As soon as possible and in any event within [n] days of the occurrence of any extension event, the concessionaire shall notify the grantor of:

- (a) *the occurrence of the extension event, giving a reasonable description of its nature and cause;*

- (b) *the concessionaire's assessment of the effect of the extension event on the performance of the works and in particular the effect on the construction programme, quantifying his assessment of the period of delay caused by the extension event, with supporting reasons for that assessment;*
- (c) *the concessionaire's proposed measures for mitigating the consequences of delay;*
- (d) *the cost implications of the extension event and proposals for how the concessionaire will fund them.*

and

For this purpose an extension event means:

- (a) *a breach by the grantor of his obligations under this contract;*
- (b) *an event of force majeure or State intervention;*

the occurrence of which, in either case, prevents the concessionaire from complying with this contract or delays his compliance with it..

and

The concessionaire shall provide such further information concerning the extension event as the grantor may reasonably require from time to time.

and

The concessionaire shall use all reasonable efforts to mitigate the delay and costs resulting from an extension event.

and

If the grantor is satisfied that, or it is determined by the external expert that, an extension event has occurred, the concessionaire shall be entitled to such extension of time as shall be reasonable (taking into account not only the extension event itself but also the reasonably foreseeable consequences of the extension event agreed with the grantor or determined by the external expert) by fixing a new milestone target date which shall replace the existing milestone target.

Late completion

190. Although delays in the construction of the facilities will hurt the concessionaire more than the grantor, it is common for the latter to insist on the insertion of a final set of clauses with respect to agreed sanctions in the event of late completion. The rationale for this insistence is easy to understand. The grantor needs to demonstrate to the political authorities and any opponents of the concession that all due diligence has been exercised by him to ensure timely provision of facilities to meet expected future demand.

Sample clause with respect to sanctions for late completion

If a milestone achievement date does not occur by the relevant milestone target date, then, subject to the provisions regarding extension events, the concessionaire shall pay to the grantor liquidated damages for delay for each day or part of a day which elapses between the relevant milestone target date and the milestone achievement date at the rates described in [relevant appended schedule].

Tests on completion

191. The commissioning of the newly built facilities raises the question of the appointment of a “test certifier” and the nature and extent of tests on completion. For mechanical and electrical plant these should include pre-tests and safety, operational, reliability and endurance tests. For civil works construction there is usually a supervisor who ensures on a day-to-day basis that the work conforms with the specified methods of construction and material quality. Because civil works are constantly covered up and cannot be verified at the end of the construction period it is not practical or meaningful to have a test on completion. The nature of civil works is one of the reasons for the appointment of a “construction observer” who will throughout the works verify that they are properly carried out. A “taking over” certificate will be established stating that “this certificate is issued subject to the builder undertaking to complete all outstanding work during the defects liability period” and a list will be attached with the items of outstanding work.

Sample clause for commissioning of civil works and mechanical and electrical plant

An actual commissioning date shall occur when the “test certifier” issues his certificate that the tests on completion for civil works and plant for the facilities in question have been successfully completed.

Sample clauses pertaining only to commissioning of mechanical and electrical plant

The commissioning tests of the plant shall be conducted by the concessionaire in accordance with the test procedures and requirements set out in [specified schedule] and in the presence of the “test certifier”.

and

The issue of a mechanical and electrical plant commissioning certificate shall not affect the concessionaire’s responsibility to ensure that the facilities satisfy all the requirements of this contract.

and

The concessionaire shall give the grantor and the “test certifier” not less than [n] days’ notice (e.g. 60 to 90 days) of the date on which he wishes to conduct mechanical and electrical plant commissioning tests.

and

Mechanical and electrical plant commissioning tests shall be conducted on the dates specified in the notice given by the concessionaire or such other date as the concessionaire and the grantor may subsequently agree in writing with the “test certifier”.

and

The grantor shall be entitled to have representatives attend to observe the mechanical and electrical plant commissioning tests. The concessionaire shall notify the grantor and the “test certifier” of the precise time and precise place for carrying out the tests.

and

The “test certifier” shall be a person specialized in the business of plant procurement and verification and able to deploy suitably qualified and experienced personnel. The grantor and the concessionaire

shall seek to agree the identity of the “test certifier” not later than [n] months (e.g. nine months) before the first anticipated actual plant commissioning date.

8.2.2.4 Lenders’ security

192. BOT schemes are by nature capital-intensive. Although some private operating companies may have the necessary capital resources to self-finance such major infrastructure development projects, it is more likely that the concessionaire will need to secure loans or arrange for other funding in order to meet the financial obligations required to fulfil the conditions of a specific BOT concession. This will demand appropriate wording in the concession contract, specifically with respect to the right to create an encumbrance over the assets and to lenders’ security. The strategic issue in this respect is to allow the concessionaire to use the BOT facilities as security for obtaining the necessary financial means without jeopardizing the interests of the grantor.

Sample clauses for the creation of encumbrances to provide security to lenders

For the sole purpose of financing its implementation of the project and the fulfilment of his obligations under the BOT project, the concessionaire may assign, by way of security, the benefit of, or his interest in, this contract, according to the requirements of any of the financing documents, and create other forms of security over any property or rights forming part of his interest in the project in favour of any lender, provided that the payment of rents and royalties to the grantor shall have priority over rank any such security and that before any such security takes effect, the holder of the security must have entered into the “lenders’ direct agreement”.

and

To facilitate compliance with the requirements of the BOT scheme, the grantor is willing to enter into the “lenders’ direct agreement” with a person as agent for all the lenders.

and

The concessionaire shall be entitled to create over his assets:

- (a) an encumbrance which arises out of title retention provisions in a supplier’s standard conditions of supply of goods which are acquired by the concessionaire in the ordinary course of his business and applies only to the goods so supplied;*
- (b) rights of set-off or liens arising solely by operation of law in the ordinary course of business.*

but

Except as permitted by the preceding provisions, the concessionaire shall not create or permit the creation of any security interest over the benefit of, or his interest in, this contract or over any property which forms part of the facilities, or over any rights or interests in any of the project documents.

8.2.2.5 Hand-back or transfer at normal termination

193. On the normal termination of the BOT concession the facilities created under the contract and any infrastructure of which title was passed to the concessionaire at the start of the concession will be returned to the grantor. This transfer can be without compensation (normally in the case of a full BOT concession) or with compensation (commonly when a BOOT was agreed). With the hand-back a number of sensitive issues need to be dealt with. These include the need for an initial joint inspection, assessment of required renewal works (where

applicable), the execution of the renewal construction programme, the level of compensation to be paid by the grantor, the details of the hand-back procedure and hand-back requirements. All of the listed issues will need appropriate treatment. This is likely to vary from scheme to scheme and will have to give full consideration to the anticipated local conditions at the end of the concession. Following are a few selected clauses that are typical for hand-over stipulations but are therefore not generally applicable for the reasons explained.

Sample clauses with respect to the hand-back

The concessionaire shall ensure that on the date of expiration of the BOT concession term each element of the facilities shall comply with the hand-back requirements;

and

Not less than [n] months prior to the expected date of expiration of the concession term, the grantor and concessionaire shall conduct a joint inspection of the facilities. Such inspection shall comply with the respective requirements of the hand-back applicable to the respective elements of the facilities.

and

A further inspection shall be carried out equivalent in content to the initial joint inspection not less than [m] months prior to the expected expiration date and a notice equivalent in content to the hand-back proposals shall be given by the concessionaire.

and

On the day on which the concession term expires the concessionaire and the grantor shall conduct a final joint inspection.

and

Within [x] days after the completion of this inspection the grantor shall either issue a hand-back certificate to the concessionaire or notify him of the decision not to issue one and state the reasons for that decision.

8.2.3 Appended schedules

194. To the BOT-type concession agreements a number of detailed schedules are appended which form an integral part of the agreement. The most common schedules include the following:

- ! the detailed description of the facilities with functional requirements and the design solution;
- ! asset transfer;
- ! the construction programme and milestones;
- ! the tests on completion;
- ! identified permits;
- ! payment of rents and royalties;
- ! employment provisions;
- ! performance standards;
- ! setting of tariffs;
- ! hand-back requirements.

195. The above listing, although not exhaustive, provides a good overview of the detailed schedules that will have to be included as part of a BOT-type concession agreement.

Chapter 9**PERFORMANCE MEASURES TO ESTABLISH TRUE VALUE OF FINANCIAL BIDS**

196. Once the technical evaluation has been completed and the non-acceptable bids have been eliminated, the envelopes with the financial bids from the remaining candidates can be opened. Thus will begin the most delicate of all the phases in the complex tendering process: the assessment of the true value of the financial bids. Because the ultimate decision will be depend very much on this final evaluation, it should be conducted in the most straightforward, unequivocal and incontestable manner.

197. The first condition to be met in this respect is that the structure of the financial bids should be strict. This will make comparisons easy and the ultimate decision irreproachable, as well as giving candidates the benefit of enjoying greater freedom in the design of a financial package:

- ! that will adequately meet the licensor's or grantor's (assumed or perceived) demands;
- ! that satisfies the bidder's objectives and takes full account of his own financial constraints.

198. The first major difficulty which the Port Authority as licensee or grantor will face when carrying out the financial evaluation is a technical one. The proposals submitted will inevitably present different revenue components, each with its own time-scale. These will have to be compared in a mathematically and financially correct manner.

199. The second difficulty concerns the risk of foreign exchange rate fluctuations. This can be quite serious if the licensor or grantor has contracted substantial foreign exchange, loans relating to the "object" to be licensed or given in concession (e.g. loans to fund land reclamation or dredging).

200. The third difficulty lies in the uncertainty of the throughput forecasts. The latter will eventually lead the bidders to present very different traffic projections in their business plans. On what traffic level will the expected revenues then have to be compared? If the projections of the business plans are used as a basis for the financial evaluation, and this is known or suspected in advance, the bidders may well manipulate their throughput projections. By doing this they would greatly (but artificially) improve the attractiveness of their financial proposal.

201. The first problem can be solved:

- ! by choosing the "maximum present value" solution. The financial evaluation will then be carried out on the basis of the aggregated revenue streams of each candidate. Thus the discounted values of the projected revenues will be totalled for each candidate. The winning bid is the one with the highest present value. As this discounting exercise should be done using a realistic discounting rate (e.g. a rate that approximates the commercial banks' lending rate available to the Port Authority at the time the evaluation takes place) the calculation should not extend beyond a 20-year period. After 20 years, revenues discounted at reasonable discount rates will generate only marginal and quickly declining yields. It is therefore not necessary to extend the financial evaluation beyond a 20-year period, even if the duration of the proposed licence or concession contract is longer;
- ! by providing a "bidder's financial offer" form. On this form the possible revenue components should have been clearly indicated as well as any instructions pertaining to them. These could include, for example:

- ! *for licences:* a licence fee (to be paid once in order to obtain the licence), an annual rental fee for the licensed facilities, royalty fees to be paid annually (based on throughput levels) and possible payments for the acquisition by the licensee of equipment, systems or existing infrastructures and superstructures (paid in one or several instalments);
- ! *for concessions:* a concession fee (to be paid once in order to obtain the concession), an annual rental fee (where land is made available) and possible payments for the acquisition by the concessionaire of existing infrastructures, superstructures, equipment and systems (paid in one or several instalments).

202. The second problem is non-existent if the financial compensations are expressed and have to be paid in foreign exchange or in a unit representing a basket of currencies. This arrangement likewise implies that the licensee or concessionaire has the sanction to set his tariffs in a foreign currency as well.

203. The solution to the third problem consists in the development by the licensor or grantor of his own realistic throughput projections. On these the various bids will then be tested irrespective of the forecasts provided in the business plans submitted. The use of the projections is, in any event, relevant only for revenue components that vary with the throughput volume (e.g. royalties). It is customary to prepare three throughput forecasts and give each of these a different probability weighting (e.g. a moderate forecast with a 40 per cent weighting, an optimistic forecast with a 25 per cent weighting and a pessimistic forecast with a 35 per cent weighting). This will then increase the likelihood of the financial evaluation being carried out on the basis of expectations for future throughput that are as sensible as possible, given that the various alternatives have been properly weighted.

204. To illustrate the above-stated principles for an effective, business-like and regular financial appraisal, a simple example has been worked out on the following assumptions:

- ! Three financial bids remain after the technical evaluation;
- ! The award is for a licence for a two-berth container terminal;
- ! The quay-wall is being provided by the licensor;
- ! The licensee will have to pave the terminal area, install the gantry cranes and provide all supporting infra- and superstructure, equipment and systems;
- ! The candidates are given total freedom with respect to the sums they pledge to pay for each revenue component and for staggering the payments according to their preferred time scale.
- ! The revenue components include a one-time licensee fee, a rental, an annual royalty payment and compensation for supporting infra- and superstructure, equipment and systems;
- ! The discounting rate used in the present value calculation is set by the Port Authority as licensor at 10 per cent.

205. The financial bids that were received and remain in the running, after the technical evaluation, are summarized in table 3. The throughput forecasts, prepared by the licensor and to be used for the present value calculation, are given in table 4. The discounting is to be carried out on the promised revenue streams for the first ten years of operation (this is to simplify the case study and to better illustrate the methodology applied). Consequently, the winning bid will be the one with the highest total present value for the four aggregated revenue streams, on the basis of the weighted throughput projection developed by the licensor.

206. The results of the discounting exercise are shown in tables 5-7. The example confirms that totally different financial proposals can be easily and sensibly compared by applying the present value method to the revenues promised by the bidders to the licensor. The methodology is financially accurate as it fully accounts for the time value of money at a commercially relevant discount rate. In the example the proposal with the highest nominal benefits is not the one with the highest present value.

Table 3

Details of financial proposals for a licence contract
(In United States dollars)

	Bid A	Bid B	Bid C
Licence fee	2 250 000 (single payment)	1 750 000 (every year for 3 years)	2 000 000 (single payment)
Annual rental	1 200 000 (increase by 5 per cent p.a.)	1 500 000 during first 5 years 1 750 000 during second 5 years	1 000 000 (constant for 10 years)
Royalty fee	5 per TEU	2.5 per TEU	7.5 per TEU
Compensation paid for equipment transfer	Year 1: 4 000 000 Year 2: 3 000 000 Year 3: 3 000 000	Year 1: 3 000 000 Year 2: 5 000 000 Year 3: 7 000 000	Year 3: 2 000 000 Year 4: 2 000 000 Year 5: 2 000 000

Table 4

Throughput projections developed by the licensor
in TEU per annum

Year	Moderate forecast (weighting 40 per cent)	Optimistic forecast (weighting 25 per cent)	Pessimistic forecast (weighting 35 per cent)	Weighted forecast
1	200 000	300 000	150 000	207 500
2	250 000	360 000	180 000	253 000
3	300 000	420 000	210 000	298 500
4	350 000	480 000	240 000	344 000
5	400 000	530 000	270 000	387 000
6	440 000	580 000	300 000	426 000
7	480 000	630 000	330 000	465 000
8	520 000	680 000	360 000	504 000
9	560 000	720 000	390 000	540 500
10	600 000	750 000	420 000	574 500

Table 5

Discounted values for Bid A
(In United States dollars)

Year	Licence	Rental	Royalties	Equipment	Total fees	Present value total
1	2 250 000	1 200 000	1 037 500	4 000 000	8 487 500	7 715 986
2	-	1 260 000	1 265 000	3 000 000	5 525 000	4 566 136
3	-	1 323 000	1 492 500	3 000 000	5 815 500	4 369 301
4	-	1 390 000	1 720 000	-	3 110 000	2 124 192
5	-	1 459 000	1 935 000	-	3 394 000	2 107 436
6	-	1 532 000	2 130 000	-	3 662 000	2 067 126
7	-	1 608 000	2 325 000	-	3 933 000	2 018 258
8	-	1 689 000	2 520 000	-	4 209 000	1 963 540
9	-	1 773 000	2 702 500	-	4 475 500	1 898 060
10	-	1 862 000	2 872 500	-	4 734 500	1 825 386
Total	2 250 000	15 096 000	20 000 000	10 000 000	47 346 000	30 655 421

Table 6

Discounted values for Bid B
(In United States dollars)

Year	License	Rental	Royalties	Equipment	Total fees	Present value total
1	1 750 000	1 500 000	518 750	3 000 000	6 768 750	6 153 471
2	1 750 000	1 500 000	632 500	5 000 000	8 882 500	7 340 942
3	1 750 000	1 500 000	746 250	7 000 000	10 996 250	8 261 703
4	-	1 500 000	860 000	-	2 360 000	1 611 927
5	-	1 500 000	967 500	-	2 467 500	1 532 145
6	-	1 750 000	1 065 000	-	2 815 000	1 589 011
7	-	1 750 000	1 162 500	-	2 912 500	1 494 579
8	-	1 750 000	1 260 000	-	3 010 000	1 404 195
9	-	1 750 000	1 351 250	-	3 101 250	1 315 240
10	-	1 750 000	1 436 250	-	3 186 250	1 228 459
Total	5 250 000	16 250 000	10 000 000	15000000	46500000	31 931 672

Table 7

Discounted values for Bid C
(In United States dollars)

Year	License	Rental	Royalties	Equipment	Total fees	Present value total
1	2 000 000	1 000 000	1 556 250	-	4 556 250	4 142 087
2	-	1 000 000	1 897 500	-	2 897 500	2 394 639
3	-	1 000 000	2 238 750	2 000 000	5 238 750	3 935 978
4	-	1 000 000	2 580 000	2 000 000	5 580 000	3 811 252
5	-	1 000 000	2 902 500	2 000 000	5 902 500	3 665 039
6	-	1 000 000	3 195 000	-	4 195 000	2 367 994
7	-	1 000 000	3 487 500	-	4 487 500	2 302 805
8	-	1 000 000	3 780 000	-	4 780 000	2 229 918
9	-	1 000 000	4 053 750	-	5 053 750	2 143 295
10	-	1 000 000	4 308 750	-	5 308 750	2 046 789
Total	5 250 000	10 000 000	30 000 000	6 000 000	48 000 000	29 039 796

207. The example well illustrates the impracticability of judging the merit of financial proposals merely from the total of the aggregated nominal fees that are pledged. As a matter of fact, bid C would in this respect have been the winning proposal. Giving a proper valuation of the time value of money makes bid B the preferred proposal, whilst bid C becomes the least attractive.

208. Although many other formulae have been devised to appraise financial proposals, most far more complex and intricate, the methodology described above has the merit of being financially appropriate and mathematically correct. Additionally, it is a transparent method for comparing different revenue streams accruing at different times. As such it helps to avoid unnecessary and acrimonious disputes regarding the ultimate decision about to which, of all the technically acceptable proposals, will be awarded the long-term licence or concession contract.

Chapter 10**OPERATIONAL PERFORMANCE MEASURES**

209. The implementation of a licence or concession agreement imposes on the part of the licensor/grantor an agreed level of supervision of the operational results of the contract's execution. The aims of such supervision are threefold. The first is to ensure that the licensee/concessionaire uses the potential of the facilities to their fullest in the most efficient manner. The second is to obtain confirmation that the port users will receive services which offer the degree of quality and effectiveness that is commensurate with the demands of international trade. The third is to verify that the private operator satisfies requirements resulting from the "public service" function, as stipulated in the bidding conditions.

210. In practice, the licensor/grantor has a choice between two extreme levels of supervision. Either he can limit the examination of the operator's performance to a few elementary measures. The risk is then that potential inadequacies, flaws, anomalies or irregularities are not noticed, or only belatedly so. Consequently, remedial action is not taken or comes too late. Or he can impose a strict and detailed set of performance indicators which will give him a comprehensive understanding of the operational results. The risk here is that such detailed performance data may not be available or take too much time to collect and analyse.¹¹ Furthermore it may be asked in this respect whether the licensor/grantor would have the competence to judge such intricate data properly. There may also be the danger that the operator will consider this degree of supervision an intrusion in and an interference with his management and operational arrangements. Hence, he might see this as an unacceptable erosion of the promised autonomy to carry on with the operations as agreed in the licence or concession contract.

211. The optimal solution must therefore lie between these two approaches. The supervision should encompass those main operational areas that will critically determine the effective use of the facilities, the service quality offered to the users and respect for the "public service" functions. A selection (consisting of a set of measures) will therefore have to be made from amongst the principal performance measures, as stated below. These will then have to be submitted at prescribed regular intervals (for most measures preferably on a monthly basis).

212. Port performance measures can be classified into four major categories:

1. measures of production;
2. measures of productivity;
3. measures of utilization;
4. measures of service.

1. **Measures of production** are measures of the level of activity of the business. Ports distinguish two broad types of production measures: **traffic** and **throughput** measures. The former measure in various ways the quantity of cargo passing through the terminal, while the latter indicate the effort involved in moving that cargo in terms of tonnes or container movements per unit of time. Throughput can be measured for a number of different subsystems: ship-to-shore throughput, quay throughput, storage area throughput and receipt/delivery throughput. For licence or concession contracts the ship-to-shore throughput measure is the key indicator of production. It is generally the basis for setting the minimum monthly or annual performance and the recorded value on which the licensee/concessionaire has to pay royalty fees.

¹¹ By which time they have been collected and analysed the data may be less relevant or already out of date.

2. **Measures of productivity** determine the efficiency of port operations in terms of the ratio of output to input. They are expressed as **quantity of production** (tonnes, container moves, ro-ro unit moves) **in unit time** (day, week, month, year). Productivity can be measured to monitor efficiency of every part of a port facility, such as **ship-to-shore productivity, crane productivity, quay productivity, terminal area productivity and storage area productivity**. For licence and concession contracts relating to port facilities the most significant productivity measures are ship-to-shore productivity measured as the output in tonnes or moves per 24 hours at berth, or port and quay productivity as the output in tonnes or units handled per linear metre of quay per month or per year. Both productivity measures - ship-to-shore and quay - particularly if used in combination, are excellent indicators of the output performance: the first one for the efficiency of the service offered to the carriers and the second for the efficiency with which the most expensive component in a port facility (i.e. the quay-wall) is being used. Consistently poor values with respect to the predetermined benchmarks set in the licence or concession contract will, beyond reasonable doubt, constitute a sufficient indication of the inadequacy of the operator's performance efficiency. This will warrant either remedial action on the part of the licensee/concessionaire or, if no improvements are noted, the early termination of the licence or concession.

3. **Measures of utilization** are those indicating how intensively the production resources of a facility are used. They are usually expressed as a ratio between the actual use of a resource and the maximum possible use of that resource over a particular period of time. Utilization measures can be developed for a wide range of terminal facilities and for their component subsystems such as **quay utilization, storage utilization, gate utilization and equipment utilization**. The most relevant of these, for a licensor or grantor of port facilities, is the quay utilization. This is also referred to as **berth occupancy** and is calculated as the fraction of the available time in a given period that a berth (or group of berths) is occupied by a vessel. Too low values of berth occupancy point to underutilization of the facilities. Too high a value is an indication of the imminent occurrence of queuing and the possibility of long waiting times. In the first case the private operator should be encouraged to look for additional business; he will do that automatically if the clauses pertaining to the payment of fees have been properly drawn up.¹² In the latter case the congestion risk may be the result of poor operating efficiency (this will be confirmed by the productivity indicators discussed in the previous paragraph) or because demand is too high and exceeds the capacity of the present facilities. If the latter is a permanent feature, extra capacity needs to be created. As a matter of fact, in a number of licence and concession contracts the exclusivity clause becomes non-operable once a mutually predetermined occupancy level is exceeded.

4. **Measures of service** indicate the quality of service to the customers of the facilities (carriers, shippers and receivers) and transport operators (truckers, rail operators and barge operators). Main measures of service quality include **ship turnaround time, road vehicle turnround time and rail service measures**. In the past, there has been criticism that operators have disregarded quality of service. This is of course unacceptable, particularly in ports where the public service function of operators is important. Within a licence or concession agreement, the single most important service measure is ship turnaround time. This is the sum of waiting time, the ship's time at berth (or service time) and various short intervals occurring during the ship's stay in port (e.g. when the vessel proceeds from anchorage to a berth). Recorded turnaround times should be compared with agreed benchmark turnaround times (possibly for different ships under different operational conditions). Because the Port Authority as licensor or grantor has an obligation to guarantee adequate service levels, since the users have normally no say in the award decision, it will have to scrutinize with particular care the values for total turnaround time. Recurring poor results should cause the Port Authority to press, without delay, for remedial action on the part of the private operator. If this would not lead to a sustained improvement of the service quality, the licence or concession should be terminated (assuming that the necessary clauses to this end have been incorporated into the contract agreement).

¹² That is, if he has to pay rent on a minimum throughput level that is set sufficiently high to cover most of the licensor's or grantor's fixed costs incurred for the facility that is licensed or given in concession.

213. In summary, a set of meaningful performance indicators that would give timely warning in the event of a deficient execution of the licence or concession contract, would preferably include all those included in table 8. The parties involved also have the opportunity of gradually increasing the minimum performance levels over the period of the lease. This is a recommended strategy, as the operator can be expected, after a number of years of operation, to have attained his full skill and know-how level. Moreover, over the years technology may improve and make previously valid standards obsolete. This will tend to raise the minimum performance levels demanded by port users. Finally, table 9 shows an application to a container terminal of the set of measurements presented in table 8. The values used for the performance measures are only indicative. They will have to be decided on a contract-by-contract basis (either by the licensor or grantor, as stated in the bidding instructions, or by the bidder in his bid proposal).

Table 8

A model set of performance measures for insertion into a licence or concession contract

	First 2 years	From years 2 to 8	From year 8 to end of licence period
Minimum annual throughput in reference units			
Gross output in reference units per vessel per 24 hours at berth			
Number of reference units per metre of quay per year			
Maximum allowable berth occupancy in per cent			
Average turnaround time per vessel call (in hours)			

Table 9

Example of the model set of performance measures applied to a licence contract for a container terminal

	First 2 years	From years 2 to 8	From year 8 to end of licence period
Minimum annual throughput in TEU	350 000	400 000	500 000
in moves	300 000	360 000	420 000
Gross output in moves per vessel per 24 hours at berth	500	750	1 000
Number of TEU per metre of quay per year	300	400	500
Maximum allowable berth occupancy in per cent	45	45	50
Average turnaround time per vessel call (in hours)	24	20	18

CONCLUDING REMARKS

214. The ten-step approach presented in this report has two objectives: to give a compact but comprehensive overview of the key issues that will arise when embarking on a port privatization scheme, and to determine best present practice with respect to the actual implementation of a scheme. In doing this, it is necessary to make choices and take short cuts. It is therefore important to keep in mind that each port privatization project must be approached from the angle that will lead to the best results in terms of the stated objectives. The project's characteristics must thus be given full attention, but not excessively so; otherwise, the excuse is too easily found for not proceeding with privatization. The fact should not be overlooked that a privatization strategy cannot and will not meet with approval from all parties involved.

215. Valuation of assets and of their future earning potential is a necessary evil. Getting it right will help both the owner of the facilities and the bidder. The latter needs a proper valuation in order to prepare a sensible business plan and make reasonable proposals for the compensation he is willing to pay to the owner of the facilities. The former, generally a Port Authority will be exposed to future scrutiny of its privatization actions. It will therefore be anxious to demonstrate that it has secured the best possible terms. The outcome of the valuation is obviously important in the event that a full privatization scheme is pursued (e.g. the outright sale of a port's facilities). Nevertheless, the valuation will also have great significance when facilities are licensed. It will then allow the licensor to refuse the proposals submitted if the compensation offered is disproportionate to the valuation result. Because the valuation considers not only the value of the assets but also the future earning potential of the facilities, a BOT-type bid will depend on an accurate valuation as well.

216. Although there are many methodologies for carrying out a valuation (earnings-based, asset-based, market-based, industry-based), the results are in any event highly dependent on the perceived interest of operators in running the facility and the projected business (in terms of volume and potential earning capacity). The latter factors, not surprisingly, can and generally will be assessed very differently by the various bidders. Additionally, factors such as the potential acquisition of surplus assets (e.g. significant additional land areas) and the possibility for the winning bidder to take over tax losses play a role and can increase the value of the facilities. The impossibility of converting and repatriating profits or the risk of political instability may decrease the value.

217. The organization of a pre-qualification round raises fewer problems. Whenever the expected number of potential bidders is high (say in excess of ten) pre-qualification becomes inevitable. This process should ascertain whether the bidders selected would have the ability to manage and operate the facilities in a manner matching the stated objectives of the privatization scheme. The information requested should therefore focus on each bidder's corporate profile, share ownership, experience in managing similar schemes and financial position. It is not necessary to link the pre-qualification round with a first level of bidding, as often happens, and to request the possible candidates to submit a comprehensive investment plan. This will complicate the selection and unnecessarily extend the time taken by the bidding process. Pre-qualification should not take more than two or three months, including the call for candidatures, screening, selection and announcement.

218. Privatization projects are bound to become complex and controversial, however straightforward and transparent the underlying principles and procedures. The present guidelines have been developed to help clarify the most contentious and frequently occurring issues. It remains, however, a fact that a privatization scheme will stand a greater chance of succeeding if at all times the initiator ensures the greatest possible simplicity with respect to the bidding rules and an above-board formulation of the contract clauses that equitably embodies the interests of both parties.

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