

POLITICAL RISKS: ANALYSIS OF KEY CONTRACT CLAUSES IN CHINA'S BOT PROJECT

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ABSTRACT: The reforms introduced by the International Monetary Fund in Asia will bring about greater transparency in the economies and innovative approaches in procurement of contracts. China has taken new initiatives in build, operate, and transfer (BOT) infrastructure projects. It is, however, important to analyze and manage the unique or critical risks associated with China's BOT projects. This is especially so after new policies were introduced in late 1996 when the first state-approved BOT project, the U.S. \$650,000,000 2 × 350 MW coal-fired Laibin B Power Plant (Laibin B), was awarded. These include the competitive tendering process and 100% foreign ownership of the operating company. An international survey on risk management of BOT projects in China was conducted to seek the views of practitioners. The overall objectives of the survey are (1) to identify the unique or critical risks associated with China's BOT projects; (2) to evaluate the effectiveness of measures for mitigating these risks; (3) to examine the key contract clauses used in Laibin B's concession agreement; and (4) to provide a risk management framework for investing in future BOT projects in China. This paper discusses the adequacy of key contract clauses in Laibin B's concession agreement related to the political and force majeure risks in China, from the perspective of foreign developers, lawyers, and lenders. The contract clauses discussed include changes in law, corruption, delay in approval, expropriation, and force majeure. Areas for further improvement in the clauses are suggested.

INTRODUCTION

The financial and currency crisis in Asia has acted as more than a rude awakening for project finance. It has brought to an end what was once dubbed the decade of infrastructure development. The Asian project finance market is in a downturn as the volume of deals dwindles to a trickle. For the infrastructure market, construction exports by construction-related firms into regional countries will decrease substantially. Despite the economic slowdown, sponsors and financiers of projects for the most part are optimistic about the long-term growth potential. There is, for example, growing international interest in China's infrastructure projects financed on build, operate, and transfer (BOT) concession contracts. In other parts of Asia, infrastructure needs are still strong, and private capital funding will be more important as governments have to restore their depleted reserves.

For the future, the crisis could also prove to be an opportunity to bring out greater reforms and innovative approaches to address the weaknesses in project development and financing in emerging infrastructure markets. Fundamentally, financing in the region will become more healthy. Lenders will tighten security structures whereas local sponsors' books will be scrutinized more carefully. The reforms introduced by the International Monetary Fund will bring out greater transparency and stable investment environments in the economies. For the infrastructure market, deals obtained through closed door negotiations will diminish. The trend toward open competitive tendering, a procurement practice favored by multilateral lending agencies, in Asia is inevitable. Among devel-

oping countries, China has taken such an initiative in the Laibin B Power Plant project, the Changsa Power Plant, and the Chengdu Water Plant project. The introduction of competitive tendering for the equity investment in a BOT project is a new development that will help provide sound commercial incentives to project developers to build the projects quickly and to operate the projects efficiently. Enhanced performance will lead to enhanced returns to the equity investors. Perhaps the most remarkable thing about Laibin B was the speed with which it was negotiated. Invitations to prequalify were issued in September 1995, and the financing documents were signed in August 1997. This was considered fast by Chinese standards.

RISK MANAGEMENT

Periods of heightened volatility bring the issue of risk management to the top of every investor's and lender's agenda. As recent events have shown, lenders will be just as concerned with foreign exchange risks, in particular, the convertibility and availability, as they are with political risks (Boey 1998a). In a 1997 survey of 188 Japanese companies, conducted by the Nikkei Weekly, on risks that they face in doing business in Asia, foreign exchange risk was cited as the top problem. On the one hand, projects will need much tighter financing and better political and commercial risk covers. On the other hand, governments' resources to provide guarantees are constrained by the plunge in their currencies and drop in sovereign and bond ratings. Innovative risk management techniques will therefore need to be pioneered to manage risks, particularly political and financial risks, more effectively and actively.

POLITICAL AND COMMERCIAL RISKS COVER

The support of multilateral lending agencies and export-credit agencies (ECAs) remain crucial in the project finance market. According to a recent report by Project Finance International (Boey 1998b), lenders' credit committees are cutting back uncovered exposure and are asking for political risk and commercial risk cover for loans to Asian countries. The \$2.2 billion 3,000-MW Shandong Power Plant in China, whose financing was closed recently, proved that such deals can work. It is the first time that the Export Credit Guarantee Department of the United Kingdom provided 100% political and commer-

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cial risk cover for a project in China. The participation of the German and Spanish export credit agencies, Hermes and Compañia Espanola de Seguros de Credito a la Exportacion, in the Rizhao and Hanfeng financings and of the French export credit agency, Compagnie Francaise d'Assurance pour le Commerce Extérieur (COFACE), in Laibin B has demonstrated that substantial progress has been achieved on limited-recourse export credits for China, in particular, with regard to regulatory and tariff approval issues and foreign exchange concerns (Edwards and Kuan 1998). In the case of the Perseroan Terbatas Jawa power project in Indonesia, political risk was covered by the U.S.'s ExIm Bank and Germany's Hermes. They apparently made it clear to the commercial bank lenders that should the latter stop funding, they would lose political risk insurance. The banks were convinced by the ECAs' commitments to the project, and they provided the funding (Boey 1998b).

Despite the opportunities, undertaking infrastructure business in China presents risks and obstacles. The traditional methods of project finance and risk allocation mechanisms that are available in other countries are still restricted in China. Therefore the effective application of risk management principles to projects is especially crucial to successful investment in China, and risk strategies have to be incorporated much earlier in the development of their projects. Some new policies have been introduced since late 1996 when the first state-approved BOT project, Laibin B Power Plant, was awarded (He 1996; Zhang 1996; Zhu et al. 1996; Orr 1997), such as the competitive tendering process and 100% foreign ownership of the operating company.

Laibin B is the second phase project for Laibin Power Plant with an estimated capacity of 2×350 MW coal-fired units and an estimated cost of U.S. \$650,000,000 [5 billion Renminbi yuan]. It is located in Laibin county of Guangxi Zhuang Autonomous Region (Guangxi). The concession terms require a tight completion schedule and appear to offer a relatively low rate of return. The Electricite de France and General Electric (GEC)-Alstom consortium finally won the concession from five other shortlisted tenderers with an aggressive tender and the backing of France's ECA, Coface.

A BOT concession agreement is a contract between a host government and the project promoter whereby the promoter is required to finance, design, build, operate, and manage the facility and then to transfer the facility free of charge to the government after a specified concession period.

Due to the characteristics of the BOT concept, it is meaningful to study the unique or critical risks associated with China's BOT projects and the adequacy of the related key contract clauses used in the concession agreement in addressing these risks.

DEFINITION OF POLITICAL AND FORCE MAJEURE RISKS

Political risk describes the risk of government actions that may endanger a project. Actions can occur at the central, provincial, or local levels of government. More specifically, primary political risks include change in law, corruption, delay in approval, expropriation, and reliability and creditworthiness of Chinese entities (Chinese entities' reliability). Force Majeure Risk describes the circumstances beyond a project developer's or government's control such as natural disasters, war, hostilities, embargo, import, or export restrictions.

RESEARCH OBJECTIVES

In recent years, several research works have been published concerning various aspects of risk management of BOT infrastructure projects (McCarthy and Tiong 1991; Tam 1995; Tiong 1995; Baker and McKenzie 1996; Platt and Arstall

1996; Shen et al. 1996; Donnelly 1997; MacDonald 1997; Nielsen 1997; Orr 1997; Ruster 1997; Staigerwald 1997; Westring 1997; Wang et al. 1998a,b; Zhang et al. 1998). However, there has been little research to date that focuses specifically on the management of unique or critical risks of China's BOT projects.

The overall objectives of this research are

- To identify the unique or critical risks associated with China's BOT projects
- To evaluate the effectiveness of measures for mitigating these risks
- To examine the adequacy of key contract clauses used in Laibin B's concession agreement (CA) to address these risks and to propose possible improvements to these clauses
- To provide a risk management framework as guidelines for project promoters planning to invest in future BOT projects in China

This paper will report on the research findings related to Objective 3, focusing on the political and force majeure risks. The rest will be reported in separate publications and also in Tiong et al. (1999).

RESEARCH METHODOLOGY

Methodology and Procedure

The methodology developed for this study includes (1) a comprehensive literature review to identify an initial list of unique or critical risks associated with China's BOT power projects and mitigating measures for these risks; (2) unstructured interviews and discussions to filter the risks and measures identified in (1); (3) an international survey; and (4) case studies to provide additional insight concerning contract clauses and risk management framework for investing in China's future BOT infrastructure projects.

The first state-approved BOT project in China (i.e., Laibin B in Guangxi Province) was studied in detail. Other BOT projects in China (e.g., Yan'an Second Tunnel and Da Chang Water Plant in Shanghai, Changsha Power Plant in Hunan Province, Tangshan Power Plant in Hebei Province, etc.) were also referred to (Tiong 1990; Guangxi 1995; "Chinese" 1996; "Changsha" 1997; Chew 1997; "Da Chang" 1997; "Laibin" 1997; "TOT" 1997; Wang et al. 1998a; and Zhang et al. 1998).

The interviews and discussions focused on specific subject matter—in this case, the unique or critical risks associated with China's BOT projects and corresponding mitigating measures. Participants included one Director of Business Development of Foster Wheeler; 35 construction professionals, and the writers, with the second writer as facilitator and the first writer as observer to take notes. The final list of unique or critical risks are shown in Table 1.

From Table 1, the risks are categorized into two groups—Risks 1 to 6 are grouped under political and force majeure risks, and Risks 7 to 10 are under foreign exchange and revenue risks. As mentioned earlier, this paper will discuss the research findings on the contract clauses in Laibin B's CA that are related to the political and force majeure risks. The following section provides the definitions of the six risks under political and force majeure risks.

Change in Law Risk

Change in law risk includes changes in government policies with respect to laws and regulations, methods to address inflation, currency conversion, rates and methods of taxation, or

TABLE 1. Unique or Critical Risks of China BOT Infrastructure Projects

Number (1)	Risk (2)
1	Change in law
2	Corruption
3	Delay in approval
4	Expropriation
5	Reliability and creditworthiness of Chinese entities
6	Force majeure
7	Exchange rate and convertibility
8	Financial closing
9	Dispatch and transmission constraint
10	Tariff adjustment

the method by which electricity tariffs are set and approved. It includes (1) the adoption, promulgation, modification, or reinterpretation after the signature data of the CA by any government authority of any laws of the host country; or (2) the imposition by a government authority of any material condition in connection with the issuance, renewal, or modification of any approval after the date of signature of the CA that in either case establishes requirements for the construction, operation, or maintenance of the BOT project that render the performance by the project developer according to its terms illegal (AES 1996).

Corruption Risk

Corruption is based on using political, legal, or regulatory leverage to extract additional costs for which no one will ever admit and the project developer can never recoup. It means that the government's officials or representatives solicit or receive an unlawful consideration or commission or exert or utilize any unlawful influence in connection with awarding and agreement to the project developer. Corruption is regarded by many companies as an unavoidable fact of life on projects in developing countries including China. This presents risks of spending either too much money on corrupt officials, or spending money in the wrong places, or at the wrong times—all at the risk of having a government agency turn against the project developer and the project (Macdonald 1997).

Delay in Approval Risk

Delay in approval risk means that the central or local government authority does not approve the project-related issues in time or even cancels the ones already approved. Obtaining approvals for a project from a complex web of government agencies and departments, from municipal to provincial to central government levels, can be an extremely time-consuming process, delaying entire projects and hurting their financial viability. The Chinese central government agency, the State Planning Commission (SPC), which must approve any infrastructure above U.S. \$30,000,000 investment, is known to be slow in its review process.

Expropriation Risk

Expropriation risk means that the government expropriates the project without giving reasonable compensation to the project developer and investor. The expropriation can take the form of nationalization of a facility wholesale (rare) or "creeping" expropriation whereby the government changes regulations, taxes, or tariffs after a project is complete to gradually take over the facility and its operating profits (common).

Chinese Entities' Reliability Risk

For a BOT project, many Chinese entities such as partners, contractors, customers, suppliers, operators, guarantors, lend-

ers, and others who are parties to agreements with foreign parties will be involved. The success of a project will hence depend on the reliability and creditworthiness of these Chinese entities. Although it is said that these counterparties have the ability to perform and will perform their obligations, the reliability and creditworthiness of Chinese entities are difficult to ascertain. This results in the Chinese entities' reliability risk.

Force Majeure Risk

As mentioned above, force majeure events are the circumstances beyond the project developer's or government's control such as natural disasters or accidents (e.g., fires, flood, storms, or earthquakes), war, hostilities, embargo, import, or export restrictions. However, in this project the project developer shall not consider the following circumstances to be an event of force majeure: (1) delay in performance by the construction contractor, the operation and maintenance contractor or any subcontractor to either of them; (2) any delay in the delivery of, or any latent or patent defects in, any materials, equipment machinery or parts for the power plant; or (3) breakdown or ordinary wear and tear of materials, equipment, machinery, or parts of the power plant. In addition, the government shall not consider any of the following circumstances to be an event of force majeure: (1) the expropriation, requisition, confiscation, or nationalization of the power plant by government authority; (2) the imposition of any blockade, embargo, import restrictions, rationing, or allocation by government authority; (3) the cancellation of any approval not caused by a breach of the CA or of any project contracts by project developer; and (4) change in law. As described above, Circumstance 1 is already defined as expropriation risk; Circumstances 2 and 4 as change in law risk, and Circumstance 3 as delay in approval risk.

SURVEY ON CONTRACT CLAUSES

Based on Table 1, the key contract clauses related to these risks were extracted from the CA of Laibin B. A comprehensive questionnaire for international survey was then designed. There were three parts: Question 1 on criticality of risks, Question 2 on effectiveness of the proposed mitigating measures, and Question 3 on adequacy of related clauses in Laibin B contracts. The international survey was used to substantiate results of the interviews and to examine the adequacy of the key contract clauses of Laibin B's CA. Table 2 shows the detailed contract clauses on political and force majeure risks. The rating systems for Question 3 are shown in Table 3. The question asked was

Question 3: Do you think the following contract clauses of the CA of Guangxi Laibin B Power Plant Project are adequate for the developer/lender to mitigate the corresponding risk?

Please rate the adequacy of each clause by circling a suitable figure at end of each clause.

Please give your comments or describe your corresponding management action.

Respondents' Particulars

The international survey was conducted from December 1997 to March 1998. Three hundred questionnaires were sent to international project sponsors, developers, consultants, lawyers, lenders, investors, and contractors by mail. A total of 40 valid responses were received that accounts for a response rate of about 13.3%. Although the response rate was a little low, the reliability of survey results is high because all of the re-

TABLE 2. Clauses from Laibin B's CA on Political and Force Majeure Risks

Risk (1)	Original clause (2)
Changes in laws	<p>CA13.2: Should changes in Chinese laws, regulations, and decrees or in any material conditions associated with any of the Approvals applicable to the Project take place after the date of this Agreement which substantially adversely affect the rights or obligations of the Company, the Company may by written notice request adjustment to the terms of this Agreement so as to place the Company in substantially the same economic position it was in prior to such changes. Adequacy: 1 2 3 4 5</p> <p>CA14.3: Should changes in Chinese Laws, regulations and decrees take place after the date of this Agreement which financially substantially benefit the Company, Guangxi Government may by written notice request adjustments to the terms of this Agreement so that the Company remains in substantially the same economic position as it was prior to such changes. Adequacy: 1 2 3 4 5</p>
Corruption	<p>CA15.5.2: Guangxi Government represents, warrants, covenants and declares that: (a) neither it nor its representatives have solicited or received any unlawful consideration or commission for this Agreement nor has it or its representative exerted or utilized any unlawful influence in connection with awarding any Agreement to the Company; and (b) it shall not knowingly permit any work related to the Project to be contracted to any of its officials or employees, or any member of the immediate family (spouse, parent, child or sibling) of any such official or employee, who is directly or indirectly involved in contract awards or supervision of the Project or to any company or enterprise in which any of such persons is an executive officer or substantial owner without the prior written consent of Guangxi Government after full disclosure of the relevant facts. Adequacy: 1 2 3 4 5</p>
Delay in approval, or adverse government action or political Force Majeure	<p>(CA15.5.1: The Company represents, warrants, covenants, and declares the similar statements)</p> <p>CA13.4: Guangxi Government shall use its best efforts to assist the Company in obtaining all Approvals. To the extent feasible within the requirements of the applicable regulatory regimes, Guangxi Government shall also use its best efforts to help coordinate the process for such Approvals and to reduce the number of different Government Authorities with which the Company must deal in connection with obtaining or renewing the Approvals. Guangxi Government's obligation under this Article to assist the Company shall not relieve the Company of its obligations under the Agreement to obtain the required approvals. Adequacy: 1 2 3 4 5</p> <p>CA2.7.1: If as a result of: (a) any delay by Guangxi Government in performing its obligations; (b) Force Majeure, any of the following shall occur: (i) unavoidable delay to the construction; (ii) the Company suffers any material cost, loss, damage or expense which does not otherwise qualify for compensation by Guangxi Government, the Concession Period may be extended by mutual written agreement between the parties if necessary and in accordance with the provisions of this Agreement. Adequacy: 1 2 3 4 5</p> <p>CA13.8: Subject to the provisions of this Agreement, Guangxi Government shall not intervene in the construction, operation and maintenance of the Power Plant save as may be necessary to protect public health and safety and for the discharge of its statutory duties. At the request of the Company, Guangxi Government shall use its best efforts to alleviate any interference with the Project by third parties which may arise. Adequacy: 1 2 3 4 5</p> <p>CA19.2: The Company's request for approval of . . . , Guangxi Government shall notify the Company of its decision within fifteen days after its receipt of the Company's request. If Guangxi Government fails to act within such fifteen day period, the request shall be deemed to be approved. Adequacy: 1 2 3 4 5</p>
Expropriation	<p>CA15.1.3: Guangxi Government shall not have the right to consider any of the following circumstances to be an event of Force Majeure that would suspend the performance or excuse the non-performance of its obligations under this Agreement: (a) the expropriation, requisition, confiscation or nationalization of the Power Plant by Government Authority; (b) the imposition of any blockage, embargo, import restrictions, rationing or allocation by Government Authority; (c) the cancellation of any Approval not caused by a breach of this Agreement or of any Project Document by the Company; (d) Change in Law. Adequacy: 1 2 3 4 5</p>
Force Majeure	<p>(See also "Delay in approval, or adverse government's action or political Force Majeure")</p> <p>CA14.12: The Company shall at its own cost obtain and maintain in force from the Effective Date until the Completion Date the insurance required by Appendix 13 and shall provide Guangxi Government with copies of the policies and proof of payment of premiums with respect thereto. Adequacy: 1 2 3 4 5</p> <p>CA15.1.5: In case of Force Majeure, each party shall cover its own costs resulting from the Force Majeure situation, except as provided in the Power Purchase Agreement (PPA) or in Articles 15.1.6 or 15.1.8 below. Adequacy: 1 2 3 4 5</p> <p>CA15.1.6: If any Force Majeure shall impede or prevent a party's performance for longer than 90 days from date of the commencement of such Force Majeure, the parties shall decide through consultation either the terms upon which to continue the performance of this Agreement or to terminate the Agreement by mutual agreement. If the parties are unable to agree on such terms or to terminate the Agreement by mutual agreement within one hundred and eighty days of the date of the commencement of such Force Majeure, either party may then terminate the Agreement by written notice to the other party. Adequacy: 1 2 3 4 5</p> <p>CA15.1.8: If an event of Force Majeure causes material damage to the Construction Work or the Power Plant which materially impairs the ability of the Company to perform its obligations under this Agreement and such change is either not covered by insurance or the insurance proceeds available are less than seventy percent of the total cost of repairing such damage, unless the absence of insurance coverage is a result of the failure of the Company to maintain insurance in accordance with this Agreement, the Company shall not be obligated to complete the construction of or repair the Power Plant until the parties have agreed upon the terms of such completion or repair. The Company shall not be obligated to accept any such agreement unless such agreement can reasonably be expected to ensure that the Company's economic return on its investment is substantially maintained and not prejudiced in any material way. Upon the occurrence of such Force Majeure, the parties shall promptly, and in good faith, enter into discussions to reach such agreement. Adequacy: 1 2 3 4 5</p>

TABLE 2. (Continued)

(1)	(2)
Force Majeure (continued)	<p>CA15.1.9: In the event the parties are unable to reach an agreement on the completion and repair of the Power Plant within ninety days following the commencement of such discussions, either party may terminate this Agreement on thirty days prior written notice. Upon such termination neither party shall have any further obligation under this Agreement, except to the extent that any obligation or undertaking under this Agreement expressly survives termination. Adequacy: 1 2 3 4 5</p> <p>CA16.7.3: In the event of a termination of this Agreement following Force Majeure arising out of the circumstances described in Article 15.1.3 (see "Expropriation"), Guangxi Government shall pay the Company the compensation amount set forth in Row 3 of the Compensation Table in Appendix 17. Upon payment of such compensation amount, the Company transfer the Power Plant to Guangxi Government. Adequacy: 1 2 3 4 5</p> <p>CA16.7.5: If following Force Majeure under the PPA, or a Force Majeure under the Fuel Supply and Transportation Agreement (FSTA), this Agreement is terminated without default of the Company, Guangxi Government shall pay the Company the compensation amount set forth in Row 4 of the Compensation Table in Appendix 17 that would apply if the relevant Force Majeure had occurred under this Agreement. Upon payment of such compensation amount, the Company shall transfer the Power Plant to Guangxi Government or its designated executive body. Adequacy: 1 2 3 4 5</p>

TABLE 3. Rating Systems on Adequacy of Contract Clauses

Rating score (1)	Adequacy of related contract clause (2)
0	Not applicable
1	Inadequate
2	Fairly adequate
3	Adequate
4	Very adequate
5	Fully adequate

TABLE 4. Respondents' Particulars of International Survey

Respondents' particulars (1)	Number of respondents (2)	Respondents (%) (3)
<i>(a) Respondent's company category</i>		
Banker/financier	17	43
Consultant (accountant/business development)	5	12
Developer/independent power producer	8	20
Lawyer	9	22
Main contractor	1	3
Total	40	100
<i>(b) Respondent's resident country</i>		
Australia	2	5
China	4	10
Hong Kong	13	32
Japan	1	2.6
Korea	1	2.6
Malaysia	2	5
Peru	1	2.6
Philippines	1	2.6
Singapore	10	25
Sweden	1	2.6
United Kingdom	2	5
United States	2	5
Total	40	100
<i>(c) Respondent's designation</i>		
Head project financing	8	20
(Vice-) managing director	16	40
(Vice-) president/general manager	7	18
Others (consultant, partner, lawyer, etc.)	9	22
Total	40	100
<i>(d) Respondent's experience</i>		
With BOT experience internationally	30	75
With business experience in China	35	88
With BOT experience in China	24	60

spondents are at top management level in their companies. More importantly, most (75%) of them have experience on international BOT projects, almost all (88%) of them have business experience in China, and more than half (60%) of them have been involved directly in BOT projects in China. The detailed respondents' particulars are shown in Table 4.

ADEQUACY OF RELATED CONTRACT CLAUSES ON POLITICAL RISKS

Based on the survey, with the exception of the change in law clauses, the related contract clauses used for Laibin B's CA for the above mentioned risks are generally regarded as adequate for the mean scores of respondents' rating for the adequacy of the clauses higher than or closer to the score of 3 (adequate) and the overall rating is 3.05 as shown in Table 5. Among them, the contract clauses for expropriation and force majeure risks were considered more adequate while the change in law clauses needed more improvements.

The general comments of some respondents who gave low ratings on the adequacy are that although the contract clauses are all drafted according to international customs and practices they are still not very suitable in the Chinese context. A more exact nonlegal wording should be used, detached from a particular legal system. To the extent practically possible, terms like "material," "substantially adversely," etc. should be quantified and more details would have to be introduced to make the clauses more specific. The following sections will discuss the possible improvements to these clauses.

TABLE 5. Adequacy of Related Contract Clauses on Political Risks

Risk factors (1)	Adequacy of Contract Clause		
	Mean score (2)	Standard deviation (3)	Ranking (4)
Expropriation	3.31	1.20	1
Force majeure	3.21	1.00	2
Delay in approval	3.01	1.06	3
Corruption	2.97	1.22	4
Change in law	2.77	1.24	5
Chinese entities' reliability	— ^a	— ^a	— ^a
Overall	3.05	1.14	—

^aNo related clause in CA.

IMPROVEMENT OF RELATED CONTRACT CLAUSES

Change in Law Risk

There are mainly two clauses (i.e., CA13.2 and CA14.3) in Laibin B's CA that address this risk. The mean score of adequacy of these clauses is 2.77 (i.e., not quite adequate).

The respondents' general comments are that the principle of these clauses is generally acceptable. The problem is in the actual determination; these clauses are too general and should be accompanied by an exhibit illustrating the tariff adjustment formula and how tariff changes if the change in law risk takes place. A strongly worded support letter issued by the Ministry of Power is required to support the power bureau's obligations. More specifically, the reasons for the relatively low rating, as suggested by some respondents, include the following: (1) These clauses still leave open the burden of proof that the rights and obligations of the project company have been substantially affected by the risk; (2) the concepts of "change," "substantially the same economic position," etc. are worrisome; (3) "request adjustment" by the company does not mean making the company whole; it is better to take care of tariff adjustment due to change in law; (4) the procedure and speed to address the change in law issue are critical to limit impact on financing and should be addressed; and (5) although the company may request an adjustment, the clause does not say whether such an adjustment is obligatory and the government has no obligation based on the current clause. Also, once the plant is built, the government has more leverage in negotiations. In addition, some respondents argued that clauses like these in a single project are unlikely to have much of an effect. The cancellation of the import duty exemption in China in April 1997 and the resumption of this exemption in early 1998 show that only when foreign investors collectively resist some changes will they prevent the government from rolling back regulations.

According to the respondents, aspects of the clauses that could be improved include the following: (1) The concepts of "change," "substantially the same," "economic position," etc. should be defined in detail although they are difficult to quantify. For example, "economic position" could be defined based on the project company's internal rate of return or other financial index or, alternatively, "substantially" will apply if a number of changes that have a substantial effect in total are included; and (2) "request" is not an obligation. Hence, a structure is needed. It should be worded that a request would entitle the company to an adjustment, and such requests for adjustment should create binding obligation between the company and the government.

One respondent commented that keeping change in law risk in mind is desirable but not crucial, and it is strange that the Chinese law makers would make a clause (i.e., CA14.3) beneficial to the company, and yet such benefits cannot be harvested.

Corruption Risk

There are mainly two contract clauses (i.e., CA15.5.2 and CA15.5.1) that address the corruption risk. The mean score of their adequacy is 2.97.

The respondents' suggested improvements to the clauses include the following: (1) The clauses should also address different country's requirement (e.g., how to arbitrate and how to identify if government breaches the contract and on occasions of Guangxi versus central government conflicts); (2) there is no continuing assurance that the government will require its officials to observe them, and monitoring responsibility unfortunately has to fall on the project company; (3) actions in addition to the warrants are also required; and (4) for a U.S.

company, the language should track more closely the U.S. Foreign Corrupt Practices Act.

However, some respondents argued that corruption never takes place out in the open. It will be difficult to preclude it by using contract language; hence, the clauses are pointless. Even if the clauses are useful, the enforcement of the clauses is the issue and that cannot be legislated.

Delay in Approval Risk

There are mainly four clauses (i.e., CA13.4, CA2.7.1, CA13.8, and CA19.2) that address the delay in approval risk. The mean score of these four clauses is 3.01.

Although some respondents think that these clauses are better than those used in contract documents for projects in other parts of Asia, particularly in the Philippines and Taiwan, some improvements to them are needed. More specifically, improvement to CA13.4 suggested by respondents includes the following:

1. It is in relation to delay in approval only, and it still leaves the company open to the delays not in his control, which should be addressed.
2. It is too general and vague. For example, "best efforts" is relative, and it does not help a project (i.e., it is not sufficient and should be quantified), and "to help coordinate the process" is useless in practice. The Guangxi government should provide all necessary resources to ensure that all the approvals are obtained.
3. Other approvals at the central government level also need to be addressed because the provincial officials, in many circumstances, have little ability to positively influence the approval process at the central level. In addition, there were instances when provincial government misrepresented to potential investors by saying that approval can be handled at a local level without having them referred to central government. In this respect, local government, instead of being a partner, could hinder the project's progress.

The comments by respondents to CA2.7.1 are as follows:

1. Tighter wording is required (e.g., "compensation" should be defined quantitatively so as to restore the company to its original financial position, and government needs to pay costs as remedy).
2. It only extends the contract for "any delay by Guangxi government in performing its obligations." If they are not responsible for making capacity payments by a certain date and if the company has not fulfilled its obligations then this clause is bad.
3. Extending the concession period does not help the company pay its debt (time value of money) because an increase in costs due to delay is not completely mitigated by an extension of concession period. Hence extension alone may not be totally adequate. In addition, extension of concession period does not require central approval (it is not stated in the clause), which may introduce another unknown."
4. The responsibility for raising funding for increased costs should also be addressed.

As for CA13.8, which deals with interference by third parties, some respondents think that it is difficult to get more guarantees from the government but the possible improvements could be (1) "best efforts" is relative and it should preferably be "immediate compliance" by the government without the "best efforts" qualifier; (2) "to protect public health and safety and for the discharge of its statutory duties"

should be clearly defined because Chinese law could change its meaning; and (3) "third party" and "any interference" should also be clearly defined (i.e. what the real risk is should be addressed). Otherwise, government could probably claim grounds for interference quite easily as the categories are subjective. It would also be better if the known third parties sign side letters to the "interference" effect.

CA19.2 is regarded as the most adequate clause for this risk. However, there are still improvements that could be made, such as (1) if approval is not given in time, the next step of action should also be spelled out; (2) should include the clause to cover other government entities (if relevant); and (3) define clearly whether inaction on part of government is sufficient to "legalize" an approval.

Expropriation Risk

CA15.1.3 is the only main clause in Laibin B's CA that addresses the expropriation risk. The mean score of its adequacy rated by respondents is 3.31, which is regarded as the most adequate clause for all risks. Hence the guarantees by the government set in the clause are regarded as reasonably tight.

Suggested improvements are as follows: (1) Add some other concepts that will not let failure to pay be in event of force majeure; (2) in addition to Guangxi government the central government should not have the right to either, and it is better to suggest a longer list of circumstances that cannot be considered as force majeure (it is narrowly drawn in current CA15.1.3); and (3) it is better to explicitly state Guangxi government will continue to pay the minimum net electrical output fees, and after a certain time buy out the plant.

Force Majeure Risk

Some clauses for delay in approval risk are also partly applicable to this risk as described above. Hence they will not be repeated here. There are the seven main clauses more specific for the force majeure risk. The mean score of the adequacy of these seven clauses is 3.21, which ranks second in the adequacy of all clauses. This indicates that the Chinese government is amenable to sharing the force majeure risk with the foreign power developer, and foreign practitioners are generally satisfied with this.

According to the respondents, an improvement to these clauses is that it should be emphasized in the clauses that extended force majeure should lead to a termination with a very stiff termination value formula, and the adequacy of these clauses depends on government's credit quality and compensations as set out in Laibin B's CA. The other possible improvements to these clauses will be discussed individually for each of these clauses.

CA14.12 is regarded as a standard clause in a CA. Some possible improvements as suggested by the respondents are (1) political force majeure and insurable force majeure could be defined more clearly as some force majeure events cannot be insured or are cheaper to transfer to a third party through risk allocation rather than through insurance; and (2) insurable "cost" must be a pass-through cost.

For CA15.1.5, there are no other improvements except defining more clearly each party's "own costs" resulting from the force majeure situations. However, the critical issue is that the Guangxi government cannot be excused for events under its control for which it will claim force majeure.

Under current Chinese laws, termination of CA as described in the CA15.1.6 will require approval from the original examining and approving authority, and there is uncertainty whether such approval will be obtained. This is an issue that needs to be confirmed. In addition, the period of "90 days" is too short and it is better to extend.

For CA15.1.8, the respondents felt that the phrase "in good faith" should be clearly defined. In addition, possible parties will never agree with the sentence "The company shall not be obligated to accept any such agreement unless such agreement can reasonably be expected to ensure that the company's economic return on its investment is substantially maintained and not prejudiced in any material way" because they would not get any compensation if they agree.

As for CA15.1.9, it has the same problem of termination approval as CA15.1.6, whereas the adequacy of CA16.7.3 and CA16.7.5 are subject to the conditions that the compensations in the CA is sufficient to cover the company's investment and potential profit (i.e., amount should be specified clearly).

CONCLUSIONS

China is actively investigating the best ways to introduce project financing, specifically through the BOT scheme, to meet the special needs of the country and to be attractive to foreign investors and lenders. The advent of concession agreements, backed by the new BOT regulations, will be a positive move forward to achieving project-financed infrastructure projects throughout China.

It has simplified the approval procedure of foreign-invested projects and tends to adopt international custom and practice for the BOT projects. For example, China is trying to formulate some model forms of project documents for various types of infrastructure projects through some selected pilot BOT projects. To expedite the implementation, China has gone to the extent of hiring foreign advisers in preparing some of these documents. Laibin B, which is the pilot BOT project in China, is planned to be a model for future BOT projects, especially the power projects in China. For example, its documents are being used for other power plants though more fine-tuning can be expected.

In this paper the key contract clauses in Laibin B's CA that are related to political and force majeure risks were evaluated by international practitioners. In general, they agreed that the contract language is effective and that the clauses conform to international practice. The clauses are relatively adequate in addressing the sponsors' and leaders' concerns toward political and force majeure risks in China.

However, there are areas for improvement, especially in the area of approval delays and compensations and on issues related to the change in law risk. Foreign sponsors and lenders would like clear definitions based on agreed formulas for adjustments or financial indicators such as internal rate of return. The preference is for all support and approvals to be endorsed by the central governments agencies such as the SPC and that such endorsement be clearly spelled out in the contract agreement.

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