

IMPACT OF INTERNATIONAL LEGAL SYSTEMS ON GLOBAL COMPETITIVE PROCUREMENT

***By Justice G.N. Ray**

The international legal system is the foundation for the conduct in international relations. The system regulates state actions under international law. The principal subjects of international law are states rather than individuals. The International Court of Justice acknowledged in the Reparation for Injuries case that types of international legal personality other than statehood could exist and over the past half century one may notice significant expansion of the scope and ambit of international law. Apart from states, international legal personality is enjoyed by international organizations and, in some circumstances, human beings. Nongovernmental organizations and national liberation movements have also been held to possess international legal personality.

It is relevant to understand the implication of the word 'globalization'. Globalisation is extraordinary explosion of both technology and information, in ways that have considerably reduced the twin concepts of time and space. It refers to global economic integration of many formerly national economies into one global economy, mainly by free trade and free capital mobility propelled by Information and Communication Technology. Integration is the act of combining into one whole. It needs to be appreciated that in order to be competitive, the productive scheme of a country is got to be reoriented and freed from its national context in order to be integrated into the globalized economy.

* Address by Mr. Justice G.N. Ray, Chairman, Press Council of India on "Impact of International Legal Systems on Global Competitive Procurement" organised by the Indian Railway Institute of Logistics and Material Management (IRILMM), New Delhi on June 6, 2009 at Hotel Taj Palace, Shahjahan Hall S.P. Marg, New Delhi.

If such integration is the hall mark of globalization, it is based on new era technologies e.g. computerization, miniaturisation, digitalization, internet...and so on. Recent innovations in science and technology have ushered in "new set of tools" which greatly increase productivity and efficiency in all areas. Technology has changed the rules of competition, rendering many traditional business strategies and processes outmoded and obsolete. The change in technology is transforming every sphere of social and commercial activities encompassing products, services, markets as well as customers and competition.

The era of isolationism has undergone sea change. The world's public procurement markets are emerging as a progressively integrated, open market. This trend accelerates as more and more nations agree by treaty, agreement, and conventional practice to open their respective procurement markets for outside competition. Trade liberalization in this sphere however is not free from controversy. Many states, particularly developing nations, fear that competition may affect their economy and growth. Experience suggests that by opening their procurement markets, nations enrich their own procurement systems and domestic economies through access to a richer and more diverse pool of goods and services, often at more competitive prices. Concomitantly, these states benefit as foreign markets open to their own producers. Increasing number of public procurement markets may lead to beneficial and important development in procurement today. Although it is an encouraging trend, the process is likely to take reasonably long time to become fully effective.

To keep pace with rapid stride of globalization, individual states must identify the barriers to foreign contractor entry regulated by

domestic procurement rules. Public procurement law that governs public contract formation often unfolds various rules and conventions which not only impede but often intimidate potential foreign entrants. As international instruments focused on public procurement emerged over the past few decades, they were aimed, to ease such hindrances and barriers to entry

One of the important facets that have emerged in the process of globalization is the rapidly changing legal and institutional framework to encourage and accommodate contemporary international trade, finance and investment. The emergence of World Trade Organization is one of the most important examples of this kind of trend and helping the convergence of global regulatory mechanism of newer genre. There have been multilateral agreements earlier also e.g. on environment and labour but what is unique in WTO and new genre of multilateral institutions is their potential capability to influence trade of a particular country.

The present trade system was developed through a series of trade negotiations, held under GATT. The last round i.e., 1985-1994 Uruguay Round led to the establishment of the WTO. The World Trade Organization came into being in 1995, which is one of the youngest International Organizations. The WTO is an International Organization under whose jurisdiction the GATT 1994 replaced the GATT 1947. WTO is a comprehensive body that deals with almost all international aspects of trade related matters.

In today's new international economic order economic entities rather than the sovereign nation states are the key players. The new international economic order is a dynamic process of global integration driven by diverse economic players. Since global integration entails gains and losses it is imperative that the economic players come

together and devise a viable system of global economic governance to mitigate any negative impact on global integration. Embodying an open, rules-based multilateral trading system, the WTO is now at the forefront of global economic governance. The WTO agreements essentially provide the legal ground-rules for international commerce.

The WTO agreements are the core of multilateral trading system, which was developed through a series of negotiation rounds over the past five decades. These agreements are essentially binding contracts governing the general conducts and norms of international business aiming to enable producers, consumers, exporters, importers, and service providers alike to perform their business functions in a transparent and predictable business environment.

One of the WTO's most important functions is to serve as a forum for trade negotiations. The member economies can avoid complicated and tortuous bilateral negotiations by using the single forum of the WTO to negotiate with all or most of their trading partners. This can help reduce transaction costs and increase the efficiency of negotiation procedure.

In principle, the WTO members have equal rights and obligations. A single set of trade rules applies to all members. The WTO's rule-making process is all-inclusive. Decisions are made by the entire membership, typically by consensus. The WTO agreements are agreed upon by the entire membership and ratified by members' parliaments. Through this process, a commitment, once made, cannot be changed or reversed without going through the formal negotiation process again. In theory, the WTO rules ensure nondiscrimination and fair competition for all. Rich and poor countries alike have an equal right to challenge others in the WTO's dispute settlement procedure. However, the members are also obliged not to act unilaterally, when

disputes arise. The impact of WTO agreements is all pervasive-domestic trade, international trade, regional trade, global trade. Even though WTO has influenced all the aspects of trade relation, it is not free from criticism and controversy. Hopefully, concern of several member nations will be addressed and WTO will be more and more effective and acceptable. I may quote here from the Extract from WTO Expansion and its impact on APCE by Taiwan Institute of Economic Research.

"The challenge is threefold

First, the WTO is undergoing a legitimacy crisis as a result of internal strife between the developing and the developed camps. Inadequate representation and participation from the developing camp results in poor accountability, which in turn, leads to legitimacy crisis (i.e. representation & participation, accountability, legitimacy). In particular, the WTO's "legislative" function has been a subject of criticism. The developing members charge that the major industrial powers have hijacked the decision-making process in the WTO. Second, the WTO is a public good. The WTO's relatively large membership (142 as of July 26, 2001) gives rise to an array of collective-action, opportunism, and free-rider problems. The collection-action problem leads to institutional sclerosis, which in turn spawns opportunism and the free-rider tendency. These problems provide a fertile stimulus for the surge of regional trade agreements (RTAs) and free trade areas (FTAs) in Asia-Pacific as in other regions of the world. All in all, the credibility of WTO rules hinges on the effectiveness of enforceability (i.e. executive function, credibility, enforceability). However, the WTO lacks cohesive power to enforce the rules. Unlike the state, the WTO does not possess a police. Third, the WTO must learn to adjudicate dispute cases impartially and expertly (i.e. judiciary function? reliability? dispute settlement mechanism). Yet, the WTO's

dispute settlement mechanism is still under test and experimentation. Moreover, the WTO lacks a viable penal system to effect legal sanctions. The WTO is experiencing institutional crisis to the extent that its accountability, credibility, and reliability have been undermined".

In order to appreciate the impact of international legal systems on global competitive procurement it is desirable to focus on International Economic Theories, Private Law of International Trade, Public Law of International Trade, Settlement of Disputes in International Trade, International Economic Institutions, GATT and WTO, International Trade Contracts, Trade Related Investment Measures of WTO, International Banking and Finance, International Corporate Legal System, International Monetary System, Trade Related Intellectual Property Rights, Tariff and Trade, International Trade and Environment, Trade and Services and Trade and Agriculture.

Impact of public procurement and rules of government contracting on public spending and attracting private infrastructure investment

The rules on public procurement and Government contracting are likely to have significant impact on the capacity of a country to attract private infrastructure investment. However, these rules are often influenced by certain attitudes or sectorial interests that generally escape detection. Such type of investments is not seen by many as a booster for a country's development problems, or as uncontroversial means to speed up investments. Therefore, it will be only appropriate to identify the reasons opposing private infrastructure investment and to address the concern of the opposition. Apart from various legal factors having considerable influence on the text of the public procurement rules applied to public infrastructure projects, there are

legal factors which influence the text of public procurement and Government contract rules and their application.

The legal rules are as follows:

a) Public procurement rules

The first issue is whether public works carried out by means of a project finance system can be awarded through competitive bidding.

Two types of competitive bidding mechanisms on a purely monetary consideration may be indicated as compatible with public works being project-financed. The first is to award the contract to the bidder who offers the lowest price for the output or services rendered by the project. Another is to fix the price of the output at the outset and then to award the contract to the bidder who offers to pay the highest price to the Government, either at a time or by instalments throughout the life of the operation of the works. Both the systems however present problems.

Awarding project-financed works by means of a merely monetary comparison often requires a prior stage of selection of bidders based on certain required qualifications. The choice of such qualifications is often subjective and discretionary but if the discretion is abused better and more acceptable bidders may be left out. It may so happen that financial statements audited by a reputed international firm, which are by and large acceptable as a reasonable standard by the international community may be preferred to State companies from First World countries assessed and audited by an Government approved agency and consequently such state companies may go out of consideration.

“Buy national” rules in the applicable procurement regulations, to the extent they are allowed by the treaties which bind the host country, are obvious mechanism to exclude foreign bidders. But the exclusion may be effected by other means. Allowing a short time to present the qualification documents and the bid, and requiring cumbersome formalities to be fulfilled (e.g. translation and legalisation

of by-laws) effectively excludes all those companies not aware of such formalities beforehand. The rules requiring that the bid will conform strictly to the specifications, including any draft of contractual documents to be used may cause hindrance to some bidders not familiar with such procedure.

Delays in deciding the award, with the consequent need for bidders to extend the term of their offers, is another deterrent for foreign contractors, more so when the local economic conditions are likely to undergo changes not reasonably comprehended earlier.

Vague and ambiguous provisions in the contract have impact on bidders for contract particularly on foreign bidders. Various Government departments are not equally responsive and agencies of various governmental departments may have different mind sets and perceptions about advantages or disadvantages of private infrastructure investments. Usually government officials may welcome firm contracts, so that the cost flowing from on going changes have been taken care of. Project finance also allows them to postpone expenditures for budget purposes and avoid increased borrowings. It is not unlikely that other sections of the Government, instead, may find that project finance limits their powers. Therefore, unless a strict discipline and uniformity of approach are exercised by the Executive, different sectors of the Government may be working differently in respect of a given project. As "ambiguity breeds consent", this conflict often gives rise to obscure, contradictory or ambiguous contracting rules. Bidders should be aware that in some countries the rule *contra preferentem* does not apply to the Government and thus doubts will be resolved against the contractor on the theory that it is only entitled to that which is clearly and expressly granted.

b) Government contract rules

The French doctrine of "*contrats administratifs*" is followed in many Latin American countries and in some European countries as well. According to this doctrine, as applied in Latin America, the Government contracting party enjoys certain powers over the contractor, who is itself subject to limitations on its rights compared to those of a party to a purely private contract. Some European countries that follow this doctrine have recently put certain limits to these rules. These powers and limitations need to be spelt out in the bidding regulations and specifications.

The most important of those powers are the ones to change the contract to cater to the perceived changes in public needs, and to terminate the contract for reasons of public interest. Compensation must be paid in both cases to cover the increased cost of the performance, or the damages caused by early termination, as the case may be. However, this last rule may not give full protection to the contractors for two reasons. First, loss of profits may not be recognized. That apart, compensation often requires a lengthy lawsuit which may often take several years. Fortunately in India, law courts particularly the Apex Court of the country have recognised internationally accepted principle of damages and loss of profit.

An important limitation on the rights of the contractor is the very restricted role played by the exception *non adimpleti contractus* in contracts deemed to be "administrative" in nature. The main consequence of the existence of the theory of the administrative contract is to "administrativise" all the contractual relation. This, in turn, means that such decisions enjoy the presumption of validity that extends to all Government decisions and forces the contractor to challenge them as otherwise they would be considered final and valid. However, very few contractors wish to antagonize Government party

on consideration of expediency. As a result, these rules force the contractor to accept many Government decisions that affect the contract even if they are not fully in accordance with its terms as valid.

The impact of the theory of the administrative contract upon project finance for public works can be considerable. If the legal rules are not spelt out in the bidding specifications, or incorporated by reference by citing regulations that include such rules, Foreign contractors, specially those coming from countries that do not apply this theory of administrative contract, may refuse to participate. Domestic contractors, who know how those rules are applied may count on some tolerance from the Government, and may not be similarly dissuaded. Thus, the theory of the administrative contract can act as a hindrance to foreign investment in the infrastructure sector.

It may be noted that all countries which apply this theory do not suffer similar consequences. In a country having a tradition of respect for its contracts, backed by professional civil service and a reliable and independent legal system, the impact of the theory may be minimal. Therefore, to determine the "bankability" of a project the analysis should not be limited only to the rules applicable to public procurement and government contracts, but should take into account the broader institutional features of the host country.

Another attitude that can dissuade private infrastructure investment is the excessive zeal of Government officers who draft the contract terms, even without applying the theory of the administrative contract. High penalties for delays or minor breaches, and limited rights for the contractor in case of Government default or of early termination for reasons of public convenience, are a common feature. The price increase and the restriction on competition brought about by these rules are seldom perceived. The mind set of the drafting officer in

being seen apparently to defend the national interest even though in ultimate analysis such national interest may not be served, as well as the position of power which said rules grant to the Government contracting officers are more often than not fondly appreciated by the bureaucracy.

Some countries have tried to overcome perceived deficiencies in their internal judicial and administrative structures by resorting to bilateral investment protection treaties. However, the mere existence of these treaties may not constitute a sufficient deterrent to allegedly infringing conduct by the host country. Time will tell whether the remedies afforded by these treaties are effective and also whether they are here to stay as criticism of these treaties and of the way they are being applied by arbitration panels is growing in certain less developed countries.

Quick and alternate dispute resolution mechanism encourages private infrastructure development. It will be interesting to note that Chile has been very successful in using project finance for its infrastructure works. Over six billion dollars have been channelled into its road network by private investors. One of the features that may have contributed more significantly to this success is the setting up, simultaneously with the signing of the contract, of an arbitration panel to resolve the disputes between the Government and the contracting party. This has been perceived by the investment community as a guarantee for fair and quick resolution of such controversies.

Conclusions

Pacta sunt servanda in Latin means 'agreement must be kept'. This principle considerably helps project finance in the infrastructure to develop. Primarily, this principle in relation to private contracts, emphasises that contained clauses are law between the parties, and implies that non-fulfillment of respective obligations is a breach of the

pact. The general principle of correct behaviour respected and followed in commercial dealing and bonafide execution of contractual obligation can never be understated.

With reference to international agreements, it is to be appreciated that every treaty in force is binding upon the parties to it and must be performed by them in good faith. Pacta sunt servanda is based on good faith. This entitles states to require that obligations be respected and to be accepted in letter and spirit. This good faith basis of treaties implies that a party to the treaty cannot invoke provisions of its domestic law as justification for a breach of the contractual terms.

The only limit to pacta sunt servanda are the peremptory norms of general international law, called *jus cogens* (compelling law). The legal principle *clausula rebus sic stantibus*, part of customary international law, also allows for treaty obligations to be unfulfilled due to a compelling change in circumstances.

Efficient drafting of contractual terms plays a very important role for international participation. If the tenderers believe that the contract terms will not be changed mid-stream and the bankability of the project may not pose any problem they will come toward for participation more liberally. But if the legal regime in force or the legal culture and mind set of administrative heads of the host country, allow the Government to exercise the traditional power of the administrative contract without providing a fast dispute resolution mechanism, some projects will find no competitive bidders, resulting the project being implemented at an increased cost more often by a less capable contractor.

If the Government wishes to retain its special powers vis a vis the contractor, it should state about it very clearly in the bidding specifications. Springing surprise on the contractor with powers based on legal theories but not spelt out in the bidding documents can only hamper the contract and result in discord and litigation. Sometimes successive Governments have different perception and political views on private infrastructure. As a result, the contractual safeguards accepted by the administration are likely to be discarded by the successor government thereby introducing uncertainty in the policy of the government.

Fair terms and fair dealing by the public administration will ultimately benefit the Government. Not all projects can be financed through PPP or similar mechanisms. In some cases, considering the urgency and inherent construction risks, resorting to a public works contract, with the Government assuming most of the risks, may conform to expediency - or the only- alternative. But project finance if properly and fairly used will enable a country to tap more widely the resources of the international capital markets. Let us hope that the Government and Public Sector Undertakings sincerely appreciate the international participation in Project finance without being over active to protective steps not consistent with international norms.

Before, I conclude I would like to thank the Indian Railway Institute of Logistics and Material Management (IRILMM) which specializes on Logistics and Material Management in the area of transport in general and Railways in particular for the excellent services they are rendering in the field with all round efficiency, quality and economy.

I profusely thank the organisers for giving me an opportunity to share my views before this august gathering on a subject which is extremely relevant in the context of surging economy of a fast developing nation like India.

Namaskar

Acknowledgement of Source Material

1. International legal system – Wikipedia, the free encyclopedia
2. Globalisation, World Trading System and Indian SMEs
[by Anil Bhardwaj Secretary General of Federation of Indian Micro and Small & Media Enterprises (FISME), New Delhi]
3. Incrementalism: eroding the impediments to a global public procurement market. [22 March. 2007] Georgetown Journal of International Law.
4. National Law University, Jodhpur <http://www.ebc-india.com/lawcoll/jodhpur/dedu3.htm>
5. WTO Expansion and its Impact on APEC (Taiwan Institute of Economic Research)
6. Modern Law for Global Commerce
Congress to celebrate the fortieth annual session of UNCITRAL Vienna, 9-12 July 2007 – Hector A. Mairal, July 12, 2007
7. Presentation of Marcos Rios at the 2007 Spring Meeting of the ABA in Washington D.C.

