THE LEGAL SYSTEM INFLUENCE ON HOW TO SET UP A COMPREHENSIVE LONG-TERM CONTRACT

Marc FRILET
Avocat au Barreau de Paris
Managing Partner, Frilet et Associés
Co-Chair PPP Task Force IBA
avocats@frilet.com

EXECUTIVE SUMMARY

Comprehensive and successful highway and road long-term contracts are subject to contract conditions and underlying legal principles substantially different from other types of contractual forms. It can be said that the beneficiary of those contracts is less the public authority or the public agency having concluded a contract with a private party, but more the public user who are not themselves part of the original contract and who is essentially interested by a reliable efficient and adapted road service. When the highway and road investments are privately financed and when as a result contracts are entered into for decades or more, the question of change and adaptation to the contract conditions to the needs of the beneficiaries and / or to their capacity to pay tolls becomes a real dilemma.

♦ One line of solution is to negotiate an extremely detailed contract between the public authority and the private investor / operator taking care of virtually any possible contingency and organizing a detailed contractual solution for it.

This unfortunately does not permit to reach satisfactory outcome for many possible contingencies, and too detailed risk allocation clauses have often shown their limits.

♦ An alternative to this scenario is to enter into a simpler contract and leaving the issue of changes and satisfaction of the end users to various adjustments mechanisms, ADR techniques and outside regulator. The question then arises on the role and capacity of the regulator and more to the point, the criteriae that a regulator will use in the exercise of its discretion.

The international experience shows that this approach is not really satisfactory and the question is whether a particular region or legal system has found more satisfactory solutions facilitating the conclusion and smooth implementation of long-term public service contracts entered into between a public authority and a private investor / operator.

♦ For various reasons, several civil law countries had to address those in a courtroom, which was not a traditional court dealing with private contracts but a special court dealing with public contracts and having the authority to rule in equity. This has been particularly the case in France and over the years, a very respected supreme court, the *Conseil d'Etat*, has developed a full set of legal principles applying to administrative contracts and more particularly to long term contracts entered into between a public authority and a private investor / operator for public services.

The administrative case-law really amounts in fact to a real "concession law" which plays a major role in regulating long term multi task contracts *inter alia* in the highway sector.

As a result, the civil / administrative law legal system facilitates the design of rather simple multi-task long-term contracts and more or less guarantees a fair legal treatment of the future contingencies which are often unforeseeable in a public service contract after some years. It is generally recognized that this system has managed to strike a good balance between two fundamental principles of contract law applicable in virtually any country, which are *pacta sunt servanda* and *rebus sic stantibus*.

The first and paramount principle is based on the contractual importance given to the overall economy of the contract. It may be summarized as follows: long-term multi-task public service contracts may only be entered into if, at the time of contracting, it is recognized that the private partner will have a chance to recover its investment and all its operative and other costs, and make a reasonable profit during the life cycle of the venture.

Thereafter this economic and financial scenario often referred to as the “financial equation” (*équation financière*) will be the basis for assessing financial consequences of the impact of any contingency, change or default.

With such a matrix and such an underlying principle, both parties can easily quantify a consequence of various situations, not really contemplated at the origin.

Implementation of the *rebus sic stantibus* theory ten years down the line, for instance for major changes of the economic circumstances unforeseeable at the date of contracting (such as increased by fivefold of the price of fuel leading to half the number of cars), will have an immediate consequence on the use of the highway, on the tolls, tariffs, etc. In that situation, the financial equation of the private investor / operator will be destroyed and the administrative law then recognizes that the private investor / operator has the right of adequate compensation. The amount of the compensation will by construction be easily quantifiable without the need of an outside regulator, and both parties will continue to perform the contract.

Similarly, if for social reasons, the authority requests to divide by two the toll price, this could be acceptable by the private partner since it amounts to a change of the original forecast, and as a result, the Concessionaire company (based on the *pacta sunt servanda* theory) will have the right to be indemnified, and a quantification by reference to the financial equation will be simple.

Those are just a sample of solutions of the civil / administrative law influence on long-term multi-task contracts in the highway and road sector.

If the administrative law principles are well appraised by the various players at the outset and if the contracts are not polluted by clauses which are too complex in allocating and / or sharing risks and benefits, the practice shows that most of those contracts have good chances to be implemented smoothly over the life of the venture with a fair equilibrium between the rights and obligations of both partners which is the real goal of any public private partnership.