CHAPTER TEHRE

CONTRACTS FOR THE CONCESSION OF PUBLIC SERVICE

1.1.The meaning of concession

- As concession is a **special type of contract, the requirement for the existence of a valid contract should be met**.
- Article 3207 (1) of the Civil Code on the definition of concession, it reads as:

  "Any activity which a public community has decided to perform for the reason that it has deemed it to be necessary in the general interest and considered that private initiative was inadequate for carrying it out shall constitute a public service."
- This very sub article provides a definition for a public service. Thus, for **a service to be a public service it needs to pass through two tests.**
- **Firstly**, the service needs to be necessary for the **general interests**. These may but not only include: **electricity, telecommunication, and transportation, water, health, education, media, defense, administration** etc.
- **Secondly**, the service must be considered as **private initiative is inadequate to carry it**.
- Therefore, for the sake of understanding the term, we may **define public service** as a service whereby government believing that such **service cannot be adequately and conveniently be served has self engaged in delivering the latter**. Let us now see what contract for the concession of public service means.
- According to Article 3207(2), a concession of a public service is the contract where by a person the **grantee binds himself in favor of an administrative authority to run a public service getting remuneration** therefore by means of fees received on the use thereof.
- Conventionally we may say that concession for public service is a contract whereby **government grants the private sector to deliver service of a defined**

nature to the public, by entrusting the private contracting party with the benefit of collecting fees from the beneficiaries of the service.

- **Concession is different from privatization**. While the nature of concession contract does not affect ownership, the latter is a process of transfer of ownership of enterprises from government to the private sector.
- **Concession is also different from lease contract**. Concession requires a close control and directing the work. On the other hand, lease contract relates to an agreement whereby the government organ transfers the object of the contract to the contracting party for the payment of money from the later. Moreover, concession is not acquired against payment of the value of the concession from government whereas **lease is acquired by paying the value for the contract,** (lease money). In addition to this **the service to be leased may not fulfill the service we have defined earlier as public service.** Hence, neither an act of privatization nor lease is concession contracts.
- However, it is not for free that the grantee will bind himself in favor of administrative authorities. **He must get remuneration in the form of fees.** So, users of the service will pay fees and these fees will be remunerations. The basic idea behind concession contracts is not profit. Still one cannot say that the grantee should run the service for free. **Unlike other business undertakings the grantee is not as free as ever to set discriminatory prices**. The public should equally benefit from the prices set by the parties.
- **The role of the administrative authority is supervisory. The grantee has a functional role.** For fear of domination, this will result in direct exploitation by the administrative authorities. **Article 3210 (1) says the control should not be excessive.** Otherwise, the nature of the concession will be altered.

1.2. Variation clause (Article 3213)

- The concession contract may have a stipulation to the effect that adjustments in prices and tariffs will be in place by default. Two issues are important here:

1. **The variation is conditional on changes occurring in the prices of certain materials, commodities or services.** Not all variations in prices matter but **only changes in certain materials, commodities or services**. **The changes should affect the prices of the public service**. **Unreasonable price adjustment is not favored here.**
2. The **new prices should be proportional** to the change in the other prices. **In case of disputes, courts are authorized to fix prices**.

1.3. Revision clauses (Article 3214)

- **Still the parties may agree to the effect that modification may be introduced "where economic circumstances change considerably…"**.
- **The underlining element in the determination of the magnitude of the economic change must be the very implication of the change on the provision of the service.**
- We must take **considerable change** to mean a **change, which significantly affects the position of the grantee** to efficiently carry out the obligations under the contract.
- **Changes in the prices of important raw materials,** without which it is impossible to provide the service and the increase of which cannot be reasonably foreseen should entitle the grantee to have revision of the contract.
- Otherwise, **minor economic changes** as well as those economic changes that a reasonable business person may foresee **must not be grounds of revision**.
- But Article 3214(1) simply mentions the possibility of revising tariffs without fixing the prices. (Note: do not forget that under Article 3213 (1), in addition to putting the possibility of revising prices, fixation of prices is also achieved).
- Here, parties therefore should sit down and negotiate the addition of an additional clause in the contract which will possibly be a clause fixing prices. If the parties fail to agree, **"the court may fix a tariff"** taking in to account the grantee i.e. a tariff ensuring an equitable remuneration to the grantee.[1]

[1] Supra note 3, Article 3214(3)

- Until now, we have discussed briefly about one from of modification called bilateral (contractual) modification. There is another form of modification called **Unilateral Modification**.
- Concession contracts are arranged to serve the public. They have public policy issue in account. To this end, one of the parties is an administrative authority having a supervisory capacity. For such reasons, **administrative authorities have the prerogative of unilaterally modifying the terms of the contract.**
- **This prerogative is so valuable that it cannot even be reversed by agreeing to the contrary.**[2]
- By modification, we are referring to making the obligation of the grantee more burdensome.
- **Article 3216(1) envisages the possibility and the grounds of doing so**.
- Thus, **administrative authorities may impose** not only an **obligation** but even "all the obligations…" that go with the basic undertaking.
- The **imposition of obligations presupposes conditions**. Let us see these conditions:

  I. **"… Fit for the proper operation…of the service…".**Because administrative authorities are responsible for the good running of the public service, they should make decisions coincident with such a responsibility. One is taking a course of action via Article 3216 (1). For example the grantor may make it an obligation on the grantee that the latter control and regulate unreasonable behavior in the vicinity of the institution where service is provided. To this end the grantee may have the obligation of **prohibiting smoking** in the institution ran by the grantee. This obligation might be burdensome but still legal.

  II. **"…fit for the improvement of the service…"-** The point is the modification should be inspired by such grand principles a responsible administrative authority should appreciate. Though we cannot talk about the extent in

[2] Supra note 3, Article 3216(3)

importance of the improvement to the public in general, it is not possible to deny that the improvement should be important to the public and it should not be a ground of abuse.

- **There are limitations and even prohibitions on this prerogative of unilateral modification.**
- A brief discussion on the **limitations and prohibitions** will be available here.

1. **Only service-related modifications are valid: Article 3217 (1)** reads as "Only the clauses concerning the services and its operation may be modified".

Administrative authorities may increase or reduce the service to be operated. **In no case** however the authorities may impose modifications which actually **change the nature or object of the contract**.

2. **The nature of the service and the potential of the grantee:** the nature of the service and the potential of the grantee are some of the considerations that should be made when the administrative authority thinks of modifying the service. **Modification should not result in the imposition of completely new service on the grantee**.
3. **Financial interest of the grantee**: financial benefits that accrue to the grantee as per the concession may **not be modified unilaterally by the authorities**. On issues involving the interest of the grantee the grantor is not as such free to fix the remuneration unilaterally.

1.4. Duration of Concession

- **Concessions are contracts of perpetuity**. They are perpetual in nature. Still these **arrangements are not unlimited by time**, thought they cannot limit time.
- Under normal course of things, durations are regulated by the contract. Just like any other issue, failure to regulate by the contract will invite in place one legal presumption. **The concession will be deemed to have been made for a period of seven years.**[3] This is not the end. Failure to renew the concession within two

[3] Supra note 3, Article 3227(3)

years implies the implicit renewal of the concession for another seven years. The renewal goes on like this for a **maximum period not exceeding sixty years**.

1.5. Termination of Concession Contracts

- The **effect of termination of concession contracts is different** from the rest of contracts.
- The concession contracts result in the establishment of an organization to effectively provide public service.
- Hence, **when the contract is terminated a winding up procedure will be the effect.**
- This **winding up** in turn will **entail** the **"settlement of accounts between the grantee and the authorities.**[4] The rules of winding up are supposed to be stipulated Article 3229(2), short of which the provision of the law to that end will be in place.
- We have **two types of laws applicable in this case**. One is the **law in the civil code**. On the other hand, the **provisions of the commercial code** will also be effective.
- **Termination of concession has different reasons and different consequences** as well. Let us first consider some causes of termination under the law.

1. Redemption

- There are some reasons that the concession may not last for a period agreed originally. One of the grounds is **when the administrative authority decides to put an end to the concession before the expiry of the period of the concession.** Such **decisions may be initiated without the grantee committing a fault.**[5] Nevertheless, it does not mean that the administrative authorities may terminate the concession without a justified ground.

[4] Supra note 3, Article 3229(1)
[5] Supra note 3, Article 3236

- **There are two grounds** that, the act of administrative authorities irrespective of any fault of the grantee are justified. These are: **for the purpose of abolishing the service** or **reorganizing the public service**.
- **However, the administrative authority cannot exercise the redemption for a purpose contrary to good faith.** The authority should not redeem it for the purpose of replacing the grantee by another grantee.[6]
- **When the authority decides to redeem the concession, the relationship between the authority and the grantee needs to be settled**. In the process of winding up of the concession agreement, it may be found out that the grantee suffers damages because of the redemption. This damage could include the costs of organizing the service by the grantee or the profits /benefits the grantee sought from the concession.
- Hence, **it is provided under Article 3237 that the grantee is entitled for compensation to all the losses caused to him by the redemption**. What kind of loss would the grantee suffer because of the redemption? One of such losses could be while **the grantee transfers properties he does not use in the service but which were destined for this purpose**. Such properties may be redeemed together with the concession. Therefore, the price of such goods must be paid to the grantee.
- The other form of loss the grantee may suffer is **"the profit which the grantee could reasonably have expected and of which he has been deprived by the redemption."** The profit the grantee would collect had the concession not been redeemed, is considered as a loss under Article 3237 (3). But the irony remains as to how much the grantee will be compensated. Would he be entitled to the amount he expects in the business? Is it a reasonable profit? Would it be an equitable compensation?
- **A provision under Article 3181 (2) provides "…….regard shall be had to all the benefits which the party could legitimately expect to derive from the contract."**

[6] Supra note 3, Article 3236(3)

Both of these provisions tell us the fact the exact compensation will not be due. The court will take equity in to consideration for the calculation of compensation in this regard.

2. **Withdrawal Order (Loss of right)**
   - What is envisaged under **Article 3238 is a grantee that commits a fault**.
   - **The rule is the grantee can lose his right only by the order of a court**.
   - **But if there is an express agreement entrusting this privilege to administrative authorities, then the grantor may order loss of right of the grantee**.
   - **This order is called withdrawal order**. It **results in a premature termination of the concession contract**.
   - **Withdrawal order presupposes the commission of an especially grave fault**. This makes the order special from redemption.
   - We do not know what special fault is. Neither do we know which one is so grave. **Courts are those who have the right to determine the nature of the fault** and that will decide the loss of right. This being the rule, the law devises a general rule which allows stipulating a clause empowering administrative authorities to order loss of right without going to courts. But can we say that the administrative authorities may order loss of right in a valid way given the volatile nature of the concept of gravity of fault?
   - The final say as to whether an act constitutes a fault or not and as to whether a fault is grave or not should be determined by a court of law.
3. **Sequestration**
   - Sequestration (seizure) is **the act or process of legally confiscating somebody's property temporarily until a debt that person owes is paid, a dispute is settled, or a court order obeyed**.
   - Just like the above situation, **sequestration presupposes, even though not always, an element of fault on the part of the grantee.** The degree of fault is not predetermined in the case of sequestration.

- **Article 3238(1) is quite indicative of this degree.** In the case of loss of right the fault required is a special one in gravity. But Article **3241(1)** shows the fault **as being default, incompetence or incapacity.**
- What are the effects of sequestration?
- **Temporary suspension of rights**: The concept of sequestration necessarily envisages a possibility of suspension of rights. **The suspension of right is only for a limited time**. It is temporary owing to the conditions attached on it.
- Under our law, **sequestration is a measure ordered either to abort a possible interruption in the provision of services as a result of the incapacity of the grantee** or **sequestration is a punitive measure taken against a defaulting grantee.**
- **Management of the expenses and works of the grantee**: The other effect of sequestration is relates to the management of the work. This issue is related with the first effect i.e. loss of right of the grantee.
- **One of the rights that the grantee will lose as a result of order of sequestration is the right to manage the work.** The loss of right by itself has its own effects.
- **Although the ultimate effect is expulsion from the management of the work**, because this intrinsically necessitates the fact of managing the work by another person, **the grantee may have a legal duty to cover the cost of management**.
- The law still has reservations on the matter. The management **expenses are to be covered by the grantee only when the sequestration is ordered in lieu of punishment.** Otherwise the expenses are going to be covered by the grantor.
- Though the above orders can be associated with the prerogative of administrative authorities, **Article 3243 on the other hand tries to strike a balance between the prerogative of administrative authorities and the interest of the grantee.**
- **It is a good indicative of the fact that measures taken under Articles 3236-3242 should be in accordance with law.**

- **Illegality of the measures as ordered by the grantor entails different consequences:**

1. **Cancellation of order**: the orders of the grantor are not absolute in the sense that they are amenable to change by a court of law. Although the law says "The court may cancel the sanctions of coercion or dissolution, such as measures of sequestration, state control, loss of right or termination, taken by the administrative authorities against the grantee of a public service", it is not clear as to when the court orders the cancellation. It is however clear that **the order should follow an arbitrary and manipulative decision of an administrative authority**. Above all, it should follow an illegal order of the same.
2. **Order of compensation**: the sanctions imposed on the grantee will definitely cause loss to the same. Taking this into account, it is important to force the administrative authorities to make good what they have made bad by their decision. **The authorities are obliged to compensate the grantee only if they have injured the interest of the grantee by their fault.**

Article 3243 (2) reads as follows:

"It may order the authorities to pay compensation for the damage caused to the grantee in consequence of sanctions applied by such authorities *contrary to the law*".[emphasis]

1.6. Effect of Termination of concession

- **End of period of concession, redemption of concession, or loss of rights of the grantee because of grave faults committed are some of the grounds for the termination** of concession agreements.
- **When the concession agreement is extinguished because of end of period of concession it entails the winding up of the concession.**
- Winding up of concession is followed by liquidation to ascertain the rights and obligation between the parties (grantee and the authority).[7]
- But in case **where the concession is extinguished because of the loss of rights of the grantee for grave faults, there is nothing to liquidate as the grantee is**

[7] Supra note 3, Article 3229 and Article 3237

denied any rights except the price of the concession from tender. The grantee takes the price of the concession of whatever amount it is sold. Hence, there is nothing to be liquidated.

- In the above two grounds of extinction of concession liquidation becomes necessary as to what has to be paid to the authority or to the grantee must be made clear and certain.

The first question to be answered is 'who is going to liquidate the relation between the two parties?'

- **In principle there is no organ established by the law for this particular purpose.** In case of disagreement among the parties, **arbitrators may be selected by the parties**.
- **Failing to establish such arbitration organ it may be taken to court.**[8]
- **However, we need to appreciate that this organs, the arbitrator or the court are not acting as liquidators.**
- By way of conclusion, we can say that there is **not a distinct organ to liquidate the accounts among the two parties**.
- One of the activities to be done in the process is **the duty of the grantee to give the necessary information to facilitate the winding up process**.
- The **liquidation process, among others, include taking back properties in the concession and making the concession ready to continue**.[9] The grantee is obliged to give information relating to returning the properties. The grantee is also bound to return the works and materials of the concession. The materials of the Concession are to be returned to the authorities up on payment or on gratuitous basis.[10] **Immovable included in the concession, movables expressly provided in the specification to be returned without paying compensation, are**

[8] Supra note 3, Article 3233
[9] Supra note 3, Article 3230
[10] Supra note 3, Article 3230

subject to return without any payment to the grantee. This may include **roads, bridges, built for the running of the service.**

- **Other returns are made up on payment of compensation.** These include movables which are not provided to be returned without compensation within the specification of the concession. **Movables which were under use in the concession; like vehicles or any other movable make up such properties**.
- However, there is one important rule we need to take note of i.e. **the authority is not obliged to take all things used for the exploitation of the concession rather the authority is only entitled to do so as a matter of principle.**
- Hence, "the authorities shall not be bound to take back the things used in the exploitation of the concussion unless such obligation has been imposed up on them by the specification".[11]
- The amount of compensation is fixed by the parties. This is implied from Article 3233(1). In case of disagreement among the parties, arbitrators may be appointed by the parties to fix the compensation. Still the parties may fail to appoint arbitrators to settle the compensation. In the later case, it will naturally be taken to court.
- **Another duty that the grantee is bound to perform in the liquidation process relates to the continuation of the concession.**[12] The grantee must inform to the authorities' relationships he/she /it has established in relation to the exploitation of the concession. One of such relations is contracts he entered for the running of the concession.
- The authority will take the place of the grantee in the contract the latter has concluded with third parties as a principal. **The authority may opt either to terminate the relation with the third party or to repudiate the relation.**

[11] Supra note 3, Article 3232
[12] Supra note 3, Article 3234

- **However, when the authority prefers to repudiate and inform the third party that it does not want to continue, there will be an interest at stake, i.e. the interest of the third party may be affected**.
- The law (Article 3234 (2)) provides that for the grantee to be liable to the third party for the repudiation by the authority they need to have a prior agreement among them. **Yet, if there is not a prior agreement the grantee will not be liable.**
- The question then is who will be liable for any loss the third party may suffer because of the repudiation? As far as the relationship is one of lawfully constructed, there is no reason to believe that the third party in good faith must suffer losses arising from act of the grantee and /or the authority. But as to the authority the law says none. There could be two arguments we may pose here. The third party should suffer such losses as he/she should have agreed otherwise to remedy such losses with the grantee prior to such decision taken by the authorities.
- The other limb of the argument could be that the authority must pay any loss the third party could suffer. This is because, in principle the authority continues with the relationship the grantee has established and repudiation is an exception to be achieved through notifying the third party. Hence, when the choice remains with the authority, it must also be bound to compensate the third party.
- The last activity in the process of liquidation is the **duty of the authority to release any security or surety given by the grantee**. **This is done after settlement of accounts among the two parties**.[13] The grantee may demand the return of securities attached.
- The liquidation process is full of obligations the grantee assumes and a few obligations the authority takes. In such a relation among the parties, we may fear that the rights of the grantee may be affected. The law also assuming the upper

[13] Supra note 3, Article 3235

hand position of the authority in the liquidation process empowers the court to cancel any unlawful act of the authority.[14]

- The court up on application may cancel sanctions of coercion, or dissolution, including measures of sequestration, state control, loss of right, or termination taken by administrative authorities against the grantee. In addition to declaration of cancellation, the court may order compensation the grantee has suffered because of the unlawful act of the authority.

[14] Supra note 3, Article 3243