

## **Management of Risk Rights between the Investee Government and Projected Company in BOT Contract Projects**

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### **Abstract**

One of the issues that arises in BOT contracts are hazards and risks of the project. Governments tend to give responsibility of risks to investors as much as possible and among BOT benefits for governments and their motivation to use the BOT is to transfer project risks to the project company. In practice, this is a relative matter, and the project company is usually unable to manage project, control and accept all risks of the project, and depending on which country it invests in, it tries to transfer some risks and dangers to the Government or donor state company and other participants in the project in different ways including construction contractors, operators, suppliers of raw materials, product and service buyers and Data Transfer and cover other risks by insurance and in fact take some risks ability which can be controlled and managed.

**Keywords:** BOT, Risk, Management.

### **Introduction**

Infrastructure projects, whether financed by traditional methods or by new methods such as BOT financing, due to high financing costs and long delivery time, are considered as risky projects and the difference between all projects that are financed by BOT or Boo methods with traditional methods that have been financed through the state and public budget turns back to domestic or foreign private sector participation in the financing of projects and transferring projects' risks from public to private sector. But the issue is not so simple and due to the fact that infrastructure projects, particularly in developing countries for various political, economic, social, cultural, legal reasons are considered as high-risk projects, less domestic or foreign private investors are willing to accept all risks and invest and if they accept to invest, they take responsibility of maximum risks or hazards that have power to control over it and overcome it in order to be able to reduce its impacts to a minimum level. Thus, the investor does not take the responsibility of the project and in case of accepting some risks by the government or other public corporation as other side of contract and its support is willing to invest and finance the project. Accordingly, developing governments, in order to attract foreign investment and conduct infrastructure projects that have a significant role in the growth and development of that country and help their development, is willing to cooperate with the investor in sharing the risks between themselves and it is expected the government or the governmental side to undertake risks that are attributable to their actions: Delays resulting from failure to provide timely facilities such as electricity and gas as the primary fuel of power plant that will disrupt and delay the start of the project or accepts political risks such as changes in law, confiscation, expropriation and nationalization that, in this respect, even the government guarantees the investor (the Project Company) and applies protective measures. Here the division of risks between the host government (investee) with investor which is in the form of a company or consortium is mentioned. And, the project company shares other risks with other participants of the project participants.

Project's features include BOT, a plurality of the people involved in them, and in addition to the government or state-owned company and project company, construction contractors, operators, buyers, suppliers of equipment and raw materials and the lenders participate in it, all of which tend to identify project risks before starting the project and specify necessary measures to manage or cover or reduce risks.

Although generalizing the risks of BOT projects to infrastructure projects is difficult to generalize and any host country, every infrastructure part and indeed any BOT project have risks and conditions of its own, BOT projects encounter some risks regardless of the type and subject of project which are analyzed in this paper separately and in this article risks management or in other words risk allocation between the project companies and the government is paid attention to and analysis of risk allocation between the project companies and other participants will be studied in another article.

### **The necessity and purpose of research**

In risk management, primarily the presence or absence of risks should be detected. After it was determined that the project is faced with the risk, two hypotheses are conceivable. First, risk is not important so it should be ignored. Second, it is noteworthy that in this case the risk should be controlled, in other words, we should react to the risk. Risk control is possible in some ways:

*First step:* Avoiding risk or eliminating it, which means avoiding the risk which is done by changes in the project plan, including changes in the scope of work and eliminating high-risk activities, risk and the conditions of its occurrence are eliminated and consequently the risk can be eliminated.

*Second step:* if the risk cannot be avoided, it should be observed whether it can be reduced which means reducing the degree of probability of its occurrence and the effects of risk. If we can reduce that risk and residual risk is not significant, you should disregard the risk and if the residual risk is significant, or the risk cannot be reduced, the third stage begins that it should be observed whether or not the risk is catastrophic? If it is not catastrophic and is acceptable, you must accept the risk and if it is catastrophic or if it is neither catastrophic nor acceptable, the fourth stage will be considered that the risk should be transferred and takes place in one of the two forms, First, by insuring the risk, risk is transferred to the insurance companies and institutions. And second, the risk is transferred to the host State, construction contractors, operators, suppliers of raw materials and equipment and the purchase of the product (Ansari, 2005; Amir Sadoughi, 2004; Masoudnia, Haq Parast, Keshvari, et al, 2012; Azad and Rashidi, 2008).

The most important point is that the process of allocating risks is that the factor of project that takes responsibilities of the project should have all abilities required for appropriate management (Ahmadi & Khazaeni, 2005). Accordingly, and in order to manage and allocate project risks efficiently in order for the BOT projects to be successful, it is required to share risks between the project participants by raising the following three questions:

- (1) Who can control risk easily, inexpensively, and effectively?
- (2) Who benefits mostly from risk management?
- (3) Who has the greatest incentive for risk control (Delman, 2000:40).

In other words, in addition to the above three cases, a risk is allocated to a person who access more supportive tools and has the necessary financial resources (Uncitral, 2001). In fact, each of the components involved in the project, including governments, investors and founders of project must adopt specific strategy to deal with the risks that in order to do it, while making clear the risks, risks are allocated to the best position to bear and manage the risk (Sebt & Maknoon).

Finally, conducting project in non-risk conditions is nearly impossible and because this directly influences time and costs etc. and impose costs on the project that should be paid jointly. Thus, determining risk taker is one of the most challenging issues in BOT contracts and because the parties to the contract face with conflicting goals in allocation of risks and each one tries to reduce the risk and transfer it to the other side, the art of risk management, proper allocation of risk is in such a way that meet the objectives of all stakeholders in the most appropriate manner, in such a way that all risks are not shifted to one side, but the risks are allocated between the parties in accordance with capabilities in risk management and commitment, otherwise, this leads the lack of timely correct implementation of the project, an increase of the contract price, conflict and too much loss of one of the parties, and consequently reducing the incentive to invest and participate in the project implementation (Makuyi, Mahdavi, Faroukhian, 2008). Therefore, allocation of risk is a critical factor for project success (khazaeni and Afshar, 2004), and to achieve the goals of the project and project conduction (Nabavi Chashmi , Aziz Pur Shui & Ghahramanian, 2012; Azad & Rashidi, 2008).

Among the important issues that justify risk allocation and its transference from project companies to other participants is the desire of lenders. A large part of project and BOT which have no direct role in project capital is mainly provided by bilateral and multilateral credit institutions and banks which are not directly involved in the construction and operation of the project, however, in order to minimize project risks and their control, they insist that the project documents, project risks, are divided between the project participants such as construction contractors, operators, buyers and suppliers of materials and equipment (Uncitral, 2001).

#### **Contractual structure of risk allocation**

The initial allocation of risk in the project contract is defined between the project company and government or state companies under contract which grants exploitation patents to the project company (Uncitral, 2001). After signing the project contract, and the allocation of project risks including the business risks to the project company, they sign several contracts with other participants of the project including construction contractors, operators in these contracts the method of risk distribution between the project company and other parties to the contract determines that attempt to transfer project risks to other participants in the project is known as serial distribution of risk (Delman, 2000:40-41) and a series of related contracts for allocating risks include Shareholders Agreement, financing contract, construction contract, agreement for equipment supply, raw materials and fuel supply contract, purchase contract, operation and maintenance contract (Unido, 1996:160).

Due to the original BOT project contract between the government and state-owned enterprises on the one hand and other participants in project on the other hand, projects such as construction contractors, etc. is signed, in this paper we pay attention to allocation and division of risks of project between the government or the state company and the project company. And the division of risks between project company and other participants in the project will be analyzed in another article.

#### **Sharing risks between the government and the Project Company or state company**

As mentioned before, among government's objectives in using the BOT method in project financing is to transfer project risks to the company project, but this is not an absolute principle rather, due to different causes mentioned in the previous section, the above principle is relative and it is necessary for the investee government to accept some of the risks of the project and in some

cases support the project. In fact, government by taking guarantees and protection measures cover some of the project risks.

#### **First topic: risks transferred to the host State**

Host state helps reduction of the project risks and its impact on the company projects in two ways. First, it will undertake some risks including political risks that the project Company has no control over it; second, by providing guarantees, it covers some risks.

In principal, political risks such as expropriation or nationalization of project delays and cost increase resulting from government actions (including delays in obtaining permits and approvals) and the risk of government change and policy climate, score derogation risk and risk of rule change which is sometimes called the political risk must be accepted by the host government because the government will finally pay compensation for it (Unido, 1996:160). On the other hand, for example, about the threat of climate change policy, the government has the ability to control it or with regard to the confiscation and expropriation, albeit against a principle of international law, this application is considered as a right for the government but they have to compensate, for example, according to article 9 of the Foreign Investment Promotion and Protection Act, in case of expropriation or nationalization, the government is committed to fairly compensate or against note 2, Article 17 of the above Act, if the state laws generation prohibited or stop the execution of financial agreements within the framework of this law, the loss up to maximum overdue installments are paid and provided by the State.

#### **Second Speech: Providing a guarantee by the government for the project company (to reduce risk)**

Providing a guarantee by the host government is a method of supporting the project and encouraging domestic and foreign private investment in the BOT method. In order to promote participation of the private sector, (domestic or foreign) in BOT projects and in order to resolve concerns about the probable risks and dangers of the project, the investee government can provide guarantees which cause the investor to be more motivated to participate in the project. This guarantee can be in different forms which is mentioned in the following cases:

Guaranteeing a permanent minimum income - ensuring optimal rates of foreign exchange - guaranteeing an agreed revenue back - guaranteeing against high interest rates - guarantee to offset the costs and expenses paid by the government if changes in current monetary laws or generating new regulations which influence the new investment. - Guarantee of the tariff adjustment mechanism / effects - guaranteed supply of raw materials (including water, electricity, gas, coal, etc.)- guarantee the purchase of the product (such as electricity and water, etc.). - For example, the Malaysian government in north Highway project - south with a length of 850 km and conducted by the BOT approach taken - committed to offset the cost and expenses of the company under contract to pay in case of reducing the volume of traffic on this route and lowering interest rates and foreign exchange. Or the Pakistan's government in the project of Karachi's power plant committed to offset these costs and ensure the return of dividends in case of reducing the value of its currency and reduce the money paid by purchasers of electricity (Rami K. Maras, 2001)

In Iran's regulations, the government, in order to attract foreign investment, provides guarantees and protection which covers cases such as compensation against expropriation or nationalization, export and supply of foreign exchange guarantee in case of prohibition of export, ensuring compensation for damage resulting from a ban or moratorium of the implementation of financial agreements based on legislation or decisions by the government, ensuring the purchase of the product in cases where the government is the exclusive purchaser of goods and services

produced (Article 9 and note 2, Article 17 of the Law on Promotion and Protection of Foreign Investment and Part A and B and article 4 of implementation Regulations) and contract guarantees can be pointed to; including the supply of raw materials and fuel, and most importantly, to ensure the payment of all contractual obligations of Iran public companies under contract by the Ministry of Economic Affairs, on behalf of the State (Section L, Note 21 of Finance Act 2004, and its Implementing Regulations) and Article 24 of the Fourth Development Plan Act.

### **Article 1: Fuel Assurance**

For the stability of BOT projects' income, especially in the energy sector, fuel availability and reliability of supply during the contract period can be crucial, usually the founders of the project Company (the private sector, either foreign or local) and the lenders demand the government or relevant state agency to conduct comprehensive study on the availability of certain fuels from national, regional or other similar external resources, import restrictions. (Unido, 1996:254).

The type of fuel supply varies from country to country and often host governments supply fuel that is abundant and inexpensive in their country. For example, in Laibin B power plant construction project of China, the Chinese government ensured to supply the fuel (coal/oil) needed for the project company according to contract between the parties and the consortium (Project Company) were allowed to not accept the fuel not conforming with the terms described in the contract. The Chinese government has pledged to ensure the availability of sufficient resources for the fuel needed by the consortium. (Wang, Tiong, Ting wash Li, 2000).

### **Article 2: ensuring Product Order**

Among market concerns and risks and projects' efficiency is the lack or reduction of demand for a project product purchase which effects negatively the revenue stream of the project and the capital repay and its profits. Accordingly, among guarantees the host government (especially in cases where the goods and services are from the products and services of the government) gives to ensure the project company is to purchase products and services specific of the project to the certain amount in the real price.

In most BOT projects, agreement to buy the product, between the government agency or Project Company is a central arrangement. The main sources of project financing including loans and its interest, operation and maintenance costs etc. are provided by the contractual obligations and conditions to be included in the product purchase agreement and conditions of the contractual agreement to buy the product and purchase credit is one of the key factors in assessing the private founders and lender of the project risk in the BOT method.

Purchase agreements are usually based on the condition of "pay or take" until the end of the project life or at least until the end of repayment of the loan contract. For example, in case of power plant foundation in the BOT method, a Power Purchase Agreement with the condition of " pay or take " is an absolute and unconditional obligation to pay the regular price and the price of electricity for delivery in the regular periods (e.g., Monthly) whether the power purchaser (government or state-owned company) receive the electricity or not. In other words, the buyer, either the government or state-owned company commits to pay price and product prices and pay production capacity of the power plant at the end of the period specified (e.g., Monthly) (Unido, 1996; Sheykhholeslami Ebrahimi and Farahani, 2010).

Guaranteeing the payment of the product and its price in a given time (e.g., Monthly), in addition to being the guarantee for the loan and interest payments by the project company were regarded as an important instrument to reduce income risk and the project company by ensuring that the bought product is more likely to show interest to investment in and implement the projects.

It is noteworthy that product purchasing guarantee by the government or public company does not necessarily include the whole product and is different based on the agreement, for example, depending on China's Libin project, which was a power plant construction project, the purchase of at least 3,500 million Kw/h of electricity (approximately 63% of the production of the power plant) can be guaranteed each year of operation (Wang, Tiong, Ting Wash Li, 2000).

### **Article 3: guarantee against expropriation or nationalization**

Nationalization is a process in which the property is already owned by private individuals according to certain rules, and if there is interest and public purpose, without discrimination and with compensation, returned to the ownership of the government (Imam, 1995: 345).

As a general principle of international law, and in order to comply with national interest and in compliance with the law and to fairly compensate the damage occurred, the right of nationalization and confiscation of the government were recognized (Mirabbasi, 1992- Lal Sarab, 2001). In the laws relating to foreign investment or particular laws pertaining to BOT, it has also been predicted that projects' properties and capital not be expropriated or nationalized as much as possible except in special cases and for public interest or fair compensation of damages.

In article 9 of the Law on Foreign Investment Promotion and Protection Act approved in 2001 states that: foreign investment is not subject to expropriation or nationalization unless to the public interest, pursuant to legal process in a non-discriminatory method and upon payment of appropriate compensation on the basis of the real value of that investment immediately before the expropriation. And in paragraph 4 of Part 1 of Article 4 of the above mentioned law enforcement passed in 2002 also it is stated that: "foreign investors are guaranteed against nationalization and expropriation and foreign investment in these cases are entitled to compensation".

### **Clause 4: ensuring against the legislation change**

The project company will invest based on existing applicable law. If the existing laws are changed or new laws enacted that have been created or caused a delay in the enforcement of the project or its closure, the investor government shall pay for compensation which this situation has been predicted in note 2 of Article 17 of the Law on the Promotion and Protection of Foreign Investment in Iran.

### **Clause 5: To ensure currency exchange**

For example, a foreign investor in order to invest in Iran imports cash capital into Iran in form of foreign currencies; including dollar, euro, and this capital and its profits should be amortized during the operation. Since the revenue of the project during the use is received in the domestic currency of the investee country, first the domestic currency should be changed to foreign currency to be able to say that the imported foreign capital have been completely amortized. Second, maybe the investor for the project financing borrow foreign currency from banks and businesses, the principal and interest repay of which shall be in the form of foreign exchange or in order to implement the project provide the necessary equipment from suppliers outside the country and import it into the country that should be paid in foreign currency that in any case, it is necessary for the host government to provide possibility to receive the proceeds from the project during the operation in the domestic currency and will be used to repay the capital and profits to the lenders and reasonable return of capital and its profit, etc. are easily converted into the foreign currency in question. On the other hand, the investor after investment and operation of the project and compensation of the capital and profits in domestic currency is inclined to convert the currency to a

transferable currency since he wants to transfer capital abroad, accordingly the host government guarantees the convertibility of the currency.

#### **Clause 6: ensuring the transfer of capital**

After investing in the host country and project implementation and operation of the project and completion of concession period and receiving capital and its profits and taking advantage of it, the investor tends to transfer money and its profit to the country of origin. In other words, the investor invests hoping that after the implementation of the project and gaining capital and its profits, transfer capital to their home country or another country to invest, therefore at the beginning of investment he tends to ensure that the host country guarantees the transfer of his capital abroad. If the investor knows at the outset that the incoming capital to the host country cannot be transferred outside the host country, he will invest. Accordingly, the home state of the investor insures the investor of the possibility to transfer capital and profits conducted in form of either exchange or the issuance of export. (Articles 13 -17, Foreign Investment Promotion and Protection Act, approved in 2001).

#### **Third speech: Other supports of the host government to reduce the risks effects**

Host country in order to attract and support private sector investment give some other concessions and facilities to domestic and foreign private investors among them the followings can be pointed to:

##### ***Section 1: The customs and tax privileges***

Among levers and incentives to attract foreign investment in the implementation of projects that are privately financed includes host government support in the form of tax exemptions and customs granted to the investor or mitigate it. In most of the rules for private investors, tax exemptions and privileges were considered the privileges of the foreign investment law and the observance of the principle is to attract foreign investment that foreign investors receive the same treatment as local citizens are also granted to foreign investors.

Tax exemptions and customs vary from country to country. Some countries have laws that all transactions are related to infrastructure projects with private capital are exempt from customs duties and some other duties. In some cases, the law considers tax privileges and authorized the project country participation in using the same tax privileges considered for foreign investment. Such exemptions and concessions are sometimes included foreign contractors involved in the project company. In addition to the privileges with tax exemptions, the national laws of some countries to import equipment for use by the Project Company applies exemption from customs tariffs. Such exemptions to pay import tariffs on equipment, machinery, raw materials and materials entered to be used for primary research, design, manufacture and operation of infrastructure projects are considered.

In Iran, there are examples of tax exemption with regard to activities of natural persons including exemption from tax on paid or allocated profit Subject to Articles 135 and 145 and exemption from corporate tax subject to articles 143 and 105 of direct taxes law and tax exemptions derived from activities predicted in specific locations can be referred to which are applicable to foreign investors under Article 8 of the Foreign Investment Promotion and Protection Act of 2002 and Section 1 of Part A of Article 4 of the Rules governing the above rule.

##### ***Section 2: Protection from competition***

Other forms of government support could include guarantees about the lack of competing infrastructure project is for a certain period or any governmental agency or company, directly or through granting the right to operate to another company will not compete with the project

company. For example, if the subject of BOT project is to build a toll road, the founder and lenders, want to ensure that no new toll or side road will not be built parallel to the target road. These guarantees make sure that the exclusive rights that the company under contract benefited from will not be denied during the project activity or at least, will continue until reaching a certain threshold of income. Protection against competition may be considered by project company and the lenders as an essential requirement to participate in the development of infrastructure in the host country. Because loans' pay off and project revenue are usually postponed to sales of products and services and is very important for the project company and lenders and banks that the government or state-owned company under contracts do not entrust concessions of establishment and operation of similar projects that would compete with the project Company, to other private, state or public companies and the project company should be fully aware of the demand and the proceeds of the project for BOT project feasibility and its financing.

It should be noted that although protection against competition may cause a monopoly for project company, this monopoly should not be detrimental to the consumers of the host country (Unido, 1996 : 235). On the one hand concerns of the project company about insurance of certain revenue from the project to pay installments and compensate investment and obtain revenue should be taken into account. On the other hand, the investee country needs to develop and grow should be paid attention to. Also, maybe in some cases in order to help the low-income sector it is necessary, for example, to build toll-free or low-toll roads along with toll roads of the project company that may affect negatively on the revenue. Thus, the point that should be taken into account by the host government (investee) is that there should be a balance between project company's interests in gaining predicted revenue from project and country's development and growth and supporting the project company against competition continues till the existing needs are met and the products' required quality and services are provided and if doing competitive actions to support low-income class negatively affect the project process, the government compensate damages of the project company (Ansireal, 2001).

### ***Section 3: sub-income resources (auxiliary)***

One of the other forms of supporting infrastructure project implementation provided by private capital including BPT is to diversify and provide side investment by project company which is realized by granting more exploitation privileges along with the main project to provide sub-services and or applying other activities. For example, if the subject of project is to establish a toll road, the project company is authorized to make use of sub-equipment of this road like establishing a store etc. along the road and the location of toll stations that give more motivation to invest in the project. If these subsidiary activities are not profitable enough, the project financing can be promoted.

In order to provide the ground for following subsidiary activities by the project company it is necessary for the government to receive the legal permission to grant the right to use properties belonged to the authority under contract (for example, ownership of the land next to the area considered for the contract) and or grant the project company the right to obtain the cost for public use of facilities made by the authority under contract.

### ***Section 4: participation in the share of project company***

Project capital is provided in two ways: capital share and loan. In some projects another form of government support includes direct or indirect participation in the project company's share. Government participation in company's share can create a better ratio between share and debt (loan) that this kind of participation particularly if the project company cannot gain the necessary capital is highly important. In the Water supply project in Izmir, Turkey which is one of the most important projects in BOT method, the Izmir Municipality also actively participated in the project.



### ***Section 5: permission for imports and exports***

In some cases, the consortium (project company) in order to implement projects requires to provide machinery and equipment from abroad, the investee country and import them to the country which requires to obtain an import license from the investee country. On the other hand, except cases that government or state companies are exclusive buyer of the product and paying the real price of product is guaranteed, in other cases in order to sell the product and payment of debt and loan and interest from product sale, it is necessary to export product aboard the investee country and the export license is issued from the investee government. In paragraph C of article 17 of Iranian Foreign Investment Promotion and Protection Act and paragraph 6 of Part A of Article 6 of the above mentioned law enforcement, the permission to export project products is given to the company as currency transfer.

For the project company, it is important to issue the import and export license at the first chance because project companies in order to finance project resort to borrowing loan from banks or credit institutions and delay in providing equipment and machinery required will lead to implementation and use of the project and on the other hand in issuing products and selling them cause delay in paying debts and loan and its interest to lenders and as a result cause paying additional interest that overall on the one side cause loss to the company and on the other side project utilization will take long that cause loss for government and the public which are the end users of products and services of the project.

### **Second topic: hazards that are undertaken by the project company**

Qualification of sponsors of project company is the most important factor when assessing BOT projects risks which are taken into account by the host government and lenders. In addition, their experience and ability to carry out such projects and their credibility and commitment to the project and to take risks, as well as the experience, ability and credibility of other participants in the project including contractors, equipment suppliers and operators entered into the project by project companies are very important for the project.

Governments and financial institutions demand project sponsors to take an integral part risks because the investment return of sponsors is linked to the project long-term success. 4 major risks to the project company typically accepted by the sponsors of the project include: the construction and completion risks - risks associated with the operation - the risks associated with interest and currency rates - risks relating to basic needs.

### **First speech: construction and completion Risk**

Construction and completion risk is the responsibility for all project development costs, additional construction costs and delay costs. Based on project contract, in order ensure adequate management of manufacturing risks it is usually require that sponsors do the following:

- Ensure completion of projects such as providing more funds - specifying the minimum and certain level of investment in form of shares' ownership. -during construction or other specified period of time, provide guarantees for the repayment of the loan. – Specified ratio of debt service coverage and minimum share of debt ownership are kept and determined for the project companies. Sign key contracts with fixed price with the main contractor in which the completion and implementation guarantees are considered and the cash cost are taken into account for company in cases that a specified level of implementation is not performed. Similar guarantees are demanded from equipment suppliers and subcontractors who are faced with the sponsors and lenders - Use the proven technology.- during the period of construction, consider insurance. - In case of failure of the

contractor or supplier of equipment in performing, the consequences of it are noticed by the sponsors of the project.

### **Second Speech: Risks associated with the operation**

Among important steps of BOT project is the operation stage at which some risks and dangers may threaten the project.

According to the project contract, risks associated with the failure of the operation or maintenance of the project must be accepted by the sponsors. Sponsors can manage these risks by transferring some of them to the one responsible for maintenance and operation of the project in operation and maintenance contracts). Project contract enforce sponsors to insure the operational risks (including insurance of project loss and responsibility insurance). Lenders of the project can also ask for revenue maintenance accounts (income).

In order to guarantee the quality of the project operator, government, sponsors and lenders consider monitoring and measurement of the operator's activities (e.g., quality and quantity of the product) as a necessity. This facilitates relating the loss or liability to actual implementation and function of project. In order to ensure an adequate investment and following a defined program of maintenance and monitoring BOT projects is also necessary. Some lenders consider as necessary technical the assistance agreement between the project company and the suppliers of the equipment.

### **Third speech: the risks associated with providing basic needs**

For construction and operation of the project, raw materials and equipment is needed. And sponsors must accept the risks associated with basic needs and to protect themselves against these risks, sign contracts for supplying raw materials with fixed price and good quality for a long time. Such contracts shall include the followings:

- Supply of raw materials, fuel and spare parts in the long run - commitments regarding the availability, quality and price of products, liability and damages whatsoever in the event of non-performance of the obligations. - A formula for increase in prices to consider factors such as exchange rate and inflation.

### **Fourth speech: risks associated with interest rate and currency**

There are many tools for management and compensation of risks associated with interest rate and currency in the capital market, such as the following method: in the event that in the capital market, there are a lot of participants; Each tries to convert the risk to a risk that can cope with and reduce it. Sometimes there may be two of the participants who can access their target list of risks through exchanging its exchange rate risk. For example, a contract side may have high financial commitment with US dollar but his income be in Germany mark and the other side has commitments in Germany mark but his income is in US dollar is totally clear that both sides are exposed to risks of currency exchange. If these two exchange their commitments, their incomes are similar to their commitments regarding currency, and consequently the risk of currency exchange reduces. This reason can be used to exchange fixed and floating interest rates to prevent the risk associated with interest rates

### **Third debate: insurance risks**

In some countries, banks' unwillingness to lend without state guarantees creates serious problems in the way of financing infrastructure projects by BOT method. To consider this issue, export guarantee agencies in various countries and international financial institutions like the World

Bank and Multilateral Investment Guarantee Agency (MIGA) and International Investment Organization (IFC) and even regional development banks, provided guarantees in this regard which include political risks and risks resulting from force majeure events that led to the failure of the payment of debts to lenders or risks derived from failure to conduct host government obligations including confiscation and expropriation or nationalization of the project, contract termination and dangers of war and internal chaos and etc. (Gholi Zadeh, P.161). But difference between guarantees of the World Bank and Multilateral Investment Guarantee Agency and international funding agencies is that the World Bank demand mutual guarantees against guarantees offered from the host government, however, the agency that mainly covered investments of ownership share and also the extended loan by investors of ownership share and provides support against political risks, currency convertibility, war and internal chaos and ownership deviation demands the host country mutual guarantee (Unido, 1996:234).

### Conclusion

Although the main sides of BOT contract were the government (or the governmental agency) as investee and the project company as investor but several other sides including construction contractors, suppliers of raw material and facilities, financial suppliers, operators, technical counselors, financial and legal, and product buyers are involved in it. Multiplicity of contracts and the number of people even if they were from different countries causes different risks and hazards which over all the political, economic and legal risks can be pointed out. Although the investee government tends to assign risks to the project company as far as possible, it does not easily invest. Therefore, it is appropriate that the risks of the project to be divided as the case and according to the party who has the power to take control.

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