# PROCUREMENT OF THE ASIAN INFRASTRUCTURE INVESTMENT BANK: FIVE LEGAL ISSUES

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## ABSTRACT

*Each multilateral development bank (hereinafter "MDB") has its own procurement policy regulating procurement in projects financed by it. This article aims to investigate those key institutional arrangements, in and out of an MDB procurement policy, that tend to impact the core procurement principles and standards in the policy. The topics addressed in this article are the impact of the non-resident Board system of the Asian Infrastructure Investment Bank (hereinafter "AIIB") on procurement, compared with the executive Board of the traditional MDBs; the role of trust funds in MDB-financed procurement; state-owned enterprises (SOEs) as private entities in MDB-funded procurement; the choice of alternative procurement arrangements; and procurement-related complaints and disputes. The methods of investigating these issues include references to the law and practice of the World Bank, other MDBs, and the World Trade Organization (WTO). This article not only describes what these methods are regarding these issues, but also suggests what should be done to optimize MDB procurement results. There is a special focus on the procurement law of the China-led AIIB throughout the discussion.*

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**KEYWORDS:** *multilateral development banks, AIIB, procurement, trust funds SOEs*

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## I. INTRODUCTION

The multilateral development banks (hereinafter "MDBs") include the International Bank for Reconstruction and Development (hereinafter "IBRD", or the "World Bank") and six smaller regional development banks: the African Development Bank (hereinafter "AfDB"), the Asian Development Bank (hereinafter "ADB"), the Asian Infrastructure Investment Bank (hereinafter "AIIB"), the European Bank for Reconstruction and Development (hereinafter "EBRD"), the Inter-American Development Bank (hereinafter "IDB") and the BRICS countries' New Development Bank (hereinafter "NDB"). Each MDB has its own procurement policy regulating procurement in projects financed by it wholly or partially.[1] These procurement policies generally follow the principles of value for money, sustainable development, and integrity,[2] which in turn take effect "through efficient, fair, ethical and transparent procurement processes".[3]

Each MDB endeavors to live up to those core procurement principles and standards in practice. They have designed and implemented legal arrangements relevant to the realization of the core value of procurement. For example, it is crucial to enable all eligible businesses to compete equally during bidding, regardless of nationality or ownership. The project preparation stage, essential for identifying a bankable project, should avoid being maneuvered to benefit certain enterprises at a later stage. Technical requirements in a bidding document must be neutral, and bidding information must be accessible in a timely manner for all parties. A different procurement system than its own is a choice, when that system is cost-effective and good for streamlining procurement processes. Regarding a complaint or dispute arising during procurement, there must be an effective and efficient handling system, producing no delay to the project while securing procurement fairness. All those legal arrangements are tied together to serve the core purpose and value of the MDBs' procurement policy.

The AIIB is the first MDB initiated by China, and has drawn the world's attention. In the second year of its operation, the Bank's

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[1] When the multilateral development banks [hereinafter MDBs] co-finance a project together, they often defer to the lead financer's procurement policy, *see infra* Section V.B.

[2] *See, e.g.*, WBG, *The World Bank Procurement Regulations for IPF Borrowers: Procurement in Investment Project Financing Goods, Works, Non-Consulting and Consulting Services*, Foreword (Nov. 2017), https://policies.worldbank.org/sites/ppf3/PPFDocuments/7ab37ad5cb6e4f4c9c07555d23cc0c42.pdf (The World Bank sets its vision that "Procurement in Investment Project Financing [hereinafter IPF] operations supports Borrowers to achieve value for money with integrity in delivering sustainable development.").

[3] *See, e.g.*, Asian Infrastructure Inv. Bank [hereinafter AIIB], *Procurement Policy*, Vision Statement (2016), https://www.aiib.org/en/policies-strategies/_download/procurement-policy/policy_procurement.pdf.

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membership has already reached eighty-four,[4] much larger than the membership of the ADB, which has been led by Japan in a history of over 50 years and currently has 67 members.[5] The young Bank is conceived for the 21st century, and commits to a modus operandi of "lean, clean and green".[6] AIIB procurement law is not only consistent with this high standard, but also boasts pragmatic innovations.

Section II of this article discusses the impact of the AIIB's unique, non-resident Board on procurement. The non-resident Board anticipates being a valuable asset for fair procurement, compared with the traditional, executive Board of other MDBs. Section III discusses the role of trust funds in MDB-financed procurement. It takes the United States (hereinafter "U.S.") as an example to see how a donor nation affects procurement by establishing trust funds in the MDBs, and foresees the role of trust funds in AIIB-funded procurement. Section IV investigates the criteria of private entity in MDB procurement law and World Trade Organization (hereinafter "WTO") law. Whether a stated-owned enterprise (hereinafter "SOE") is treated as a private entity has significant impact on MDB procurement. Section V looks into alternative procurement arrangements, and divides them into two general categories—"country systems" and "co-financings". Section VI examines the subject of dispute settlement relating to MDB procurement. Section VII concludes the article.

## II. THE AIIB'S NON-RESIDENT BOARD SYSTEM RELATING TO PROCUREMENT

### *A. Impact of the Executive Board of Traditional MDBs on Procurement*

The MDBs traditionally have an executive Board of Directors. The executive nature means that the Board is closely involved in bank daily business. For example, the World Bank's twenty-five executive directors hold meetings three times weekly at its headquarters in Washington to discuss and decide important matters. They not only decide rules and policies, but also have a final say in project investment proposals made by borrower governments and submitted to the Bank by management.

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[4] Of the 84 members, 61 are members and 23 are prospective members subject to ratification instruments being deposited with the AIIB, see *Members and Prospective Members of the Bank*, AIIB (Dec. 19, 2017), https://www.aiib.org/en/about-aiib/governance/members-of-bank/index.html.

[5] *See Members*, ASIAN DEV. BANK [hereinafter ADB], http://www.adb.org/about/members (last visited Dec. 25, 2017).

[6] The modus operandi is defined as follows: lean, with a small efficient management team and highly skilled staff; clean, an ethical organization with zero tolerance for corruption; and green, an institution built on respect for the environment.

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The enormous power embodied in the executive Board system clashes with the function of management. The management has professional experience with, and necessary expertise in, an investment project. Its view and assessment on the project is paramount for achieving loan sustainability for an MDB. Under the executive Board system, however, management does not hold the final say over a project proposal, while nonetheless having to bear responsibility for a decision made by the Board if the project goes wrong.

This unfair distribution of responsibility between the Board and management leads to criticisms of low operational efficiency of the World Bank and other MDBs. It also has the result that management lacks necessary autonomy from member countries,[7] whose interests are represented by the executive directors at the bank.[8] A conflict of interest arises in the procurement market when executive directors have a natural obligation to promote business interest of their own nationality. By comparison, businesses of other nationalities will be disadvantaged with regard to their procurement opportunities in MDB-financed projects.[9]

For example, as a lead shareholder in the World Bank and four regional MDBs,[10] the U.S. has an executive director of its own in each of those banks. It makes use of its executive directors for maximizing its own business interest. In principle, U.S. government instructs its executive directors to "make business development and exports one of their highest priorities within the MDBs."[11] That priority is carried out in the following ways:

First, from an institutional perspective, both the U.S. Treasury and Department of Commerce are responsible agencies. The Treasury not only appoints executive directors to the MDBs, but also within itself has created a new position called "Assistant Director for Business Development and Exports", responsible for MDB office and procurement-related issues. The Department of Commerce assigns its staff to work in the offices of

[7] SARAH BABB, BEHIND THE DEVELOPMENT BANKS 230 (2009) (noting that management has a natural tendency to pursue multilateralism and organizational autonomy).

[8] The directors of the MDBs attend the Board meetings, and vote on behalf of the governments that appoint or elect them. This role played by the Board is termed "political counterweight". *See* Independent Evaluation Office of International Monetary Fund [IEO], *Executive Boards in International Organizations: Lessons for Strengthening IMF Governance*, at 9, IEO Doc. BP/08/08 (May 2008).

[9] The Board does not equally represent the members. For example, the World Bank's Board composes 25 directors representing its 189 members. In that case, each of the top five members are represented by one director, while a group of some 20 small members are represented by another director.

[10] These regional MDBs include the Inter-American Development Bank [hereinafter IDB], the African Development Bank [hereinafter AfDB], the ADB, and the European Bank for Reconstruction and Development [hereinafter EBRD].

[11] U.S.; CONG.; HOUSE; COMM. ON BANKING, MULTILATERAL DEVELOPMENT BANK PROCUREMENT 41 (2015) [hereinafter U.S. MULTILATERAL DEVELOPMENT BANK PROCUREMENT].

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executive directors in the MDBs, and provides a one-stop shopping service to facilitate procurement for U.S. business.[12]

Second, on business information, executive directors are able to provide U.S. business with accurate and timely procurement information[13]—the "early warning" so desired by U.S. business.[14] Expanded procurement staff at the U.S. executive directors' offices will surely enhance such capability by greater accessibility to procurement information and internal bank documents.[15]

Third, on procurement contracts, executive directors must assure that MDB procurement practices are fair.[16] For contracts awarded above certain specific levels, international competitive bidding is the norm. Since the norm is equivalent to the U.S. system in important respects, it actually helps to enhance U.S. businesses' competitive advantage. If U.S. firms were treated unfairly in MDB-financed procurements, U.S. executive directors residing in MDBs may pursue the reversal of the awards of contracts, or otherwise cancel bank loans.[17]

It is evident from the above that an executive Board system indeed has great influence over MDB-financed procurement. To be clear, the system is helpful for countries that have their own executive directors in the MDBs, but disadvantages those that share one executive director representing twenty members or so altogether in a vote; let alone those non-member countries, whose interests no body is legally obliged to serve in the MDBs.

### *B. The AIIB's Non-Resident Board System Contributes to Fair Procurement*

The AIIB adopts a non-resident Board of Directors system. AIIB Article of Agreement (hereinafter "AOA") Article 27.1 provides that "The Board of Directors shall function on a non-resident basis except as otherwise decided by the Board of Governors by a Super Majority vote as provided in Article 28." AIIB By-Laws Section 2(b) provides that "Said Rules of Procedure shall provide, inter alia, for regular meetings of the Board of Directors at least quarterly, for special and electronic meetings, and for voting without meeting, as provided in Article 27 of the Articles of Agreement." Following this, AIIB Rules of Procedure of the Board of Directors Section 3(b) provides that "Pursuant to Section 2(b) of the By-Laws, the Board shall hold regular meetings at least quarterly in each

[12] *Id*. at 41-42.
[13] U.S. business fully recognizes the importance and benefit of the executive director mechanism. *See id*. at 71.
[14] *Id*. at 16, 51.
[15] U.S. business particularly advocates this point, see *id*. at 67.
[16] *Id*. at 40-41.
[17] *Id*. at 41.

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year."

The Board meets four times a year at least, drawing on the non-resident experience of the European Investment Bank (hereinafter "EIB"),[18] whose Board of Directors meet not less than six times per year.[19] The non-resident Board system contributes to equilibrium between the Board and management, and also helps to level the playground for members regardless a director representing a single member or a group of members.

The AIIB follows a global procurement rule, i.e., the business opportunities of procurement are available to non-members as well as to members,[20] which draws upon the EBRD.[21] The non-resident Board system will thus put all firms on an equal footing in competition regardless nationality, exerting particular significance for firms from non-members. Thus, the non-resident Board system creates a favorable context for global procurement.

It is noted that the non-resident Board system might devoid the advantages of early warnings for business, which is unique to the executive Board system. In order not to compromise such advantage, transparency for procurement information is key. It is no wonder that the AIIB "is committed to achieving a high level of transparency under each Project."[22] And the AIIB procurement policy requires that "sufficient and relevant" information avail in an open manner to interested parties.[23] Additionally I suggest that AIIB procurement information avail in a "timely" manner, making up the function of early warning under the traditional, executive Board system.

The AIIB's twenty-four projects so far were all approved by the Board rather than by management, however, starting the first batch of projects in June 2016.[24] It follows a temporary arrangement that "[a]ll financings are

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[18] The European Investment Bank [hereinafter EIB] is the European Union's policy-driven bank, established in 1958 under the Treaty of Rome. It is the world's largest international public lending institution with a capital-base of EUR 243bn in 2013, but is not considered as an MDB in a strict sense. *See Some Dates and Figures*, EUR. INV. BANK, http://www.eib.org/about/key_figures/index.htm (last visited Mar. 30, 2017).

[19] Rules of Procedure of EIB, art. 11.1 (Sept. 1, 2016), http://www.eib.org/attachments/general/rules_of_procedure_en.pdf.

[20] AIIB Articles of Agreement, art. 13.8 (Jan. 19, 2016) (providing that "The Bank shall place no restriction upon the procurement of goods and services from any country from the proceeds of any financing undertaken in the ordinary or special operations of the Bank.").

[21] Agreement Establishing the European Bank for Reconstruction and Development, art. 13.xii, May 29, 1990, 29 I.L.M. 1083 (providing that "the Bank shall place no restriction upon the procurement of goods and services from any country from the proceeds of any loan, investment or other financing undertaken in the ordinary or special operations of the Bank . . . .").

[22] AIIB, *supra* note 3, art. 5.1.7.

[23] *Id.*

[24] *See Approved Projects*, AIIB, https://www.aiib.org/en/projects/approved/index.html (last visited Dec. 24, 2017).

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currently approved by the Board"[25] which fits into the early development stage of the AIIB. Since the Board is non-resident, however, it is untenable to have each such financing approved by the Board. Rather, as a daily business, most decisions on financing should be left with management. Thus, the Board is expected to delegate to management this important power.[26]

There are concerns about management's decision-making following power delegation. The composition of management, the possible bureaucracy of management structure due to the non-resident Board system, as well as transparency of project review process, may all have implications on fair procurement. Here are a few facts worth reiterating as a response. First, the AIIB vows to be "lean" by applying a non-resident Board system; it has no interest in maintaining a bureaucratic staff team, which has widely been seen as a demerit of the traditional MDBs and should be avoided by the AIIB. In fact the AIIB recruits staff in a very prudential manner, maintaining only around 100 staff for the second year into operation. Second, the AIIB's project process is clearly illustrated,[27] and guided by its strategic goals and thematic priorities: sustainable infrastructure, cross country connectivity and private capital mobilization. Detailed project news, information and official documents, including procurement information, are accessible on the AIIB website.[28] Third, AIIB management is diversified in terms of nationality,[29] and in particular, the vice president in charge of investment is non-Chinese. In fact, there is only one project destined in China, of the twenty-four projects the Bank decided to finance.

## III. TRUST FUNDS RELATING TO PROCUREMENT

Trust funds at the MDBs are multilateral funds donated by bilateral donors.[30] The reasons for donors to channel their contributions through

[25] AIIB, *Operational Policy on Finance*, at 7 n.16 (Mar. 27, 2017), https://www.aiib.org/en/policies-strategies/_download/operation-policy/policy_operational_financing_new.pdf.

[26] *Id.* ("The Board is expected to consider (in late 2016) a delegation of authority to the President to approve certain Financings and subsequent changes related to them.").

[27] *Project Process*, AIIB, https://www.aiib.org/en/projects/process/index.html (last visited Dec. 24, 2017).

[28] *Proposed Projects*, AIIB, https://www.aiib.org/en/projects/proposed/index.html (last visited Dec. 24, 2017); *Approved Projects*, *supra* note 24.

[29] AIIB senior management comes from a variety of countries. Its five Vice-Presidents are Sir Danny Alexander from the U.K., Mr. Thierry de Longuemar from France, Dr. D.J. Pandian from India, Dr. Joachim von Amsberg from Germany, and Dr. Luky Eko Wuryanto from Indonesia. The General Counsel is Mr. Gerard Sanders from New Zealand. The Chief Risk Officer is Mr. Martin Kimmig from Germany. Senior management's nationalities embrace both regional and non-regional members, as well as developed and developing countries. *See* GU Bin, *Chinese Multilateralism in the AIIB*, 20(1) J. INT'L. ECON. L. 137, 152-53 (2017).

[30] Bernhard Reinsberg et al., *Which Donors, Which Funds?: The Choice of Multilateral Funds by*

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trust funds at multilateral agencies, rather than bilateral aid for the same purpose, are dual in nature: "[d]onors [are able to] reduce their own administrative costs, while benefiting from the expertise of the multilateral agency." [31] However, since these funds often earmark the donors' preference on fund use, they are not completely out of the donors' control.[32]

There are generally two types of trust funds, i.e., tied ones and untied ones. The practice of tied funds means that the donor member donates money to MDBs with conditions, dictating how and where the money should be used. Tied funds may not be welcomed by MDBs, compared with untied funds, and may also frustrate donors of untied funds by putting the latter in a disadvantaged position back at home when facing their business and Congress. According to a testament before the U.S. Congress in 1993, Japan and Taipei, China practiced untied funds,[33] France and the United Kingdom (hereinafter "U.K.") used tied funds regularly, and the U.S. established both tied and untied funds at the MDBs.[34] The U.S. called on peer donors to drop off the tied conditions, while trying to maintain its own funds "tied".[35]

Trust funds are established for various purposes. Specific to trust funds relating to MDB-funded procurement, they are technical assistance funds used for financing engineering and architectural services, the initial portion of a project.[36] Because engineering firms are responsible for project design, they are also responsible for developing the technical specification for further equipment and works procurement required for project construction.[37] Therefore, engineering services are the "opening wedge" of the entire procurement process.[38]

### *A. The U.S. Experience with Trust Funds*

The U.S. gives high regard to trust funds because trusts give U.S. firms the first shot at a major project, and secures U.S. firms with higher visibility with the borrower government when the project moves into its implementation phase.[39] The U.S. Trade and Development Agency

*Bilateral Donors at the World Bank*, abstract (WBG, Policy Research Working Paper No. 7441, Oct. 2015), http://documents.worldbank.org/curated/en/948551467997028331/pdf/WPS7441.pdf.

[31] *Id.*

[32] Vera Eichenauer et al., *"Bilateralizing" Multilateral Aid?: Aid Allocation by World Bank Trust Funds*, 1 (Feb. 2014) (unpublished manuscript) (on file with author), http://wp.peio.me/wp-content/uploads/PEIO8/Eichenauer,%20Knack%207.2.2015.pdf.

[33] Taipei, China is the official name of membership for China's Taiwan region in the ADB.

[34] U.S. MULTILATERAL DEVELOPMENT BANK PROCUREMENT, *supra* note 11, at 21-23.

[35] *Id*. at 21, 23.

[36] *Id*. at 71.

[37] *Id*. at 70.

[38] *Id*. at 69.

[39] *Id*. at 70.

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(hereinafter "TDA") is responsible for establishing trust funds at the MDBs, and deciding fund use involving MDB-financed projects.[40]

"Early involvement will succeed in getting more of the bigger procurement," former Treasury deputy assistant secretary Susan Levine once testified before the Congress in 1993.[41] The TDA gets involved in MDB-financed projects at the drawing board stage by funding feasibility studies. These studies are carried out by U.S. engineering and consulting firms with the objective of directing procurement toward U.S. companies when the projects move off the drawing board and into the implementation stage.[42] In other words, trust funds help to develop standards and specifications which will dictate the ability of U.S. suppliers and manufacturers to compete for follow-up contracts.[43]

According to statistics, every dollar the TDA spends for trust funds provides $40 through $178 in exports.[44] This success is largely due to the effective relationships the TDA has developed with MDB staff, as well as its ability to gain early project information and pass it to U.S. business.[45]

Here is a perfect example showing how a TDA trust fund works.[46] In 1989 the TDA established a fund at the World Bank, donating $500,000 to pay for U.S. consultants to appraise projects in selected countries. Following the requirement of the fund, World Bank staff must request the borrower government to use a U.S. consultant in the project formulation stage. The TDA would first review the World Bank's description of the U.S. consultant's job according to the following criteria: Does the project represent the potential for a significant amount of U.S. exports? Is the U.S. competitive in the sector? Is there likely to be foreign competition for U.S. firms in this project? The TDA then gives final approval or disapproval over the use of its trust funds for the proposed project.

The TDA debriefs the U.S. consultant after he finishes consultancy work at the World Bank project. The TDA then delivers the information gained from this debriefing to U.S. firms. The TDA also helps to train U.S. firms on how to compete and win World Bank procurement awards.

### *B. Trust Funds in the AIIB*

The AIIB established a Project Preparation Special Fund (hereinafter "the Fund") during the bank's first annual meeting in June 2016, whereby

[40] *Id*. at 57-61.
[41] *Id*. at 21.
[42] *Id*. at 58.
[43] *Id*. at 69.
[44] *Id*. at 59.
[45] *Id.*
[46] *Id*. at 59-60.

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China contributed US$50 million.[47] The Fund aims to provide grants to the bank's low and middle-income member countries for project preparation activities,[48] including "procurement and technical assessments and analyses".[49]

The U.K. followed China by committing US$50 million to the Fund in 2016,[50] and recently confirmed the contribution.[51] The Republic of Korea committed another US$8 million.[52] The Fund is open for more contributions. The Fund has recently agreed to channel US$1 million to Nepal to prepare an urban infrastructure investment project and US$700,000 to Sri Lanka to prepare a solid waste management project.[53]

This Fund is timely and necessary for preparing the AIIB with bankable infrastructure projects,[54] mainly by strengthening the borrowers' capacity to prepare projects. Obviously the Fund is a multi-donor one. Compared with a single-donor trust fund, a multi-donor one tends to be less maneuvered by donors, and less costly in the administrative sense from the perspective of the AIIB, thereby leading to improved aid effectiveness.

The Fund's Rules and Regulations governs how the resources of the Fund are "received, administered, used and disposed of".[55] Any country, regardless of whether it is a member or non-member, as well as any person, may be a contributor to the Fund.[56] As a matter of principle, "there will be no restriction upon the procurement of goods and services from any country to be financed from resources of the Fund".[57]

There is a contribution agreement between the AIIB and the contributor, besides the governing Rules and Regulations. The template of a

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[47] *AIIB's Board of Directors Establish a Project Preparation Special Fund: China Provides Initial $50 Million Start-up Contribution*, AIIB (June 25, 2016), https://www.aiib.org/en/news-events/news/2016/20160625_004.html [hereinafter *China Provides Start-up Contribution*].

[48] Low and middle-income member countries refer to recipients of financing from the International Development Association [hereinafter IDA], including blend countries, see Asian Infrastructure Investment Bank, *Rules and Regulations of the AIIB Project Preparation Special Fund*, art. 3.01(a)(i) (June 24, 2016) [hereinafter *AIIB Rules and Regulations of Special Fund*]; Eligibility for IDA support see *Borrowing Countries*, IDA, http://id a.worldbank.org/about/borrowing-countries (last visited Apr. 4, 2017).

[49] *China Provides Start-up Contribution*, *supra* note 47.

[50] *Factsheet: UK–China 8th Economic and Financial Dialogue*, HM TREASURY (Nov. 10, 2016), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/567526/UK-China_8th_EFD_fact_sheet.pdf.

[51] *U.K. Government Pledges U.S.$50 Million to AIIB Project Preparation Special Fund*, AIIB (Dec. 16, 2017), https://www.aiib.org/en/news-events/news/2017/20171216_001.html.

[52] *Id.*

[53] *Id.*

[54] Although Asia faces a huge infrastructure-financing gap, there has long been lacking shovel-ready bankable infrastructure projects.

[55] *AIIB Rules and Regulations of Special Fund*, *supra* note 48, art.1.02.

[56] *Id.* art. 2.02(a).

[57] *Id.* art. 3.03. It is consistent with AIIB, *supra* note 20, art. 13.8, which provides as follows, "The Bank shall place no restriction upon the procurement of goods and services from any country from the proceeds of any financing undertaken in the ordinary or special operations of the Bank."

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contribution agreement is publicly available by being annexed to the Rules and Regulations. While China's contribution agreement is not available, and we are not sure whether the contribution is "tied" or "untied", that agreement should not be inconsistent with the above "no-restriction" requirement in the Rules and Regulation.[58] Neither of the contribution agreements of the U.K. or Republic or Korea are publicly available.

The AIIB further requires no conflict of interest for all stakeholders involved in the procurement process.[59] In particular, no contractor is allowed to provide goods, works, or non-consulting services "resulting from or directly related to consulting services provided by it",[60] or by any other related entity. In other words, procurement contractors should hold the borrower's interests paramount, without any consideration of future work. This requirement roots out the possibility of a direct aim for a higher proportion of MDB procurement for the donor nation.

However, it does not mean that China as a donor has no interest of its own. China initiated the Fund for win-win purposes. China is undergoing the supply-side structural reforms,[61] and as an important step for its international campaign, China keeps calling for industrial capacity cooperation across borders, and exports goods and services where they have competitive advantages.[62]

China's contribution to the Fund expects this to help its own engineering and consulting firms to get a fair shot at the initial stage of an AIIB-financed project. It would then provide favorable conditions for Chinese machinery and equipment industries to participate in the open bidding process during the implementation stage of the project.

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[58] *AIIB Rules and Regulations of Special Fund*, *supra* note 48, art. 2.02(b) (providing that "In the event of any inconsistency between a Contribution Agreement and these Rules and Regulations, these Rules and Regulations shall prevail.").

[59] AIIB, *Interim Operational Directive on Procurement Instructions for Recipients*, art. 4.4 (June 2, 2016), https://www.aiib.org/en/policies-strategies/_download/operational-directive/policy_operational_directive_procurement-instructions.pdf.

[60] *Id.* art. 4.4.1(a).

[61] The supply-side structural reforms include depletion of excess industrial capacity as one of its leading tasks. The other tasks are to reduce housing inventory, financial leverage and business costs, to streamline bureaucracy, to quicken urbanization and abandon the one-child policy, etc., see Xinhua, *Backgrounder: What Is China's Supply-Side Reform?*, XINHUANET (Dec. 22, 2015, 6:51 PM), http://news.xinhuanet.com/english/2015-12/22/c_134941783.htm.

[62] Chinese companies have a competitive edge in industries such as railways, electricity, telecommunication, construction, e-commerce, equipment and machinery. *See* GU Bin, *High Standards Would Suit AIIB's Lofty Goals*, GLOBAL TIMES (July 3, 2015, 12:43 AM), http://www.globaltimes.cn/content/930187.shtml.

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## IV. THE CRITERIA OF A PRIVATE ENTITY RELATING TO PROCUREMENT

The MDBs generally lend to both public and private entities,[63] but their lending priorities vary. For example, the IBRD focuses on lending to developing governments, while its sister institution under the World Bank Group, i.e., the International Financial Corporation (IFC), takes care of private entities. The EBRD mainly lends to private sector entities, while also lending to developing-country governments. The ADB, the IDB, the AfDB and the AIIB are similar to each other in lending profile: they lend mainly to developing-country governments but also to private entities.

Lending priorities are significant for the MDBs. In developing countries, public entities generally have the credit support of their government, and thus lending to them is deemed safe and sound for the MDBs. It not only helps in achieving loan sustainability, but also contributes to a positive credit rating for a new MDB, which is imperative if it wants to issue bonds in international capital markets. This may well explain why the AIIB loans only to public sector entities in its first infrastructure projects,[64] at a time when it seeks to issue bonds in international capital markets.

There are two implications of making a distinction between a public and private entity in MDB-financed procurement markets. First, a public entity and a private one, acting as borrowers, apply different procurement methods. In the case of public entities as loan recipients, procurement follows the formal international open competitive tendering norm in principle,[65] which is an MDB's preferred method of procurement,[66] while private entity borrowers only need to follow alternative, established

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[63] The term "public entity" is used interchangeably with "government" in this article, except as otherwise stated. Normally the government includes its political and administrative sub-divisions in addition to public entities, see AIIB, *supra* note 25, art. 2.1(e). Similarly, in WTO law the concept of "public body" shares certain attributes of the "government". Appellate Body Report, *United States — Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, ¶ 317, WTO Doc. WT/DS379/AB/R (adopted Mar. 25, 2011) [hereinafter *U.S. — Anti-Dumping and Countervailing Duties (China)* Appellate Body Report].

[64] *See* Approved Projects, *supra* note 24.

[65] *See, e.g.*, AIIB, *supra* note 3, art. 5.6 has the following requirement on Bank-financed contracts procured by public entities:

> An international open competitive tender process is the normal method of procurement conducted for a Bank-financed contract. Alternative methods may be applied, provided the Recipient demonstrates to the Bank's satisfaction that the alternative method is the best strategic procurement approach for the Project and that it adequately reflects the Core Procurement Principles . . . .

[66] *See* AIIB, *supra* note 59, § II, ¶ 10.1; WBG, *supra* note 2, ¶ 6.11.

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commercial practices to satisfy their lenders.[67]Compared with competitive tendering methods, alternative commercial practices such as direct contracting tend to save time, reduce cost and increase efficiency. For loan recipients, this advantage is meaningful.

Second, a private entity in the borrower country may be eligible to compete and be awarded contracts,[68] while no public entity, as an affiliate of the borrower government,[69] is eligible to participate in a tender.[70] The eligibility requirement is significant for SOEs in the borrower country, depending on whether SOEs are treated as private entities or not.

The issue underlying this discussion is what constitutes a private entity. The question's thrust is whether the identifying rationale is ownership-based or function-based. Sectors of international law essentially converge in respect of the answer to this question, after surveying the laws of the MDBs and the WTO.

### *A. MDB Definition*

The World Bank experienced a comprehensive overhaul of its procurement system from 2012 to 2015.[71] The resulting New Procurement Framework aims to move from a traditional one-size-fits-all policy to a

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[67] *See, e.g.*, AIIB, *supra* note 3, art. 6.1 has the following requirement on Bank-financed contracts procured by private entities:

> The Bank's concerns for the appropriate use of funds, with due consideration from economy and efficiency, apply equally to Bank-financed contracts procured by Private Entities. Private Entity Recipients often meet these concerns by following established private sector or commercial practices other than formal international open competitive tendering for their procurement. Nevertheless, whenever the Bank deems appropriate, it may require the use of competitive tendering methods by Private Entities, particularly for large contracts.

It is noted that the EBRD similarly encourages the use of competitive tendering methods by its private sector clients, particularly for large contracts, see EBRD, *Procurement Policies and Rules*, art. 4.1 (Oct. 2014).

[68] See *infra* the discussion on "domestic preference" in Section V.A.1 in this article.

[69] AIIB, *supra* note 25, art. 2.1(e) (defining "government" as follows: "Government means the government of a Member, and includes its political and administrative sub-divisions and all other public sector entities and instrumentalities of the Member.").

[70] AIIB, *supra* note 59, §II, ¶ 4.10.1 provides as follows:

> "No affiliate of the Recipient, or of a procurement agent engaged by the Recipient, is eligible to participate in a tender or RFP [request for proposals] in any capacity whatsoever, unless the Recipient demonstrates to the satisfaction of the Bank that there is no significant degree of common ownership, influence or control between the Recipient on the one hand, and the Recipient's agent and the affiliate on the other.".

[71] WBG, *New World Bank Procurement Framework Approved* (July 21, 2015), http://www.worldbank.org/en/news/press-release/2015/07/21/world-bank-procurement-framework.

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fit-for-purpose policy,[72] applying to all new lending operations after July 1, 2016.[73] While there is no formal definition of a private entity in this Framework, the SOEs in the borrower country are eligible for bidding if they "(i) are legally and financially autonomous, (ii) operate under commercial law, and (iii) are not under supervision by the agency contracting them" .[74] The eligibility requirements are consistent with the past practice of the World Bank.[75]

The EBRD has a clear definition of a private entity. It uses two specific benchmarks to define a private entity, i.e., "operating autonomously in a competitive market environment" and "subject to bankruptcy or insolvency law".[76] This definition is not based on ownership, and an SOE is a private entity if it meets the two-benchmark conditions.

The European Investment Bank (hereinafter "EIB") offers a sophisticated definition of a public entity.[77] Pursuant to the EIB's Guide to Procurement,[78] a public entity has three features:[79] first, it "is established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character"; second, it "has legal personality"; and third, it "is financed in most part by public authorities or is subject to management supervision by public authorities, or has an administrative, managerial or supervisory board in which more than half of the members are appointed by public authorities". Otherwise, an enterprise "operating in markets which are not liberalized" is deemed to be a public entity.[80] In a word, the EIB's definition of a public entity is more functional than

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[72] *See* WBG, *New Procurement Framework and Regulations for Projects After July 1, 2016* (July 1, 2016), http://www.worldbank.org/en/projects-operations/products-and-services/brief/procurement-new-framework.

[73] Procurement for Projects and Programs, WORLD BANK, http://www.worldbank.org/en/projects-operations/products-and-services/procurement-projects-programs (last visited Apr. 1, 2017).

[74] WBG, *supra* note 2, ¶ 3.23(b).

[75] The SOEs were termed as "government-owned enterprises" in the World Bank's past procurement policy, and the relevant part stated as follows, "Government-owned enterprises in the Borrower's country may participate only if they can establish that they (i) are legally and financially autonomous, (ii) operate under commercial law, and (iii) are not dependent agencies of the Borrower or Sub- Borrower."; *see* WBG, *Guidelines: Procurement Under IBRD Loans and IDA Credits*, art. 1.8(c) (Jan. 1999); WBG, *Guidelines: Procurement Under IBRD Loans and IDA Credits*, art. 1.8(c) (May 1, 2010).

[76] EBRD, *supra* note 67, art. 3.2(c).

[77] The EIB is not a typical MDB in the sense that it is the bank of the European Union and regulated by E.U. law, but it is often considered as a peer institution of the MDBs since it is the largest international long-term public lending institution.

[78] EIB, *Guide to Procurement*, annex 5, art. 1 (June 2011), http://www.eib.org/attachments/strategies/procurement_en.pdf.

[79] The EIB terms the concept "public authorities" as "bodies governed by public law", see *id.* annex 5.

[80] This provision applies in the specific case of gas; heat; electricity; water; transport; exploration for, or extraction of, oil, gas, coal or other solid fuels; ports and airports; telecommunications; and postal services. *Id.* annex 5, art. 2.

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ownership-oriented.

The AIIB distinguishes between "public entity" and "private entity" in its Procurement Policy much more straightforwardly than its peer institutions. The Procurement Policy provides that any entity that is not a private entity will be a public entity. A private entity, in turn, is defined as follows:[81]

> Private Entity means any natural or legal person, whether publicly or privately owned: (i) which is carrying out or is established for a business purpose, and is operating on a commercial basis; (ii) which is financially and managerially autonomous from the government; and (iii) whose day-to-day management is not controlled by the government.[82]

The above definition of a private entity clearly states that ownership is irrelevant for the distinction between a public and private entity. Since the AIIB's procurement policy chooses not to define a private entity on the basis of ownership, it enables an SOE to be a private entity if the three said functional elements were met. In other words, "commercial", "autonomous" and "control" are all the magic words that are relevant for identifying a private entity.

The AIIB's Policy on Prohibited Practices, another important legal instrument of the bank, explicitly provides that "a state-owned commercial entity" is equivalent to "a private enterprise".[83] Consistent with the provision of the Procurement Policy, it further confirms the principle that ownership is irrelevant for the identification of a private entity.

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[81] AIIB, *supra* note 3, art. 2.1(b).

[82] The AIIB gives the same definition for "private entity" in other legal documents, *e.g.*, *Environmental and Social Framework*, AIIB, at 1, 24 n.12, 31 n.4, 36 n.12 (2016), https://www.aiib.org/en/policies-strategies/_download/environment-framework/20160226043633542.pdf. It is additionally noted there that "a private-sector project" is defined as a project established or carried out by "a private entity".

[83] *Policy on Prohibited Practices*, AIIB 1, art. 2.1.19 (2016), https://www.aiib.org/en/policies-strategies/_download/policy-on-prohibited-practices/policy_on_prohibited_practices.pdf, reads as follows:

> Non-sovereign-backed Financing means any Financing extended by the Bank that is not a Sovereign-backed Financing; it includes any Financing to or for the benefit of a private enterprise, or a state-owned or sub-sovereign owned commercial entity that is not backed by a guarantee or counter-guarantee and indemnity provided by the Member to the Bank.

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### *B. WTO Definition*

The WTO Appellate Body has elaborated the term "public body" on many occasions. A milestone case took place between China and the United States.[84] In that case, the Appellate Body concluded that "A public body within the meaning of Article 1.1.(a)(1) of the *SCM Agreement* must be an entity that possesses, exercises or is vested with governmental authority."[85] Hence, what matters is *whether* an entity is vested with authority to exercise governmental functions, rather than *how* that is achieved.[86] There are several approaches that may assist in making this decision. First, one can look at legal instruments.[87] Second, one can look at the actions of the said entity.[88] Third, one can look into whether the government exercises meaningful control over the said entity.[89]

The Appellate Body emphasized that meaningful control is something more than mere formal links such as majority ownership.[90] In other words, the evidence of government ownership in an entity does not suffice to establish the necessary possession of governmental authority.

The concept of public body seems clear at this point. One should be clear that ownership is not a benchmark for distinguishing a private entity from a public one, and that "meaningful control" must be conducted on a day-to-day basis. One may well envision an entity that is controlled by government as a major shareholder, but is autonomous in daily operations, and does not possess or exercise government authority.

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[84] *U.S. — Anti-Dumping and Countervailing Duties (China)* Appellate Body Report, *supra* note 63.

[85] *Id.* ¶ 317.

[86] *Id.* ¶ 318.

[87] *Id.* ("In some cases, such as when a statute or other legal instrument expressly vests authority in the entity concerned, determining that such entity is a public body may be a straightforward exercise.").

[88] *Id.* ("Evidence that an entity is, in fact, exercising governmental functions may serve as evidence that it possesses or has been vested with governmental authority, particularly where such evidence points to a sustained and systematic practice.").

[89] *Id.* ("It follows, in our view, that evidence that a government exercises meaningful control over an entity and its conduct may serve, in certain circumstances, as evidence that the relevant entity possesses governmental authority and exercises such authority in the performance of governmental functions.").

[90] *Id.*

> We stress, however, that, apart from an express delegation of authority in a legal instrument, the existence of mere formal links between an entity and government in the narrow sense is unlikely to suffice to establish the necessary possession of governmental authority. Thus, for example, the mere fact that a government is the majority shareholder of an entity does not demonstrate that the government exercises meaningful control over the conduct of that entity, much less that the government has bestowed it with governmental authority.

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### *C. China's SOE Reform and Its Relevance to AIIB-Financed Procurement*

The identification of an SOE as a private entity, exemplified in AIIB law, represents an overwhelming endorsement of a function-based (not ownership-based) criterion by the international community. This enables an eligible SOE to compete equally with peer enterprises in project procurement markets. An eligible SOE should not be marginalized by being criticized as an arm of the government pushing for non-commercial, strategic purposes; neither should it be treated favorably due to protection by the government through illegitimate subsidy.

Chinese SOEs have been undergoing reforms for decades. The baseline of China's SOE reforms has been consistent: to separate SOEs from government function, enabling them to operate as an independent market entity. There remain challenges for Chinese SOEs, and they are at the juncture of reforms, and have been enduring fierce criticisms.[91] After lengthy exploration, two key methods of reform have been agreed, i.e., categorization and marketization.

On categorization, Chinese SOEs are categorized into two major types: public-interest-type, and commercial-interest-type,[92] the latter of which is sub-divided into three groups: those in full competition sectors, those in national security industries, and those in natural monopoly.

On marketization, all SOEs should be reformed in a bid to be a market entity, regardless of categorization. SOEs should be autonomous from the government and should not be directly controlled by government. Corporate governance is pivotal for pushing for marketization.[93]

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[91] For example, the U.S. Department of Commerce summarized the manifold indicia of control indicating that Chinese SOEs possess, exercise, or are vested with governmental authority: (1) the predominant role of the state sector and industrial policies; (2) managing competition; (3) SASAC's supervision as a tool of meaningful control; (4) the Government has control over all appointments in the state sector, and uses this as a means to ensure that industrial policy objectives are being achieved; and (5) meaningful control is exercised through the presence of communist party groups and committees. U.S. Department of Commerce, *Section 129 Determination of the Countervailing Duty Investigation of Circular Welded Carbon Quality Steel Pipe; Light-Walled Rectangular Pipe and Tube; Laminated Woven Sacks; and Off-the-Road Tires from the People's Republic of China: An Analysis of Public Bodies in the People's Republic of China in Accordance with the WTO Appellate Body's Finding in WTO DS379*, 11-37 (May 18, 2012).

[92] Xinhuanet, *Zhonggong Zhongyang, Guowuyuan Guanyu Shenhua Guoyou Qiye Gaige de Zhidao Yijian* [Guidance Opinion on Deepening SOE Reforms from Central Committee and State Council of Communist Party of China (CPC)], WWW.GOV.COM (Sept. 13, 2015, 8:59 PM), http://www.gov.cn/zhengce/2015-09/13/content_2930440.htm; *see also* State-owned Asset Supervision & Admin. Commission (SASAC), *Guidance Opinion on SOE Function Identity and Categorization* (Dec. 29, 2015), http:// www.gov.cn/xinwen/2015-12/29/content_5029253.htm.

[93] The burning issues in corporate governance are, among others, establishing the board of directors and hiring professional management. GU Bin, *Corporate Governance Pivotal Part of State-Owned Enterprise Reforms*, GLOBAL TIMES (Nov. 25, 2013, 7:03 PM), http://www.globaltimes.cn/content/827509.shtml.

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China's SOE reform is consistent with the standard of a private entity as set in AIIB law. And this can be significant. When a Chinese SOE qualifies as a private borrower in MDB law, a different procurement method other than open competition will apply; when the SOE qualifies as a private entity and is not under the supervision of the procuring agency,[94] it is eligible to compete and be awarded contracts in the borrower's country.

The significance of the reform is unfolding. In an AIIB-financed project in China,[95] the loan recipient is Beijing Gas, an SOE while being considered as a private entity.[96] According to the Project Summary Information, an official document of the AIIB, "Beijing Gas was established for a business purpose and operates on a commercial basis".[97] Therefore, "All procurement decisions for procurement planning, tendering and contract administration are reviewed and approved by its own management".[98] The AIIB's procurement policy for private entities applies.[99]

## V. ALTERNATIVE PROCUREMENT ARRANGEMENTS

Each MDB has its own procurement policy. Meanwhile, it permits alternative procurement arrangements (hereinafter "APAs") for a project it finances either wholly or partially. APAs are often explicitly provided for in an MDB's procurement rule. They exist in two major forms: country systems and co-financing.

For procurement under "country systems", an MDB-financed project defers to the borrowing country's system of procurement design and implementation, which is unique to each country. For procurement under "co-financing", an MDB-financed project defers to its co-financer's

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[94] AIIB, *supra* note 59, § II, ¶ 4.10.2.

[95] It is noted that the Chinese government initially made a commitment that it would not request funds from the AIIB at the beginning of bank operations, in a bid to spare the AIIB fund for borrowers that were more in need. Han Jie & Shen Cheng, Ya Touhung Chengli Chuqi Zhongfang Jiang Zhanbu Shenqing Zijin Zhichi, XINHUA NEWS AGENCY (Jan. 16, 2016, 7:39 PM), http://www.gov.cn/xinwen/2 016-01/16/content_5033496.htm.

[96] See the project information at *China: Beijing Air Quality Improvement and Coal Replacement Project*, AIIB, https://www.aiib.org/en/projects/approved/2017/air-quality-improvement-coal-replacement.html (last visited Dec. 24, 2017).

[97] *Beijing Air Quality Improvement and Coal Replacement Project Summary Information*, AIIB 1, 3 (2017), https://www.aiib.org/en/projects/approved/2017/_download/beijing/beijing-air-quality.pdf.

[98] *Id.*

[99] The AIIB's procurement policy for private entities is set forth in AIIB, *supra* note 59, § III. The Section mainly provides for use of "established commercial practices other than formal open competitive tendering for their procurement", and use of "appropriate procurement methods that ensure a sound selection of goods and services at fair market prices", particularly by means of contracts being negotiated on an arm's length basis.

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procurement system.

Among others, one key advantage offered by APAs is flexibility. They bring flexibility to both the MDBs and borrower countries. For example, under the "country systems", APAs will strengthen national institutions in developing countries for public expenditures, and will help harmonize aid flows, streamline the disbursement of funds, reduce donor overhead costs and return control over aid flows to borrowing countries.[100] Thus, borrowing governments particularly emphasize country systems. They said, "We have our own laws, why should we follow your procedures?"[101] In the case of "co-financing", APAs make it possible for one set of procurement systems, rather than all co-financiers' systems, to apply to a co-financed project. It will reduce the borrower's compliance costs, and help to achieve efficiency for the project.

However, some people are concerned about the practice of APAs, particularly country systems. They claim that country systems would deviate from international best practices; would increase costs for business enterprises, which are used to traditional international open competitive bidding process, and are not ready to learn country-specific procurement systems; and would increase chances of corruption during procurement.[102]

An underlying motive for the non-borrowing countries to deter country systems is to safeguard these countries' commercial interests as donors to the MDBs. It is in their interest that their companies can bid on projects. For example, U.S. Treasury officials must assure their congress that "for every dollar we put in to these multilaterals, we get seven back for US Inc."[103] They see using country systems as detrimental to their commercial interests.[104]

After decades of project financing development by the MDBs, APAs seem however to be even trendier than ever before. Regardless of resistance from some countries and businesses,[105] the World Bank has formally

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[100] MULTILATERAL DEVELOPMENT BANKS: US POLICIES AND CONTRIBUTIONS 31 (Gregory F. Smith & Timothy D. Ross eds., 2012).

[101] Chris Humphrey, *The "Hassle Factor" of MDB Lending and Borrower Demand in Latin America*, *in* GLOBAL ECONOMIC GOVERNANCE AND THE DEVELOPMENT PRACTICES OF THE MULTILATERAL DEVELOPMENT BANKS 143, 157 (Susan Park & Jonathan R. Strand eds., 2016).

[102] Smith & Ross eds., *supra* note 100, at 31.

[103] Humphrey, *supra* note 101, at 157.

[104] For example, in 2005 the U.S. Congress threatened to withhold a fund appropriated to the IDA, the soft lending arm of the World Bank, unless the Treasury could verify that the IBRD had withdrawn its proposal on increasing the use of country systems in procurement. Smith & Ross eds., *supra* note 100, at 31.

[105] Mainly those infrastructure consultants and contractors prefer World Bank procurement system and International Federation of Consulting Engineers international standard contracts to the country system. WBG, *Procurement in World Bank Investment Project Financing Phase II: The New Procurement Framework*, § III, ¶ 58 (June 11, 2015) [hereinafter *Procurement in World Bank IPF Phase II*], https://consultations.worldbank.org/Data/hub/files/consultation-template/procurement-policy-review-consultationsopenconsultationtemplate/phases/phase_ii_the_new_procurement_fr

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adopted APAs in its New Procurement Framework,[106] opening a hole in its long centralized procurement system. The AIIB also explicitly provides for APAs in its *Procurement Policy*,[107] including both country systems and co-financing.[108] What follows next is a review of the AIIB law regarding APAs.

### *A. Country Systems*

For AIIB-financed procurement, the use of country systems is subject to the AIIB's review and acceptance. Specifically, the AIIB assesses the borrower's procurement system and the fiduciary risk involved.[109] Such review and assessment assure that the national procurement system to be applied should be consistent with the AIIB's statutory procurement principles and standards.[110]

Pursuant to the AIIB Procurement Policy, the AIIB conducts an assessment of the borrower's procurement system in accordance with the *OECD's Methodology for Assessing Procurement System* (hereinafter "MAPS").[111] The MAPS provides a common tool for the MDBs and other users to assess the quality and effectiveness of procurement systems.[112] Besides guaranteeing effectiveness in the use of funds, the application of the MAPS in the AIIB country system assessment may additionally help borrowers to improve their national procurement systems to meet internationally recognized standards.

The AIIB assessment framework is expected to be updated in due time, given that the MAPS has been in the process of update since 2010, and the

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ame work_-_board_paper.pdf.

[106] *Procurement Policy in Investment Project Financing and Other Operational Procurement Matters*, WORLD BANK, § III.F (2016), https://policies.worldbank.org/sites/ppf3/PPFDocuments/a3656cb78847417b886f11fa0235216e.pdf.

[107] This exhibits the AIIB's operational principle of being client-responsive. For the same purpose, country systems are observed in other legal instruments of the AIIB, such as the *Environmental and Social Framework*, *supra* note 82, at 19.

[108] *See* AIIB, *supra* note 3, art. 5.4 on country systems and art. 5.11 on co-financing.

[109] *Id.* ¶ 5.4.

[110] *See id.* ¶ 5.1 on core procurement principles, and ¶ 5.3 on procurement standards.

[111] *Id.* ¶ 5.4 n.2; *MAPS Methodology for Assessing Procurement Systems*, OECD, http://www.oecd.org/governance/ethics/commonbenchmarkingandassessmentmethodologyforpublicprocurementsystemsversion4.htm (last visited Mar. 23, 2017) [hereinafter *MAPS*]. So far the *MAPS* has been used by over 60 countries.

[112] It is noted that the World Bank's New Procurement Framework also has the *MAPS*, with some variations, as the bank's base for alternative procurement arrangements assessment. The World Bank's assessment framework includes an additional pillar, covering procurement operations and the use of minimum standards. It also uses an evidence based approach, analyzing procurement data and gathering the views of the private sector and civil society organizations [hereinafter CSOs]. The Work Bank is still testing the new assessment methodology to assess the legal and regulatory framework, and the capacity and capability of a borrower implementing agency. *See* WBG, *supra* note 72.

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update should draw upon the upcoming new MAPS, as well as the operational experiences of the AIIB itself.

*1. Domestic Preference* — The AIIB Procurement Policy provides that "The Bank may, under special circumstances and conditions, accept the application of provisions of the relevant Bank member country's procurement rules that promote or encourage the development of domestic industry through preference margins, 'offsets', preference schemes or similar innovative approaches."[113] The provision is termed "domestic preference", and reflects the common practice of the MDBs. The provision applies to open international competitive tendering of goods and works.[114]

A review of the World Bank practice may be helpful for understanding how the AIIB's domestic preference provision will be operated.[115] The World Bank implements domestic preference in three steps.[116] First, the borrower's request for bids shall clearly indicate any preference to be granted to domestic products and the information required to establish the eligibility of a bid for such preference. Second, the bidders' bids shall be evaluated and classified into different groups based on local content. Third, those bids shall be compared both within and across groups, allowing for a certain domestic preference margin (a preference margin of 15% in price for domestically manufactured goods, and 7.5% for domestically provided works, in the case of the World Bank), in selecting the favorable bid for the award of contract.

Developing countries such as India, Mexico and China have been leading borrowers from the MDB fund, and perhaps due to the practice of domestic preference, these countries are also important contract winners on MDB-financed projects.[117]It is thus anticipated that developing borrowers' domestic industry will similarly benefit from the AIIB's prospective practice of domestic preference.[118]

*2. Government Procurement Agreement* — The AIIB procurement policy emphasizes "efficient, fair, ethical and transparent procurement processes."[119] These high standards, which are similar to those of peer MDBs, coincide with the WTO's Government Procurement Agreement

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[113] AIIB, *supra* note 3, art. 5.7.

[114] AIIB, *supra* note 59, annex V; *see also* WBG, *supra* note 2, annex VI (1).

[115] AIIB, *supra* note 59, annex V, 2(d) explicitly provides that "Where domestic preference margins are permitted by other MDB's in Bank Member countries the Bank may permit the application of the same preference margins in accordance with the requirements of other MDB's procurement policies." It shows that World Bank standards on domestic preference margins are highly referable for AIIB.

[116] WBG, *supra* note 2, annex VI.

[117] U.S. MULTILATERAL DEVELOPMENT BANK PROCUREMENT, *supra* note 11, at 37, 45.

[118] Chinese business may not benefit from this practice initially, because China promises that it will not request funds from the AIIB at the beginning of bank operations, in a bid to spare AIIB fund for borrowers that are more in need. Jie & Cheng, *supra* note 95.

[119] AIIB, *supra* note 3, "Vision Statement".

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(hereinafter "GPA").

The GPA is a plurilateral agreement within the framework of the WTO.[120] The fundamental aim of the GPA is to create mutually open government procurement markets among its parties.[121] The GPA rules require that open, fair and transparent conditions of competition be ensured in government procurement. The GPA currently has nineteen parties comprising forty-seven WTO members,[122] and twenty-nine observers.[123]

It should be feasible to permit the use of the procurement system of a GPA party in MDB-financed procurement, since the GPA party typically has high procurement capacity. However, GPA parties are subject to MDB review for application of their own systems in MDB-financed procurement,[124] just as non-GPA borrowers are.[125] This is perhaps because of the limited nature of parties' commitments under the GPA.[126]

Once the MDB approves the use of country systems, it does not mean that the GPA borrower's implementing agency is completely cleared and free to procure, using its own procurement arrangements and with no more intervention by the MDB. Rather, the MDB will review the specific procurement activities to measure performance and determine the continued use of country systems.[127]

### *B. Co-Financing*

Co-financing is a common method used by an MDB to mobilize the flow of investment to countries in need. The MDB's co-financer may be

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[120] The plurilateral agreement means that not all World Trade Organization [hereinafter WTO] members are parties to the Government Procurement Agreement [hereinafter GPA].

[121] As a result of several rounds of negotiations, the GPA parties have opened procurement activities worth an estimated US$1.7 trillion annually to international competition (*i.e.*, to suppliers from GPA parties offering goods, services or construction services).

[122] This counts the European Union and its twenty-eight member states, all of which are covered by the GPA, as one party.

[123] See the list of GPA parties and observers, *Agreement on Government Procurement: Parties, Observers and Accessions*, WTO, https://www.wto.org/english/tratop_e/gproc_e/memobs_e.htm (last visited Mar. 23, 2017).

[124] For example, during the consultation of World Bank New Procurement Framework, private sector stakeholders emphasized that "even in GPA member countries, a robust assessment of agency procurement capacity and practice is essential to ensure high procurement standards." *Procurement in World Bank IPF Phase II*, *supra* note 105, § III, ¶ 59.

[125] *Id.* § III, ¶ 63.

[126] The GPA is composed mainly of two parts: the text of the GPA and parties' market access schedules of commitments. The GPA does not automatically apply to all procurement activities of each party. Rather, the coverage schedules play a critical role in determining whether a procurement activity is covered by the GPA or not. Only those procurement activities that are carried out by covered entities purchasing listed goods, services or construction services of a value exceeding specified threshold values are covered by the GPA.

[127] The review includes both prior-review of specific procurement strategies and plans and post-review of performance. *Procurement in World Bank IPF Phase II*, *supra* note 105, § III ¶ 64.

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another MDB, a bilateral agency, an export credit agency, or a commercial entity. According to AIIB Procurement Policy, co-financing is categorized into two types: parallel co-financing and joint co-financing.[128]

Parallel co-financing refers to the case in which co-financers individually finance separate contracts under one project;[129] joint co-financing means that co-financers finance portions of the same contract under the project.[130] APAs often appear in joint co-financing, where it is untenable to apply two or more procurement frameworks to the same contract. In such situations, the lead co-financer is normally responsible for overseeing the procurement process, and its procurement policy applies accordingly.[131]

Most of the AIIB-financed projects so far have been co-financed with peer institutions, including the World Bank, the ADB, the EBRD, to name a few.[132] Since these peer institutions are lead co-financers in those projects, their procurement policies (not the AIIB's) apply to relevant procurement activities.

Interestingly in a project co-financed with the ADB, both financers agree that the AIIB standard of worldwide procurement is preserved for the sake of project quality,[133] meaning that the procurement should be open to business from all countries.[134] It deviates from ADB law that confines the institution's project procurement to membership only.[135] The AIIB is thus

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[128] AIIB, *supra* note 3, art. 5.11.

[129] Parallel co-financing should not be confused with special fund for project preparation as discussed in Section III in this article. In principle, the former is a concept relevant to project implementation, whilst the latter applies only to the pre-project stage.

[130] AIIB, *supra* note 3, art. 5.11, nn.3-4.

[131] *Id.* ¶ 5.11.3; *see also Procurement in World Bank IPF Phase II*, *supra* note 105, § III, ¶ 65.

[132] *Approved Projects*, *supra* note 24.

[133] WBG, *Project Document: Islamic Republic of Pakistan National Motorway M-4 (Shorkot-Khanewal Section) Project*, ¶ 14 (2016), https://www.aiib.org/en/projects/approved/2016/_download/pakistan-national-motorway/document/approved_project_document_pakistan_national_motorway.pdf. ("In the case of ADB's member country eligibility restriction for procurement, ADB and the Government have agreed to widen procurement eligibility to all countries for this Project, as permitted by ADB's Article of Agreement and as required by the Bank's Articles of Agreement.").

[134] AIIB, *supra* note 59, § II., ¶ 6.1 provides that "worldwide eligibility to participate in procurement must be applied" in joint co-financing.

[135] Agreement Establishing the Asian Development Bank, art. 14 (ix), Dec. 4, 1965, 571 U.N.T.S. 123 provides as follows:

> The proceeds of any loan, investment or other financing undertaken in the ordinary operations of the Bank or with Special Funds established by the Bank pursuant to paragraph 1(i) of Article 19, shall be used only for procurement in member countries of goods and services produced in member countries, except in any case in which the Board of Directors by a vote of the Directors representing not less than two-thirds of the total voting power of the members, determines to permit procurement in a non-member country or of goods and services produced in a non-member country in special circumstances making such procurement appropriate,

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not only able to learn from peer institutions by co-financing with them, but may enlighten them about open and inclusive procurement arrangements.[136]

## VI. DISPUTE SETTLEMENT RELATING TO PROCUREMENT

Each MDB finances procurement contracts, and has a strong interest in seeing the procurement process completed satisfactorily, as well as having post-award contracts implemented soundly. Therefore, the MDB endeavors to achieve prompt and equitable handling of procurement-related disputes, albeit not being party to procurement contracts. During recent years, some MDBs have even enhanced their approach to procurement-related disputes.[137]

MDB involvement in procurement-related dispute handling may benefit different stakeholders. First it may compensate for institutional or professional capacity constraints on the part of the borrower.[138] It in turn inspires trust and confidence of bidders, encouraging more of them to bid on MDB-financed procurements.[139] MDB procurement staff may also hone their skills and knowledge through actual practice.

Meanwhile, it is crucial for an MDB to strike an appropriate balance between its need for involvement in procurement-related dispute handling and management of the risks involved. For example, in the case of hands-on expanded implementation support,[140] it would no longer allow an MDB to fully disconnect itself from procurement decisions and outcomes, thereby exposing the MDB to potential legal and reputational challenges.[141]

### *A. Procurement-related Disputes: Classification*

The AIIB has a dual position of both monitoring and supporting the

> as in the case of a non-member country in which a significant amount of financing has been provided to the Bank[.]

[136] A general discussion on this topic can be found in Stephany Griffith-Jones et al., *The Asian Infrastructure Investment Bank: What Can It Learn from, and Perhaps Teach to, the Multilateral Development Banks?* 19 (Inst. Dev. Stud., Evidence Report No. 179, Mar. 2016), https://opendocs.ids.ac.uk/opendocs/bitstream/handle/123456789/9701/ER179_TheAsianInfrastructureInvestmentBankWhatCanItLearnFromandPerhapsTeachTotheMultilateralDevelopmentBanks.pdf;jsessionid=9C17FF870071FD4259237421A02CA999?sequence=1.

[137] *Procurement in World Bank IPF Phase II*, *supra* note 105, § III, ¶ 66

[138] *Id*. § III, ¶¶ 20, 80.

[139] *Id*. § III, ¶ 66.

[140] For example, the World Bank may provide hands-on expanded implementation support in challenging operating environments, which may be either a low-capacity borrower or in an emergent situation. WBG, *supra* note 2, § III., ¶ 3.10.

[141] The MDB's privileges and immunities against judicial process would be significantly weakened, and alongside with their staff, they would be sued in national courts as they had gone beyond their role as financers. *Procurement in World Bank IPF Phase II*, *supra* note 105, § III, ¶ 45.

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procurement process, and its involvement in the procurement process depends on different situations. Based on the degree of bank involvement, there are three types of procurement-related disputes: communications relating to clarifications regarding the tender documents and contract execution; complaints relating to any aspect of the selection process; and disputes relating to contract execution.[142]

The first type is "communications",[143] which is sub-divided into tender-related and contract-related ones. The borrower is fully responsible for conducting communications in both situations. Specifically contract-related communications are governed by the contract signed between the borrower and the winning bidder, to which the AIIB is not a party.[144] The AIIB keeps its hands off such communications, even not being informed of what is going on.[145]

The second type is "complaints", where the AIIB steps in and monitors the borrower's handling of relevant complaints. In this situation, the AIIB needs to be informed of any complaint duly addressed to the borrower, whose subsequent, responding action must receive no objection by the AIIB in order to take effect.[146] Complaints are the most common type among the three that the AIIB might get involved in.

The third type is "disputes" relating to contract execution. The borrower must promptly inform the AIIB of any controversy arising between the parties to the contract during contract execution, which could trigger the use of a dispute resolution mechanism under the contract.[147] If the dispute does arise, the AIIB has an interest in calling for prompt and equitable settlement of the dispute, by assisting in facilitating this result through implementation support and monitoring.

### *B. Business Standards*

The AIIB's business standards for procurement-related complaints are generally elastic and flexible, compared with World Bank law. This is particularly true in the timeframe for response to relevant complaints. Where World Bank law stipulates a specific deadline for action,[148] AIIB

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[142] Some scholars might add a fourth type of procurement-related dispute, i.e., sanctions against business corruption involved in contracts in MDB-financed projects, which will not be discussed in this article.

[143] AIIB, *supra* note 59, annex IV, 2.

[144] *Id*.

[145] In the World Bank, a borrower is not required to inform the bank of either tender-related or contract-related communications, except its debriefing for a contract subject to prior review. WBG, *supra* note 2, § V, ¶¶ 5.81-87.

[146] The practice of no-objection is exemplarily observed in the AIIB's standstill period provision, as discussed below in Section VI(C).

[147] AIIB, *supra* note 59, annex IV, 9.

[148] WBG, *supra* note 2, annex III, tbl. 1.

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law generally requires a "prompt" action.[149]

Here are some examples. The first one is a complaint challenging the terms of the tender document. The World Bank requires the borrower to respond not later than seven business days from the date of receipt of complaint,[150] while AIIB law is silent on the deadline for response.[151] The second example is a complaint addressed to the bank only. The World Bank must forward the complaint to the borrower within three business days from the date of receipt of the complaint,[152] while AIIB law only requires prompt forwarding to the borrower for review and action.[153] The AIIB timeframe is not always unspecific, however. For example, it requires the borrower to acknowledge in writing the receipt of the complaint within three days following its receipt,[154] which is the same as the World Bank.[155]

The AIIB's flexible approach makes sense. The young bank is growing, and it is untenable for it to make comparable commitments as the veteran World Bank does. Notwithstanding that, the AIIB standard should improve as the bank grows in size and experience.

### *C. Standstill Period*

A standstill period literally means the period between the date of the borrower's notification of intention to award a procurement contract and the date of contract signature. It is a pause between identifying who should win the contract and actually awarding them the contract so that other bidders can voice any concerns before a contract is actually legally formed and awarded. A standstill period contributes to an open, fair and non-discriminatory procurement process, and provides equitable opportunity and treatment for bidders in having their tenders duly considered.[156] A standstill period as a legal requirement was first introduced into the World Bank's New Procurement Framework in 2015.[157]

Under AIIB law a standstill period lasts ten business days normally, starting from the date of the notification of intention to award the contract to all bidders, and may be extended.[158] If the borrower does not receive any complaint during the standstill period, it may duly award the contract after the standstill period.[159] If a complaint is received during the standstill

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[149] AIIB, *supra* note 59, annex IV, 4.
[150] WBG, *supra* note 2, annex III, tbl. 1.
[151] AIIB, *supra* note 59, annex IV, 5.1.
[152] WBG, *supra* note 2, annex III, tbl. 1.
[153] AIIB, *supra* note 59, annex IV, 4.
[154] *Id.* annex IV, 2.
[155] WBG, *supra* note 2, annex III, tbl. 1.
[156] AIIB, *supra* note 3, art. 5.1.4.
[157] *New Procurement Framework and Regulations for Projects After July 1, 2016*, *supra* note 72.
[158] AIIB, *supra* note 59, § II, ¶ 4.6.1.
[159] *Id.*

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period, the borrower must propose a course of action in response to such complaint, and can only award the contract after it receives the AIIB's no-objection to its proposal.[160] If the AIIB's no-objection is received after the standstill period, the standstill period is automatically extended accordingly.[161]

During the standstill period, an unsuccessful bidder may also request a debriefing by the borrower about the basis for its selection decision.[162] However, such a debriefing is different from a resolution of complaint in that it does not require the AIIB's no-objection statement.

While a standstill period in World Bank law applies to all contracts,[163] for the AIIB a standstill period applies to contracts subject to prior review.[164] The AIIB makes an assessment of procurement risks during project preparation,[165] and carries out prior review of procurement decisions for contracts that are considered to be high-value and/or high risk.[166] The assessment result, being either prior or post review,[167] may be reassessed and updated during project implementation.[168]

### *D. Envisioning Hands-on Expanded Implementation Support*

The AIIB is not a direct party in the procurement process,[169] and in principle, is not responsible for any action incurred there. However, the possibility exists that AIIB procurement staff need to get involved in the procurement process to actually help the borrower, for example in the case of a low-capacity borrower or in an emergent situation. This support, termed as "hands-on expanded implementation support" under World Bank law,[170] might endanger the bank's privilege and immunity position against

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[160] *Id.*
[161] *Id.*
[162] *Id.* § II, ¶ 4.7.
[163] In World Bank law, however, a standstill period is not required in the following four situations: only one bid/proposal was submitted in an open competitive process; direct selection; call-off process among firms holding Framework Agreements; and emergency situations recognized by the Bank. *See* WBG, *supra* note 2, § V., ¶ 5.80.
[164] AIIB, *supra* note 59, § II, ¶ 4.6.1.
[165] *Id.* § II, ¶ 4.2.1.
[166] *Id.* By comparison, the World Bank has different mandatory procurement prior review thresholds. *Procurement in World Bank IPF Phase II*, *supra* note 105, § III, ¶ 75, tbl. I.
[167] Post review takes place in contracts that are not subject to prior review. It is within the AIIB's discretion to carry out post review or not, and to carry out post review by itself or by engaging a third party. AIIB, *supra* note 59, § II, ¶ 4.2.2.
[168] During project implementation the AIIB monitors and reassesses the risk and risk mitigation measures, and may require the borrower to revise the prior or post review requirements in the Procurement Plan. *See id.*
[169] AIIB law explicitly provides that "Except for acknowledging the receipt of the complaint, the Bank does not enter into discussion or communication with any tenderer or consultant." *Id.* annex IV, 4.
[170] WBG, *supra* note 2, § III., ¶ 3.10.

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judicial process, exposing the bank to potential legal challenges.[171]

Three measures are available for mitigating legal risks for the AIIB's close involvement in the procurement process.

First, the AIIB should prioritize due diligence work on project selection and evaluation at the outset, aiming to avoid and mitigate situations requiring hands-on expanded implementation support. Bank procurement staff must focus on ethical outcomes to minimize fiduciary and fraud and corruption risks during the process.

Second, when the day comes and hands-on expanded implementation support is introduced in AIIB procurement law, it is important to add the following statement, "Such support does not result in the Bank's executing procurement on behalf of the Borrower, and project execution remains the Borrower's responsibility,"[172] in order to mitigate risk *vis-à-vis* third parties with whom the AIIB has no contractual relationship.

Third, a "hold harmless" provision should be inserted in the legal agreement between the AIIB and the borrower. Under such a "hold harmless" provision, the borrower would agree that the Bank will not be liable for any loss, damage, or liability that the borrower may incur as a result of the services provided by the Bank.[173] The contractual provision manages and mitigates the AIIB's risk *vis-à-vis* the borrower or other recipients of hands-on expanded implementation support.

## VII. Conclusion

This article has covered five key legal issues relating to the AIIB-funded procurement, i.e., the impact of the AIIB's non-resident Board system on procurement; the role of trust funds in MDB-financed procurement; state-owned enterprises (SOEs) as private entities in MDB-financed procurement; alternative procurement arrangements; and procurement-related disputes and complaints.

On the Board system, the AIIB's non-resident Board anticipates being a valuable asset for fair procurement. Compared with the traditional, executive Board system, which may well lead to conflicts of interest in MDB-financed procurement, the AIIB's non-resident Board system helps to level the playground.

On trust funds, the U.S. experience indicates how a donor nation affects procurement by establishing trust funds in the MDBs. The AIIB has

[171] AIIB procurement law is silent on hands-on expanded implementation support, possibly demonstrating the young institution's prudential attitude towards a high degree of involvement in the procurement process. However, such silence does not help when situations requiring hands-on expanded implementation support indeed occur.

[172] WBG, *supra* note 2, § III., ¶ 3.11.

[173] *Procurement in World Bank IPF Phase II*, *supra* note 105, § III, ¶ 46.

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a Project Preparation Special Fund, to which China, the U.K. and Republic of Korea have agreed to contribute. The three countries' contributions expect to help their own engineering and consulting firms to get a fair shot at the initial stage of an AIIB-financed project, in a manner consistent with the Bank's "non-restriction" procurement requirement.

On the criteria of a private entity, the identification of an SOE as a private entity, exemplified in AIIB law, represents an overwhelming endorsement of a function-based (not ownership-based) criterion by the international legal community. It enables an SOE as a private borrower to follow other established procurement practices than formal competitive methods, and the SOEs of the borrower's country are eligible to participate in contract bidding.

On alternative procurement arrangements (APAs), there are two general categories, i.e., "country systems" and "co-financings". APAs bring flexibility to both the MDBs and borrower countries, while causing concerns among some non-borrowing countries. Recently both the World Bank and the AIIB have endorsed APAs by adopting them in their new (or renewed) procurement policies.

On dispute settlement, the MDBs have a dual position of both monitoring and supporting the procurement process, and get involved in the prompt and equitable settlement of procurement-related disputes in varying degrees. Meanwhile, the MDBs should be cautious to strike an appropriate balance between their need for involvement and their management of the risks in order to avoid potential legal and reputational risks.

This article is not intended to cover all issues relating to the topic of MDB-funded procurement. I select the above five key issues because they fundamentally impact the core procurement principles and standards in each procurement policy. Some of the issues are fresh and new, such as the non-resident Board system, while others are old but worth revisiting. I wish to inspire further discussion in a bid to optimize MDB-funded procurement results.

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