



FINANCING BUILD OPERATE TRANSFER (BOT)
PROJECTS: AN ISLAMIC LEGAL ANALYSIS

BY

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the degree of Doctor of Philosophy

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ABSTRACT

The main purpose of the study was to establish a *Shariah* framework legal structure for *Shariah*-compliant Build-Operate-Transfer (BOT) projects and contracts as solutions for problems related to components of BOT contract and risk profiles. The doctrinal study was undertaken as a library research with combined approaches of descriptive, explanatory, analytical, historical, comparative and harmonization methods. Harmonization approach is conducted where compatible *Shariah* principles and conventional are synchronized to produce a new *Shariah* framework of legal structure for BOT projects and contracts. BOT is a conventional concept of financing that utilises the private investment in undertaking the public sectors infrastructure projects. It is a complicated process with multiplicities of parties, contracts, and sources of financing. It is a project finance mechanism with repayment of expenditure relies on the cash flow of the project. In practice, the success of BOT projects depends on sound privatisation policy and adequate legal framework which protects the parties involved. However, BOT projects may suffer failures when component of contract and risk profiles such as policy and regulatory framework, government support, project formulation and documentation, project priority, transparency, profitability and fair dealings were compromised by uncertainty in the terms and conditions of the concession contract, lack of transparency in the project application process, and inadequate project appraisal. Islamic BOT is deemed to be a viable solution. Though BOT is a new concept to Islamic law but with the structure, its contracts are common to the Islamic principle of *muamalat*. Islamic law is also pliable for all aspects of *muamalat*, including BOT projects. Therefore, the *Shariah* principles are applied in determining the *Shariah* compliancy of BOT projects and contracts. To make the study more viable, it will also frame the BOT contracts and projects from the *maqasid* perspective. The study has found that many of the BOT projects and contracts are *Shariah* compatible and therefore could be made more *maqasid* oriented. Nevertheless, the study reveals that the current practice of Islamic financing in BOT projects was still facing many constraints, due to limited use of *Shariah* principles, burdensome to certain parties and uncompetitiveness. The analyses elucidate the suitability of BOT with *Shariah* contracts, *Ūqud al musammah* (nominate contracts) like *al kafalah* (contract of guarantee), *ijarah* (contract of lease), *iqta* (government awards) and *istisna* (manufacturing contract) as well as modern contracts like *imtiyaz* (concession contract), *muqawalah* (public construction contract) and *siyanah* (maintenance contract). In addition, BOT is discussed in the light of the development of *waqf* land. Then, the study examined the strengths and weaknesses of BOT projects that utilized the *al bay bithaman ajil* sale-based financing, the partnership based financing of *sukuk musyarakah*, the lease and profit sharing based financing of *sukuk ijarah* and *mudarabah* and the lease and time sharing based financing of *sukuk ijarah* and *intifa*. This study in sum made a proposal for an Islamic BOT framework of legal structure for consideration by the authorities in constructing BOT contractual structure and project appraisal.

خلاصة البحث

الغرض الرئيسي من هذه الرسالة هو إيجاد التكييف الشرعي للإطار القانوني لمشاريع وعقود - البناء - التشغيل - التحويل) المطابقة مع الشريعة كحل للإشكاليات المتعلقة بهذا النوع من العقود و مخاطرها. وعقود (البناء-التشغيل-التحويل) عبارة عن مفهوم تقليدي للتمويل الذي يستخدم استثمارات القطاع الخاص لإنشاء مشاريع البنية التحتية للقطاعات العامة. وهو عملية معقدة مع أطراف، وعقود، ومساهمات، ومصادر تمويلية متعددة. كما أنه أيضا آلية لتمويل المشاريع يعتمد لسداد النفقات على التدفقات النقدية الناتجة عن مشروع. من خلال الممارسة العملية، فإن نجاح المشاريع يعتمد على سياسة خصخصة سليمة و إطار قانوني كاف يحمي كافة الأطراف. وفي المقابل، فإن انعدام الشفافية في عملية تطبيق المشروع، وعدم كفاءة تقييم المشاريع، وعدم اليقين في شروط وأحكام عقد الامتياز، يسهم في بروز مشاريع متأزمة. وبالرغم من أن عقود (البناء-التشغيل-التحويل) مفهوم جديد بالنسبة للمعاملات المالية الإسلامية، إلا أن العقود المستخدمة فيها تتوافق بمبادئ العقود في الشريعة الإسلامية. من خلال هذه الأطروحة تعتمد هذه الدراسة على تطبيق الأسس الشرعية ومبدأ تحقيق مقاصد الشريعة من أجل التأكد ولتحديد مدى توافق عقود مشاريع (البناء-التشغيل-التحويل) مع الشريعة الإسلامية. ولتوضيح مدى تلاءم (البناء-التشغيل-التحويل) مع عقود الشريعة، والعقود المسماة وكذلك العقود الحديثة، فإنه قد تم تحريرها في مواضعها. وبالإضافة إلى ذلك، تم البحث في ضوء مشروع تطوير أرض الوقف، ثم بحثت الدراسة نقاط قوة وضعف المشاريع التي تستخدم التمويل القائم على البيع، والمشاركة والمضاربة. ولقد تم استقصاء هذه الدراسة من خلال البحوث المكتبية، كما تم اعتماد مزيج من المناهج منها: الوصفية، والتفسيرية، والتحليلية، والتاريخية، والمقارنة، بما في ذلك المواءمة وذلك من أجل تكييف الأسس والأساليب المستخدمة في النظام التقليدي مع الأسس الشرعية وذلك بغرض الوصول إلى إطلال شرعي للهيكل القانوني لعقود (البناء-التشغيل-التحويل). وقد وجدت الدراسة أن مشروعات وعقود (البناء-التشغيل-التحويل) متوافقة مع الشريعة. وبناء عليه، فإن (البناء-التشغيل-التحويل) نوع من العقود الحديثة في الشريعة. كما تكشف الدراسة أيضاً أن الممارسات الحالية للتمويل الإسلامي تواجه العديد من القيود، حيث أنها تستخدم مبادئ محدودة، مثقلة للأطراف وغير تنافسية. وعليه توصي هذه الدراسة الحكومات والأطراف ذات الصلة بالنظر في نهج مقاصد الشريعة في إجراء تقييم مشاريع (البناء-التشغيل-التحويل)، والبنية التعاقدية لها.

APPROVAL PAGE

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DECLARATION

I hereby declare that this thesis is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

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Electricity Supply Act 1990
Electricity Regulations 1994
Federal Roads (Private Management) Act 1984
Licensee Supply Regulations 1994
Water Commission Act 2007

LIST OF ABBREVIATIONS

ADB	Asian Development Bank
AAOIFI	Accounting & Auditing Organization of Islamic Financial Institution
BOT	Build Operate Transfer
BORC	Build Operate & Renewal of Concession
BOO	Build Own Operate
BTO	Build Transfer and Operate
BTLB	Build Transfer and Lease Back
BBO	Buy Build Operate
ECA	Export Credit Agencies
ECGD	Export Credits Guarantee Department of the United Kingdom
EFIC	Australia Export Finance and Insurance Corporation
EU	European Commission
EIB	European Investment Bank
EBRD	European Bank for Reconstruction and Development
IDB	Islamic Development Bank
JBIC	Japan Bank of International Cooperation
LDO	Lease Develop Operate
MDBs	Multilateral Development Banks
MFI	Multilateral Financial Institutions
NDF	Nordic Development Fund
ODA	Overseas Development Administration of the United Kingdom

OECD	Organisation for Economic Development and Cooperation
ROT	Rehabilitate Own Transfer
ROO	Rehabilitate Own Operate
TOR	Transfer of Operational Rights
USAID	United States Agency for International Development
USEXIM	Export-Import Bank of the United States

TABLE OF TRANSLITERATION

Arabic		Example	Transliteration Example
ء	'	سأل	sa'ala
ب	B	بدل	Badala
ت	T	تمر	Tamr
ث	Th	ثورة	Thawrah
ج	J	جمال	Jamal
ح	Í	حديث	×adith
خ	Kh	خالد	Khalid
د	D	ديوان	Diwan
ذ	dh	مذهب	Madhhab
ر	r	رحمن	Rahman
ز	z	زمزم	Zamzam
س	s	سراب	Sarab
ش	Sh	شمس	Shams
ص	Î	صبر	Øabr
ض	Ì	ضمير	Öamir
ط	Ï	طاهر	Ùahir
ظ	Ð	ظهر	Úuhr
ع	°	عبد	°abd
غ	Gh	غيب	Ghayb
ف	F	فقه	Fiqh
ق	Q	قاضي	Qadi
ك	K	كأس	ka's
ل	L	لبن	Laban
م	M	مزمارة	Mizmar
ن	N	نوم	Nawm
هـ	H	هبوط	Habata
و	W	وصل	Wasala
ي	Y	يسار	Yasar

Short Vowels

<u>Arabic</u>	<u>Latin</u>	<u>Example</u>	<u>Transliteration Example</u>
اَ	a	فَعَلَ	Fa°ala
اِ	i	حَسِبَ	Hasiba
اُ	u	كُتِبَ	Kutiba

Long Vowels

<u>Arabic</u>	<u>Latin</u>	<u>Example</u>	Transliteration
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ا،ى	É	كاتب ، قضى	<u>Example</u> kÉtib, qadÉ
ي	Ê	كريم	karÊm
و	Ë	حروف	hËruf

Diftong

<u>Arabic</u>	<u>Latin</u>	<u>Example</u>	<u>Transliteration Example</u>
اُ	aw	قول	qawl
ي	ay	سيف	sayf
ي	iyy/i	رجعي	raj ^c iyy / raj ^c i
و	uww/u	عدو	^c aduww / ^c adu

CHAPTER ONE

INTRODUCTION

1.0 INTRODUCTION

This chapter introduces the background and purpose of the study which includes definition of major concepts; statement of the problem; objectives; hypotheses; significance; method; theoretical framework, and the scope and limitation.

1.1 BACKGROUND TO THE STUDY

The background of the study begins with the definition of two major concepts, namely; privatisation and BOT mechanism which straddle the conventional and Islamic perspectives of this study's BOT financing analyses.

Privatisation is the utilization of the private investment in undertaking the public sectors infrastructure projects. Privatisation has transformed the landscape of Malaysian infrastructures with the consequence being Malaysia experiencing a flexible infrastructure development.¹ The initial phases of privatisation and infrastructure development in Malaysia began in the late 1960s when the government initiated the transformation of the agricultural-based economy to the one driven by industries and manufacturing. To fulfil the nation industrialisation needs, modern infrastructures like highways and power plants were required to support the economic growth. In addition to ensure stability and growth of the economy, the government was also responsible for the socio-economic restructuring and poverty alleviation

¹ G. Naidu, Cassey Lee, "The transition to privatisation: Malaysia" in *Infrastructure strategies in East Asia*, edited by Ashoka Mody, The World Bank, 1997 at 36.

programs. Thus, the Privatisation Policy² of the infrastructure development was of twofold strategies for the promotion of economic expansion and to alleviate poverty through fair distribution of economic benefits to all the 13 states in Malaysia.

Prior to the implementation of privatisation policy, the government played major roles in financing road construction because there were no direct user fees charged for use of public roads, hence the state government could not compensate their expenditures on the road. By the mid 1980s, the government was overburdened with high level investment required to expand and upgrade the country's road system. Thus, privatization of road construction was then seemed a viable option.

Build Operate Transfer (BOT) is a kind of legal mechanism of privatisation. It is a structure that utilizes the private investment in undertaking the public sectors infrastructure projects. It is a complicated process with multiple parties and contracts. BOT is a business venture between the government and the concessionaire, with the ownership of the project asset transfers to the government at the end of the concession period.

Malaysian privatisation of road projects via Build Operate Transfer (BOT) mechanism began in 1984, whereby the Federal Roads (Private Investment Management) Act was enacted to allow privatisation of road construction and management. BOT mechanism was adopted because it was a "win-win situation" in which the private entity may compensate the financing via toll collection and the completed project will be transferred back to the Government at the end of the concession period.

² See *Guidelines on privatisation*, Economic Planning Unit, Prime Minister Department 1985.

Table 1.1
Total Number of Project and Privatisation Mechanism in Malaysia
From 1990 until 2008

Sector	Concession	Divestiture	Greenfield Project	Management And lease contract	Total
Energy	0	4	22	0	26
Telecom	0	1	6	0	7
Transport	18	1	27	1	47
Water and sewerage	11	1	2	2	16
Total	29	7	57	3	96

Source: Private Participation in Infrastructure Projects Database of the World Bank, <<http://ppi.worldbank.org>>, viewed at 20/11/2009.

Table 1.1 shows the total number of projects according to sectors, privatisation mechanism adopted, and investment. BOT is considered as one of the categories of Greenfield project. A Greenfield project refers to private entity or public-private joint venture which builds and operates a new facility for the period specified in the project contract. The facility may return to the public sector at the end of the concession period. Other categories of Greenfield project includes build, lease, and transfer (BLT), build, operate, and transfer (BOT) and build, own, and operate (BOO). On the other hand, concession is a technique whereby a private entity takes over the management of a state-owned enterprise for a given period during which it also assumes significant investment risk. It consists of modes such as rehabilitate, operate, and transfer (ROT), rehabilitate, lease or rent, and transfer (RLT), build, rehabilitate, operate, and transfer (BROT). Table 1.1 stated that 57 out of 96 projects opted for Greenfield mechanism in all sectors. Two sectors with high usage of Greenfield technique is energy and transportation.

Table 1.2
Total investment in projects by type and primary sector (US \$ million) in
Malaysia from 1990 until 2008

Sector	Concession	Divestiture	Greenfield project	Management and lease contract	Total
Energy	0	3,805	10,508	0	14,313
Telecom	0	2,469	7,127	0	9,596
Transport	3,626	130	12,796	0	16,552
Water and sewerage	9,422	16	706	0	10,144
Total	13,048	6,420	31,136	0	50,605

Source: Private Participation in Infrastructure Projects Database of the World Bank, <<http://ppi.worldbank.org>>, viewed at 20/11/2009.

Table 1.2 highlights the total investment of the projects according to sectors. Energy and transportation sectors were high investment projects compared to others during the period. Due to the high investment nature, both projects were suitable for BOT mechanism whereby the Government awarded the concession to the private entity to build and operate the facilities. In the course of operation, the private entity may recoup the expenditure incurred by collecting tolls or fees from the end user. After the expiration of the concession period, the project will be returned back to the Government.

A decade after the beginning of privatisation was marked by the emergence of capital market which consisted of conventional and Islamic capital market.³ Both capital markets facilitate the privatisations and infrastructure projects by the issuance of bonds, equity financing securities and Islamic securities. Islamic capital market products provide long term fund raising and investment.

³ Securities Commission, *Capital market development in Malaysia history and perspectives*, Securities Commission, 2004 at 243.