



Seek Truth & Ensure Justice

**ESTABLISHMENT
OF
FINANCE AND CORPORATE DIVISION**

DECEMBER 2021



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1. Title

This is the *Foundational Paper for the Establishment of the Finance and Corporate Division* (FCD) under the Department of Legal Service of the Office of the Attorney General.

2. Introduction

In pursuant to His Majesty's concerns on the lack of commercial and financial legal expertise in the justice sector, the emerging trends of losing government cases, and high pre-trials costs compared to the outcome of the cases leading to huge financial burden on the government, the creation of FCD under the OAG was dearly felt to fulfill the sacred vision of His Majesty the King to build a specialized and competent legal team in the corporate and financial field.

Accordingly, the FCD was proposed by the present Attorney General, *Dasho* Lungten Dubgyur, who has taken over the leadership at OAG since his appointment as the Attorney General (AG) on 20th July 2020. The Human Resource Committee of the OAG vide order OAG/AFD-OR/2020-21472 dated 15th September 2020 has officially created a Unit with the name Governance & Corporate Legal Service Unit (GCLSU), and appointed officials who were transferred from other divisions within OAG to lead the Unit. The Unit is now upgraded to a Division, which is the Finance and Corporate Division (Refer Schedule 1 containing the OAG Organogram). Briefly, the new Division will: scrutinize government tender documents; review existing contractual documents and agreements to which the government is a party including evaluating cost-benefit analysis; examine the financial burden arising from litigations and pre-empt government from engaging in avoidable litigations; and attain clear understanding and interpretation of financial laws.

The Government through its agencies and organizations enters into hundreds of contract agreements every day. It starts right from procurement of works of goods and services, seeking grants and loans from international partners, to settlement of disputes and enforcement of contractual obligations with partners. Major challenges in the procurement system still prevails: the need of standardization of government contracts are dearly felt to ensure due diligence and seamless implementation; revisiting into the commercial laws are also seen as opportunities to liberalize our trading tools; and resources are unnecessarily wasted due to verbose and unending litigations.

The FCD is established to discreetly bring reforms to the existing system involving government procurement and contracting, financial institutions, and any corporate or commercial activities whether as a regulatory or as a service delivery entity. Further, the Division proposes to support the OAG in delivering effective and efficient legal advice, drafting and vetting of contractual documents and trainings to professionals through regular mandates. Similarly, prosecution of financial crimes will be strengthened by utilizing financial expertise to analyze calculations and deduce uncontroverted figures.

The objectives are purported to be realized through professionalizing the FCD, which includes among others capacity development of lawyers in the Division, notably, by specializing in pertinent fields of corporate and commercial laws. It may also consider recruiting financial experts such as professional accountants, or collaborate with Royal Audit Authority (RAA), Ministry of Finance, Royal Monetary Authority (RMA), or any financial institutions for capacity building or undertaking tasks related to litigation and prosecution, risk assessment, contractual formation, and reviewing commercial and financial legal instruments for standardization.

3. Background

(a) Policy rationale

Guided by the philosophy of Gross National Happiness (GNH), government policies in Bhutan are based on the four pillars of sustainable economic development; preservation and promotion of culture and tradition; conservation of environment; and good governance. The economic development policy, foreign direct investment policy, construction industry policy and, most recently, e-commerce policy (draft stage) are few areas that are directly involved in boosting economic activities. The implementations are being put into place and few policies have even been revised testing the practicality of its implementation. The Covid-19 pandemic further calls for flexibility and online workings to be integrated in the strategies and plans which offers challenges as well as opportunities for better systems and sustainability.

Since the commencement of planned socio-economic development in the 1960s, Bhutan has transitioned from a traditional stage of development to an economically advanced stage. This has brought about significant structural changes in the economy by moving away from the primary sector towards secondary and tertiary sectors. Modern development can be broadly simplified into public sector and private sectors, both of which are equally important economic limbs for development and prosperity.

Public procurement is a crucial pillar for service delivery for any government. The government still is the biggest employer with a majority in the civil service and others with numerous public sector undertakings, which routinely procure goods and services of any size. It is suggested that the government may be spending around 17.6 percent of GDP on procurement annually (ACC report 2014), which excludes budget allocated for mega hydropower projects and east-west highway road widening. Public sector undertakings through

hydro projects and construction of public sector buildings account for large quantities of high-end works while procurement of stationery at offices and maintenance work accounts for equally large numbers of small-scale works.

Amongst the sectors, the construction sector plays an important role in the national economy. As a developing country construction works are intensely desired for laying foundational and basic infrastructure. In 2016, the contribution from the construction sector to the Gross Domestic Product (GDP) was 16.28% (NSB, 2017) which translates to Ngultrum 24,204 million. The sector had a huge share of 63 % of the total capital expenditure outlay for the Government, which translates to about Nu. 18.462 billion for the Financial Year 2017-2018. As of 8th May 2018, the number of contractors registered with Construction Development Board (CDB) stood at 4,023 of which 219 are Large, 398 are Medium and 3386 are small contractors (National Construction Industry Policy 2018). Given the highest potential to generate wealth, the construction industry has been identified as one of the priority sectors in the revised Economic Development Policy 2016.

It is discernible that cross-cutting issues from the economic and financial policies have laid out wider roles and mandates in the government procurement and contract works including financial agreements for financing of investments. All of these activities and transactions must be governed by a diligent framework of laws and legal instruments in order to avoid unnecessary disputes, enhance cost effectiveness and mitigate damages and legal intricacies. If law and legal instruments are canny enough to get to minor details such as fixing accountabilities through contractual terms and conditions, the system should be swiftly streamlined, although it is easier said than done. Equally, it is imperative to look for good practices from similar jurisdictions as they are results of years of trials and errors.

His Majesty's forward-looking policy has ably guided the developmental activities in a balanced way for many years. It certainly reinforces motivations and principles in various policies that are being adopted. The policies are invariably designed for fitting into changing time and conditions and thus it must be used as an instrument for exploring better and smarter means and not as limitations.

(b) Contracts and financing framework agreements

- *Nature of government contracts and settlement of disputes*

It is evident that the government enters into contractual agreements for execution of any activity. This is to build trust and to obtain goods and services delivered on time for desired outcomes. It begins with a tendering process in order to award contracts and works fairly to individuals through an open tendering process by observing level playing field and transparency, and it is through such a process the government intends to get best value for money invested. Depending upon the size and nature of works and goods, different procedures and methods are devised for outsourcing, and different experts and personnel are deployed to carry out assessment of proposals and offers. Accordingly, contracts are being signed with awardees for execution according to terms and conditions, and to make timely payment as per works delivered and milestones achieved. Such contracts are mainly in the form of standard forms of contracts that are to apply uniformly throughout Bhutan. International contractors are also invited for large quantity works.

It is prudent to expect disputes and therefore settlement of disputes is designed through alternatives dispute settlements (ADR) notably negotiations and mediations; they are amicable and expedient for small causes as per current practice. Settlement of disputes involving government contracts or complex matters are largely being done through arbitration as per terms dictated in the contracts or voluntarily

by parties as it offers a variety of advantages. Appeals can be filed to the courts but restrictively. It is often seen that parties end up appealing even on trivial grounds to a higher court, taking advantage of our lenient appeal system.

- *Funding and financial framework agreements*

The funding of the government capital investments is sourced through domestic revenue and external sources. External sources include borrowings and grants from development partners. UNDP, UNICEF, World Bank (IDA-IBRD), Asian Development Banks, SAARC Development Fund (SDF), Austrian Development Assistance (ADA) and Government of India (GoI). These are some of the development partners providing grants and concessional borrowings for many years and still continue to do so.

The financial agreements entered into by the government with development partners and donors are arranged in the form of framework agreements consisting of financial agreements as well as project agreements; occasionally they also contain sovereign guarantees. Such financial agreements are usually signed by the finance minister or Secretary on behalf of the government while project agreements are normally signed by implementing agencies themselves with donor partners. Grant agreements usually offer very little option for negotiation thereby mandating us to sign as how it is proposed. Hydro power investments are usually signed bi-laterally with the foreign counterparts and parties. It is important to note that signing of agreements or treaties are done as per the Rules of Procedures for such purpose; while small grants and loans are being signed by government representatives, those that are prone to future challenges and consequences that are likely to be substantial, creating exception or overriding existing laws or have the effect of creating rights and liabilities require ratification of the Parliament as per Article 10(25) of the *Constitution*. It is imperative to review such financial framework

agreements carefully weighing pros and cons, and every likely impact in order to help make informed decisions for the government.

(c) Legislative Frameworks

Government contracting and procurements are governed under many laws, treaties and agreements. Following are a few of them that are directly relevant to governance of government contracts and financial agreements.

Public Finance Act 2017: This Act regulates financial management of the government determining efficient raising of revenue and prioritizing investments and budgeting of developmental activities. It authorizes the ministry of finance to make borrowings domestically and externally, and rationalizing budgets and investments. It also lays down monetary policies and implements largely through the Royal Monetary Authority (RMA) and financial institutions.

Procurement Rules and Regulations 2019: Adopted by the Ministry of Finance under the *Public Finance Act*, this provides a uniform procurement procedure for procurement of goods, works and services in government agencies and organizations. It ensures accountability, transparency and fairness in the procurement of goods and services, and accessibility for private sectors that wish to participate.

Tax laws including *Sales Tax, Customs and Excise Act of Bhutan 2000, Income Tax Act 2001, the Customs Act of Bhutan 2017* are important components for raising revenue. Government contracts as well as private individual contracts are subject to payment of taxes for works being carried out thereby making them important tax entities. The existing tax laws are already repealed by the well-known *Goods and Service Tax Act (GST) 2020*; however, the new tax regime will be effective once all infrastructures are ready.

Contract Act of Bhutan 2013: The Contract Act is intended to regulate making of contracts and their performance, and ensure uniform implementation of contracts. However, this law is being used rarely or rarely even spoken about. The validity of any agreements or contracts are examined with the provisions of the *Evidence Act 2005*, which provides making of a ‘valid written agreement’ and circumstances for ‘invalid written agreement’. These provisions are not repealed by the *Contract Act* which makes it reasonable to refer to. The general understanding with regard to contractual principles laid down in the *Contract Act* is limited to formation of contracts to satisfy ‘offer/proposal’, ‘acceptance’, and ‘consideration’.

Bankruptcy Act of Bhutan 1999: The Bankruptcy Act was enacted in 1999, yet to date, this Act was hardly implemented due to: lack of clarity on numerous provisions under the Act such as on the differentiation between individual bankruptcy and corporate insolvency; lack of a competent authority (nodal agency) to keep records on the bankruptcy proceedings in the country; and heavy responsibilities which could be executed by the competent authority being imposed on the courts. Hence, the OAG in collaboration with the World Bank on the request of the Ministry of Finance drafted the new Insolvency bill addressing the issues found under the previous Bankruptcy Act. The National Law Review Taskforce in their Report submitted in June 2018 also listed the Insolvency bill amongst the laws that are important to be enacted. The new Insolvency bill once enacted into an Act is hoped to improve the ease of doing business in Bhutan through a systematic exit of non-viable businesses, and saving the viable ones through alternative modes such as reorganization of business instead of insolvency or winding up.

In addition to the above, there are other laws such as *Negotiable Instrument Act 2000* and *Movable and Immovable Property Act 1999* (“MIPA”), both of them are instrumental for boosting commercial activities as they are intended to facilitate easing financial transactions and enforce security interest. However, both are minimally implemented

as they are found to be complex for our context. Such laws were adopted by the erstwhile National Assembly in order to liberalize trade or commercial activities in the country at the time.

(d) Challenges and Opportunities

Challenges and opportunities provided here are based on a brief desk review, and they are non-exhaustive findings. They are illustrative of prevailing issues, which could be used as a starting point for study or review of laws, regulations and systems. They are also an outcome of preliminary discussions held by the Attorney General with the officials of the Division and office meetings.

(e) Procurement system

In 2015 the Good Governance Committee of the National Council in fulfilling the oversight role of the Parliament conducted a study on the Public Procurement System. This important piece of report has enumerated challenges, opportunities and recommendations. One of the factors affecting the quality attributes to the trend of quoting lowest price by vendors. This happened even after the PRR 2009 clarified and corrected that the lowest evaluated bid means a bid which offers best value for money and that this does not necessarily mean lowest quoted price. On a deeper analysis, it is found that technical scoring of a bid is not added to the final scoring, it only maintains the threshold for qualification to participate in the bidding. Likewise, lack of professionalism and due diligence on the part of contractors in preparing rate-quotes and the excess supply of contractors in the market are reasons for quoting unreasonably low prices. Weakness in quality control mechanism especially after award of work with no clear delineation of responsibility and accountability, and unrealistic time frame of deliverables directly compromise quality of work. Inefficiency in the complaint mechanism especially with respect to award-result has unduly delayed final award of work and its implementation, which also

increases the overall cost of a work due to inflation. This necessitates reforms in administrative dispute settlement mechanisms.

Opportunities are therefore seen in enhancing quality control mechanism both internal (within procuring agencies) and external (regulatory authorities) front by providing clarity in the roles and responsibilities of employers as well as contractors; professionalizing contractor by liaising with associations for proper representations, establishing prompt grievance redressal mechanism, and introducing collaborative learnings among stakeholders. For instance, Bhutan Power Corporation (BPC) is said to have effective control mechanisms which others may learn from.

Furthermore, the report considered that the magnitude of work under the PRR 2009 was ever increasing and therefore it was found necessary to have separate legislation such as a Public Procurement Act in order to strengthen the existing system while considering challenges described above. This will also lay down a solid basis for establishing a quasi-judicial body for settlement of disputes.

Although the PRR was replaced by PRR 2019 last year, it will be an opportunity to review gaps and anomalies, and an additional opportunity to explore whether a legislative consideration for a new Act is plausible. It will be a holistic approach to review and study gaps and prepare forward implementation plans in light of pandemic such as the Covid-19 to cater future uncertainties and ensure sustainability.

(f) Avoid unnecessary litigations

As per the Judiciary's Annual Report 2019, the highest number of cases are recorded for monetary cases with 3185 cases in a year, and 84 cases relate to contract disputes. It is apparent that default in payment of monthly installments will lead to litigation which will take some time while exhausting intricate court procedures. In actuality, such litigations

can be avoided if MIPA had been implemented since its adoption in 1999 or afterwards. The mechanisms for perfecting security interest of a debt as provided in the *MIPA* would have taken care of enforcement of defaults and insolvency by debtors. It would have aptly resolved many unwarranted cases.

Likewise, in order to avoid unnecessary litigation, the judiciary has in collaboration with BNLI established court-annexed-mediation at various courts since October 2019. Court clerks and designated officials were trained to handle mediation procedures uniformly and professionally. Professionalizing the ADR system by strengthening the existing ADR system can help minimize litigation and boost commercial activities. It can help strengthen government contracts and would help in improving public sector infrastructures. Further, there is also the need to explore whether jurisdiction of the ADR Centre for contractual matters can be made optional under the terms of the contract. Currently many agreements provide compulsory submission of disputes with arbitration, when the arbitration standards are not matched to resolve complex matters it does not help in constructive settlement of disputes.

(g) Harmonize contracts

The *Contract Act* is very less referred to as we are generally accustomed with the usage of *Evidence Act* and customary practices to validate contracts and agreements. The *Contract Act* has many aspects like *bailment* and *contract of guarantees* which are special forms of contract. One example worth citing is that guarantors for debt with financial institutions or banks or with private lenders are unjustly pursued by creditors and many even being detained when they could not fulfill payment of guaranteed-debt when principal debtor absconds as collaterals were not sufficient to recover the debt. The obligation of a debtor and guarantor are enumerated in the *Contract Act* separately as they are to be executed duly through contract of guarantees.

Opportunities are seen in harmonizing the making of contracts not only for government entities and financial institutions but also for general usage in accordance with standards and parameters set in the Act.

(h) Streamline making of treaties and agreements having financial components and bearing on economic activity

Existing review of treaties and agreements entered into by the government are largely based on constitutional screening as per Article 10(25) of the *Constitution*, which includes assessing whether rights and freedoms of individuals are contradicted and whether the agreement creates exception to existing laws. It is important to enhance expertise in financial matters and their implications so as to understand consequential benefits and advantages at present and in the future. Financial stability is one of the important components of national sovereignty; every penny the government borrows must be wisely spent for its intended purpose. Knowing financial management and their appropriations will be an asset while reviewing any treaties and agreements.

(i) Enhancing financial experts and collaboration

As per the annual report OAG continuously received financial crimes for prosecution. It includes common financial crime such as embezzlement, tax evasion and bribery which are increasing every year or commonly seen each year. These cases get prolonged for years and the common grounds for appeal to higher courts are due, largely, to discrepancies in the amount embezzled or in computation of tax evasion amount. These cases have a huge stake in financial recoveries and must be strengthened only through enhancing expertise in the field. Enhancing the competency of lawyers in the financial matters will be helpful but it will also be judicious to collaborate with Royal Audit Authority (RAA) or Ministry of Finance (MoF) to seek their assistance in the financial matters. The office can consider recruiting a regular

employee of these agencies to scrutinize and audit the financial and accounting documents.

4. Objective

With the establishment of the FCD the knowledge and competencies of the employees must be upskilled. This can be done by, immediately, providing training and knowledge-sharing programs within as well as outside Bhutan. In the longer run, sending for master's studies for experienced and advanced-level employees, and PhD's for expert-level employees will be sought in order to professionalize the Division.

It is the intention of the FCD to initiate a comprehensive assessment of the existing laws, procedures, systems, contracts, and find gaps so as to swiftly implement or improve existing regime with what is relevant and best, and recommend concerned agencies and individuals to implement forward plans and actions. For this, thorough studies based on qualitative survey and consultation must be carried out with focus groups composed of key stakeholders. Collaborations with lead agencies and key stakeholders will be conducted. For effectiveness of research task-force groups may be formed within OAG or on a cross-sectorial basis.

5. Functions

The functions of the FCD are as follows:

- (1) professionalize the Division by recruiting experienced lawyers and enhance their capacities in the areas of contract & government contracting, financial and corporate laws, and other commercial instruments;
- (2) effectively advise the Ministries, Organizations and Organs of the State on a wide spectrum of issues such as:

- (a) contracts and agreements;
 - (b) public finance;
 - (c) financial laws;
 - (d) corporate law;
 - (e) foreign direct investment;
 - (f) sole proprietorship, joint venture and partnership;
 - (g) intellectual property law; or
 - (h) arbitration and dispute settlement;
- (3) engage in diligent drafting and vetting legal instruments such as:
- (a) tender documents for government procurement of goods or services;
 - (b) lease agreements and licenses;
 - (c) loan agreements (financial agreements); or
 - (d) investment agreements;
- (4) timely review of government standard documents and legally binding instruments to update or keep abreast of changing time and technology;
- (5) engage in capacity development through conduct of specialized or tailor-made trainings for practicing lawyers, employees of financial institutions, private contractors or anyone that is directly or indirectly relevant;
- (6) carryout comprehensive advocacy programs including workshops and sensitizations to educate general public on trade and business laws, and execution of contracts and agreements to make informed decisions at micro level; and

(7) ably carry out any legal needs assessment or study under instructions of the Attorney General for matters that are deemed pertinent, or that require urgent interventions within the mandates and expertise of the FCD.

6. Work process

The FCD shall render its services according to the *Rule of Procedure for Rendering Finance and Corporate Legal Services*.

7. Expected results

The establishment of the FCD in itself achieves a huge milestone for the Office in its capacity and organization development front. Two Senior Attorneys, namely, Sangay from Legal Service Division, and Namgay Om from Drafting and Review Division (DRD), are being transferred to lead the Division. Sangay had already completed his master's program through *Ausaid* Scholarship, and Namgay Om, who just returned from master's study through *Chevening* Scholarship, is a huge advantage for the Division.

The appointment of officials through in-house transfer is a smart move as it costs nothing additional. In-fact this further provides the officials with an opportunity to become experts in identified subjects. Likewise, it is expected that any officials transferred or recruited for the Division hereafter should already have many years of experience in legal practice, and should be equipped with subject-relevant experience and knowledge after joining the Division. They should be able to work on any complex subject surrounding the mandate of the Division. Therefore, a succession planning will be developed or incorporated and implemented so the Division is able to discharge its mandates (as per the objectives and TOR) efficiently and professionally in a continuous manner.

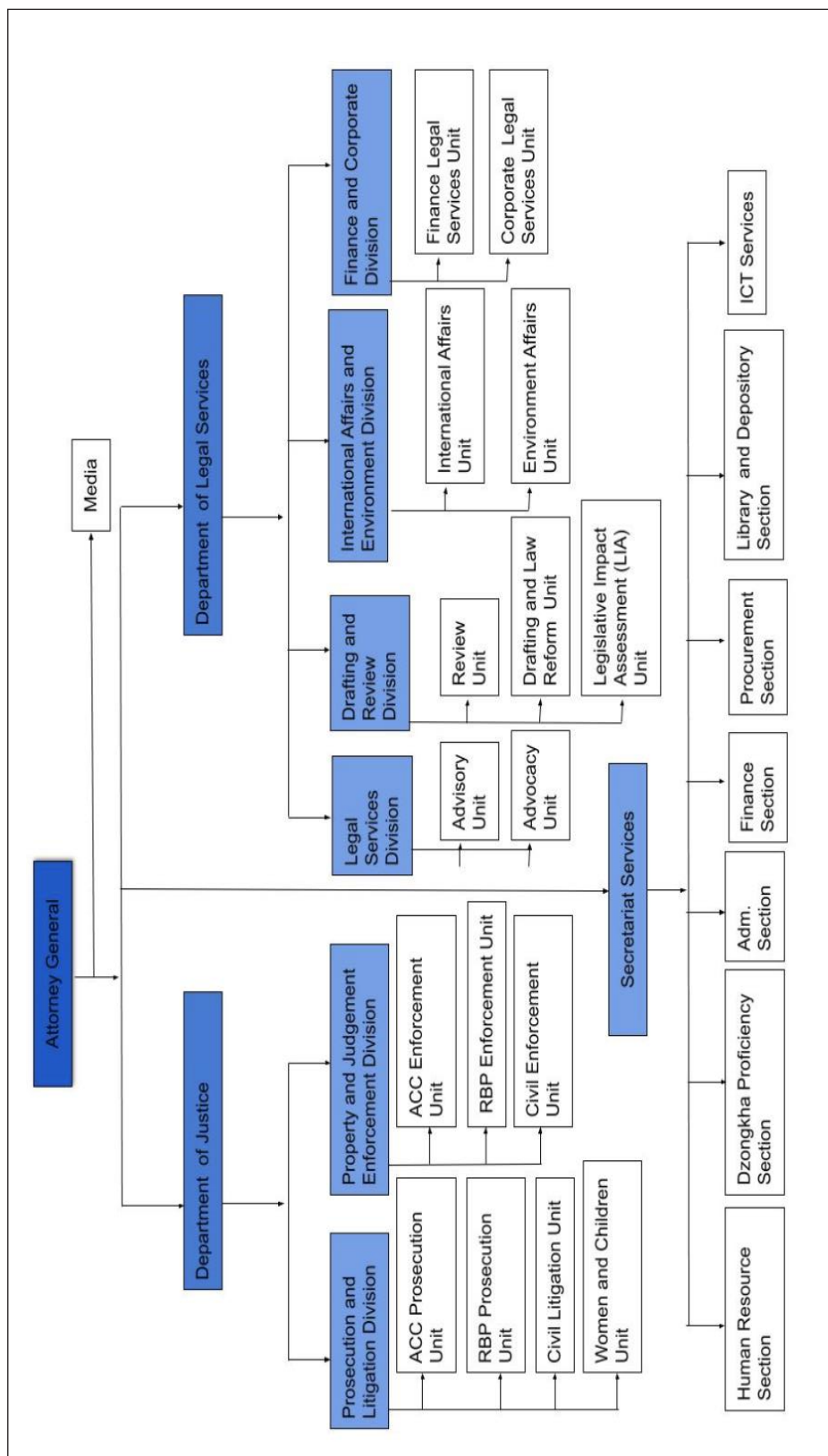
As per the guidance and instruction of the Attorney General, the assessment and mapping of the current system, laws including rules, regulations, manuals, guidelines and SOPs, and customs and practices surrounding public finance, government contracts and corporate affairs has been carried out. Likewise, financial agreements with external investors or donors can be under different frameworks and domestic loan agreements with financial institutions to be in a different theme will be carried out.

As described in the methodology, the study entails activities such as consultations, surveys, workshops, and, if possible, training and knowledge sharing for the benefit of the researchers.

Simultaneously, as part of fulfilling regular mandates, the Division should carry out works assigned by the Attorney General or the Office in connection to:

- (a) rendering legal opinion on: contracts and agreements; public finance; corporate law; foreign direct investment; joint venture and partnership; intellectual property law; arbitration and dispute settlement; and any other matters of trade and commercial importance; and
- (b) drafting and vetting legal instruments such as: tender documents for government procurement of goods or services; contracts, lease agreements and licenses; loan agreements; and investment agreements.

Schedule 1: Organogram





OFFICE OF THE ATTORNEY GENERAL
Post Box No. 1045, Thori Lam, Lower Motithang
Thimphu, Bhutan
PABX: +975-2-326889/324604/336947
Fax: +975-2-324606
Website: www.oag.gov.bt