

**International Seminar on
Strengthening Public Investment and Managing Fiscal Risks from
Public-Private Partnerships**

Budapest, Hungary

March 7–8, 2007

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PPP Regime In Central And Eastern Europe: Status And Challenges

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Introduction

There are numerous ways in which the private sector may invest in public infrastructure. Depending on the level of associated risk, the variety of possible contractual arrangements ranges from public procurement, where a contractor does not assume any project risks, to privatisation, where public assets or shares in a publicly owned company are disposed of to an investor together with all the associated risks. Arguably, the most interesting and sophisticated arrangements lie in the area somewhere between procurement and privatisation. Such options are generally considered to be more effective than those at the extremes of the spectrum.

Since the early 1990s, the volume and number of Public-private partnerships (“PPPs”) has increased significantly worldwide. When regulated effectively, PPPs allow for flexible risk sharing between the public and private sectors, with the aim of carrying out infrastructure projects or providing services for the public in areas including transport, waste management, water distribution and public health and safety.

The EBRD Legal Transition Programme focuses on a particular category of PPPs - concession type and Build Operate Transfer (BOT)/Design Build Finance Operate (DBFO) type arrangements - and does not address privatisation or procurement contracts. The selected category is regarded as the most complex since it involves more sophisticated legal and financial arrangements as well as risk sharing. The legal environment for concessions is vital to the implementation of many types of public-private partnerships (PPPs).

The EBRD has in the past decade accumulated experience in providing legal technical assistance to its countries of operations by a combination of its activities in the sector of PPP/Concession, from playing an important role in standard setting, through the various assessments the Bank undertakes to evaluate both the quality of laws and its workability in practice, to advising individual country’s authorities on the improvement of its legal framework.

Concessions law plays a vital part in the implementation of many types of PPPs. Under a concession arrangement, a public authority entrusts to a private sector operator total or partial management of services or assets for which that authority would normally be responsible and for which the private sector operator assumes all or part of the risk. A key feature of concessions is the right of the private operator to exploit the construction or service granted as a consideration for having completed the construction or delivered the service. For a number of years, the EBRD has been evaluating both the quality of national concessions laws and their workability throughout its countries of operations. Recent evaluations were devoted to concessions legislation and practices.

CONCESSION LAWS ASSESSMENT

In 2004-05, the EBRD undertook an assessment of concessions laws (the 2005 Assessment) in transition countries. The 2005 Assessment is part of the EBRD's efforts to improve the legal environment in its countries of operations. Through such

projects, the EBRD compares the legal environment in certain areas to international standards and, in doing so, aims to encourage, influence and provide guidance to policy and law makers, while developing the legal reform in the region. The 2005 Assessment was the fifth assessment of this type led by the EBRD. Previous assessments examined secured transactions, corporate governance, bankruptcy and securities markets legal environment. These assessment projects concern legal areas that the EBRD considers essential to the investment climate and private sector development.¹

This involved a detailed analysis of concessions laws in selected core areas: (i) the general policy framework; (ii) the general concession legal framework; (iii) definitions and scope of the concessions law; (iv) selection of the concessionaire (the entity to which a concession has been awarded); (v) the project agreement; (vi) availability of security instruments and state support; and (vii) settlement of disputes and applicable law.

The selection of core areas and the questionnaire used in the 2005 Assessment were based on international standards developed in the concessions field by the United Nations Commission on International Trade Law (UNCITRAL) and other organisations² and on EBRD's experience in implementing PPP projects. It is against such internationally accepted standards that the laws were assessed.

In the course of developing the rating methodology it was thought appropriate to develop a separate list of questions for countries where rules governing concessions are contained in various contract laws and/or sector-specific legislation. Rules in these countries were benchmarked against internationally accepted principles rather than standards only.

Using the answers provided by lawyers in the transition countries, the relevant laws were assigned a rating of their compliance with internationally accepted standards (or principles, as applicable), ranging from very high to very low.

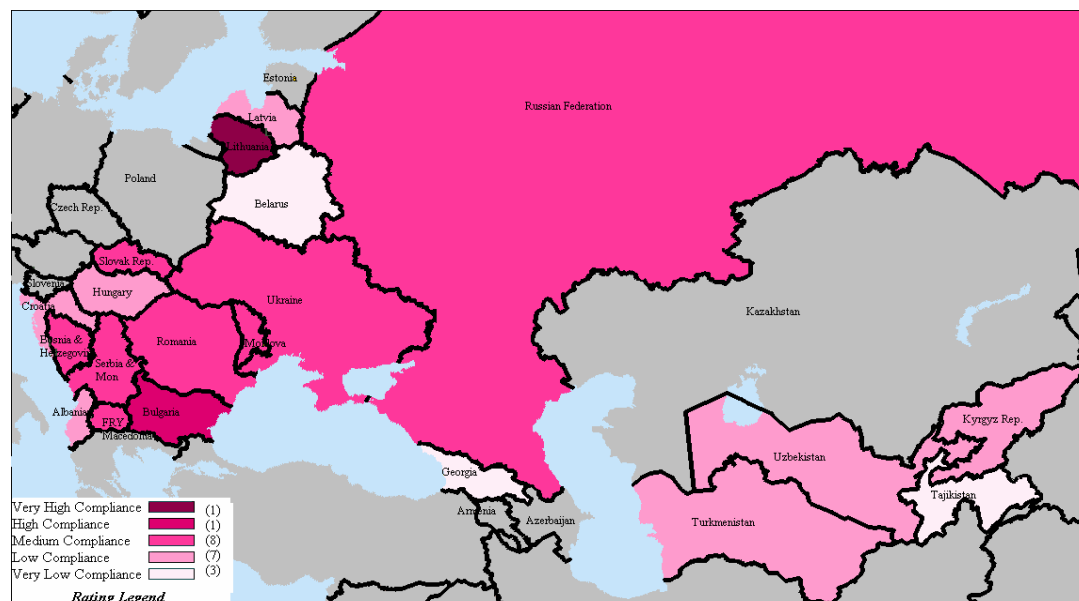
As illustrated by the Map, only Lithuania achieved a "very high" rating. Three countries were rated "very low", while the majority achieved the "medium" category.

¹ For more information, see: <http://www.ebrd.com/country/sector/law/index.htm>. The results of the 2005 Assessment are valid as at July 2005. Changes in the concession legal framework in some transition countries since July 2005 are not taken into account in the results and analysis presented here. The EBRD worked with Gide Loyrette Nouel on the EBRD concession Law Assessment assisted by experts from each of the 27 countries .

² See UNICITRAL Model LEGISLATIVE Provisions on Privately Financed Infrastructure Projects, 2003. Other international standards used are: Commission Interpretative Communication on Concessions under Community Law, 2000; UNIDO BOT Guidelines, 1996., European Commission Guidelines for Successful Public-Private Partnerships, 2003 and OECD Basic Elements of a Law on Concessions Agreements, 1999-2000. See also the European Parliament Resolution on Public-Private Partnerships and Community Law on Public Procurement and Concessions of 26 October 2006, Communication From the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on Public-Private Partnerships and Community Law on Public Procurement and Concessions of 15 November 2005, the Green Paper on Public-Private Partnerships and Community Law on Public Contracts and Concessions of 30 April 2004 and a Report analysing all contributions of 3 May 2005.

This illustrates the need for reform of concessions legislation in virtually every transition country³

Figure 1: Compliance/conformity with international concessions standards and principles⁴



Policy framework plays an essential role in a PPP enabling regime. Therefore, policy issues are worthy of mentioning separately. Policy, regarded as a concept/strategy of a particular Government, is in fact a manifesto of its political will in the area of PPPs and its mid to long term commitment to certain principles. It is therefore of utmost importance to both the private and public sector itself. A clear, well-spelled policy, habitually, will be found in the form of a governmental resolution or endorsement. It will typically state the Government's vision of PPP development in the country, its objectives, the principle that it will promote, including the legal and regulatory regime, institutional framework and possibly training policy and educational campaign. In setting out the institutional framework, a policy paper will be expected to proclaim the delineation of policy formulation from regulatory responsibilities and operational functions.

In many transition countries a general policy framework for PPPs has not been identified. The results of the evaluation revealed that the existence of such a framework is not necessarily linked to a good quality law. For example Latvia scored strongly for policy framework, but did poorly in the overall assessment. Conversely,

³ The complete results of the 2005 Assessment are published on the EBRD website together with the Cover Analysis Report and the full text of the EBRD Core Principles of a Modern Concession Law. See <http://www.ebrd.com/country/sector/law/concess/assess/index.htm> and <http://www.ebrd.com/country/sector/law/concess/core/mcl.pdf>.

⁴ Azerbaijan, Estonia, Kazakhstan, Czech Republic, Poland and Slovenia do not have a general concessions law. For a more detailed explanation of results please see <http://www.ebrd.com/country/sector/law/concess/assess/report.pdf>.

Lithuania does not have an extensive general policy framework, but its concessions law is very close to best international standards (see Chart 1).

Chart 1 also pinpoints strengths and weaknesses in the concessions legal regime of some of the Central European states. For example, while rules governing disputes settlement in Latvia approximate to international standards, project agreement rules are not adequately regulated.

Estonian laws are reasonably strong in terms of the selection of a concessionaire and dispute resolution, but rather weak in all other core areas. Where a general policy exists, it is often based on policy framework documents. The existence of a PPP taskforce is rare.

In most of the countries, it is difficult to identify the legislation applicable to the award of a concession in a particular sector owing to (i) unclear boundaries between the general concessions law and sector specific laws and (ii) unclear boundaries between the concession and the public procurement law.

Certain laws do not define the term concession (for example, in Hungarian law) and most laws contain unsatisfactory definitions (such as the term “the right to use”). Contracting authorities are often referred to in fairly imprecise terms. The majority of laws do not discriminate against domestic or foreign persons becoming concessionaires, though some do (in Tajikistan and Georgia for example, domestic entities are discriminated against). Numerous laws contain a list of sectors in respect of which concessions may be granted (for example, the Albanian, Bulgarian and Hungarian laws), but certain laws limit the scope to a very restricted number of sectors (for example, in Uzbekistan the law is limited to natural resources).

Most countries scored well for settlement of disputes and applicable law, due, in part, to the ratification by many countries of the relevant international treaties on enforcement of arbitral awards and protection of foreign investments. However, few countries scored well on the availability of reliable security instruments for lenders regarding the assets and cash flow of the concessionaire. This includes lenders’ rights to step in, that is, to select a new concessionaire to perform under the existing project agreement, in case of a breach of contract by the initial concessionaire.

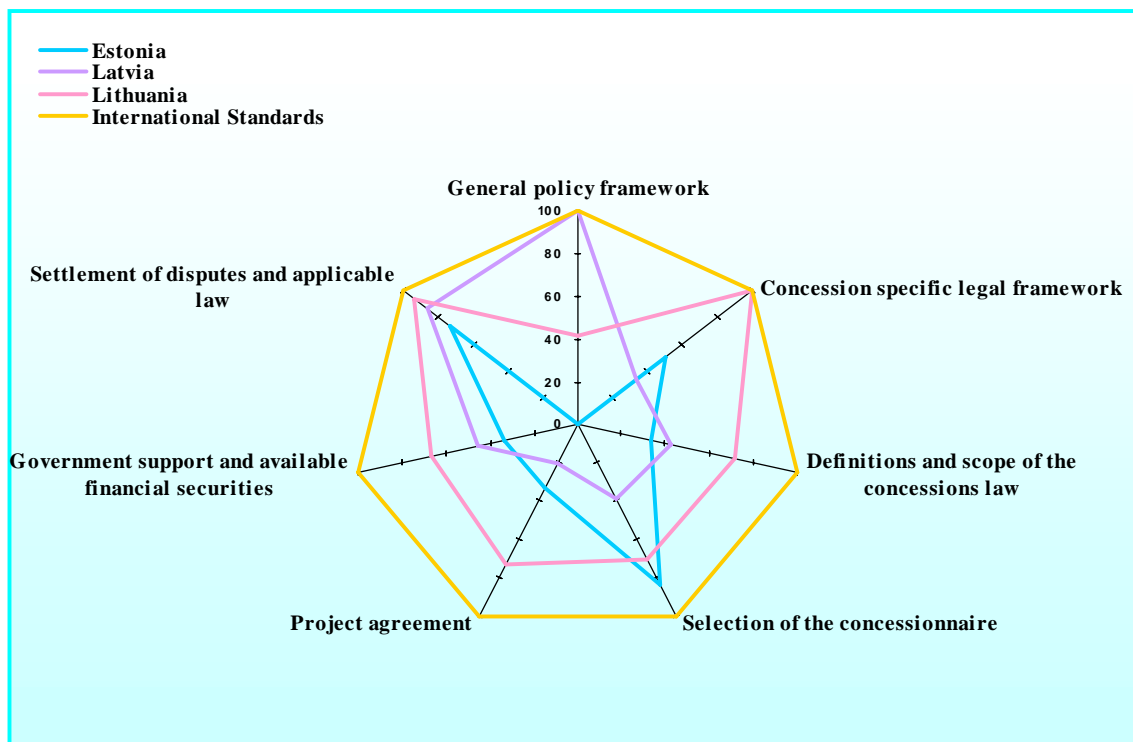
The survey also found that state financial support or security and guarantees rules were generally entirely omitted from the law or contained unnecessary restrictions. Among the few exceptions were the Lithuanian and Albanian laws, which contain specific reference to a concessionaire’s entitlement to create security and to obtain government support.

Although the majority of laws include provisions on competitive procedures for the selection of the concessionaire, very few contain sufficient guidance in this respect. Provisions related to direct negotiations and unsolicited proposals are often not regulated with sufficient precision and so they leave room for uncertainties (for example in Turkmenistan).

Legal provisions regarding the terms of the project agreement are often prescribed too narrowly, giving rise to inflexibility and uncertainty as to what can be included.

Chart 1 Quality of concessions laws: Levels of compliance in core areas of concessions legislation in Estonia, Latvia and Lithuania– 2005

Chart 1



Note: the extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The fuller the 'web', the more closely the concessions laws of the country approximate to these standards.

Source: EBRD Concessions Sector Assessment 2005.

Contrary to general perceptions regarding the relatively good quality of their investment climate and private sector development legislation, a number of countries (for example Croatia, Hungary, Latvia and Poland) were rated as having a low level of compliance. However, in most of those countries there has been progress in the reform of concessions legal and/or policy frameworks since the completion of the 2005 Assessment and the EBRD team works in Hungary on a number of elements aiming to improve further its PPP allowing regime. A number of other countries in the region have undertaken similar efforts, upgrading elements of their respective framework, be it policy, institutional or legal/regulatory one.

LEGAL INDICATOR SURVEY

The EBRD's 2006 Legal Indicator Survey (2006 LIS) measures the effectiveness of concessions laws in the transition countries and complements the 2005 Assessment. The 2006 LIS used a case study to assess how a country's legal and institutional framework for concessions functions in practice.

Lawyers in each country were presented with a typical scenario for the award and implementation of a concession and were asked a series of questions about how the legal and institutional framework in their country would operate in such a situation. Given the nature of concessions and related agreements involving long-term partnerships between a public and a private party, the scenario was divided into two parts, the second taking place three years after the first. The case study was preceded with: (i) a short section containing an explanation of the terminology used (for

example, concession, concession law, concessionaire, contracting authority, financial close and project agreement) in an effort to keep answers consistent and avoid ambiguity; and (ii) a preliminary questionnaire (for a full case study and detail results of the survey see www.ebrd.com/law). Scores for effectiveness were based on four core dimensions of the concessions legal and institutional framework:

- *Presence/potential* – whether concessions have been implemented successfully and/or whether there is a potential for such implementation;
- *Process* – whether there is a fair and transparent selection process, measured by the possibility of challenging a concession award effectively;
- *Implementation* – whether there is a fair and transparent implementation of concessions, measured by how effectively the contracting authority adheres to the project agreement terms and by the efficiency of remedial action in cases of non compliance; and
- *Termination* – whether an investment can be recovered in cases of early termination, measured by the capacity to enforce arbitral awards and counter obstruction by the contracting authority

Each of the four areas was rated out of 10 points and a total of 40 points represented a score of 100 per cent. Effectiveness for all areas was graded as follows: very low (less than 30 per cent of the maximum total score), low (from 30 to 49 per cent), satisfactory (from 50 to 69 per cent), high (from 70 to 89 per cent) and very high (90 per cent and above).

For countries that had only implemented one concession project or none at all by July 2006, the *potential* for an effective regime and any recent developments towards establishing one were assessed. The countries in this category comprised Belarus, the Czech Republic, the Kyrgyz Republic, Mongolia, the Slovak Republic, Tajikistan and Uzbekistan.

Analysis of responses to the questionnaire demonstrated that in the Czech Republic and Slovak Republic, a relatively quick move to the successful implementation of concessions in practice can be expected given the improvements in the legal and institutional framework and/or pilot projects. For the other countries in this category, the route seems much longer, with numerous legal, institutional and/or political obstacles.

As evident from Chart 2, four countries with experience of concessions were rated as highly effective: Bulgaria, Lithuania, Romania and Slovenia. In each of these countries concessions have been awarded generally following a transparent selection process and without major difficulties in implementation although in some cases the awards led to criticism and complaints. Bulgaria and Romania, for example, have each successfully implemented a number of concessions since the late 1990s on the basis of their concessions laws. Recent reforms of the legal framework in these two countries are expected to have a further positive impact. In Lithuania, concessions implementation started only recently and no major difficulties have been encountered to date.

The Czech Republic was rated as potentially highly effective as its survey was based on a hypothetical implementation rather than any actual experience of concessions. In this country, even though many public services are carried out by private entities, such exercises are not based on concessions, but rather on licenses. After the creation

of a PPP Centrum in 2004, a new concessions law was adopted in the Czech Republic in 2006 and several concession-based pilot projects have been launched by various ministries, including for prisons, hospitals and motorways.

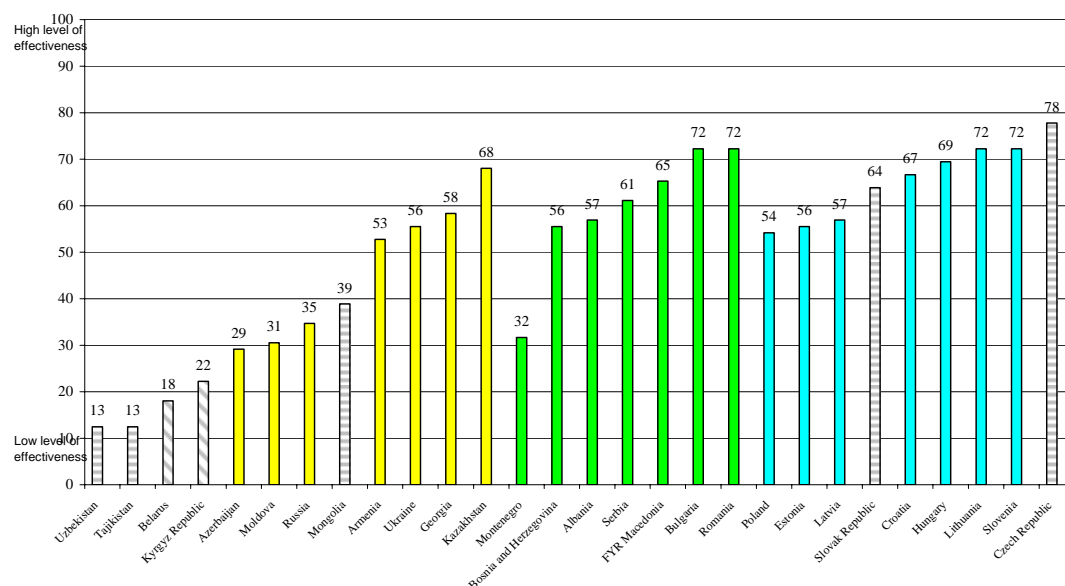
The Czech Republic scored highly due to the following: concessions in discussion currently benefit from strong political support; concession awards can be challenged before the contracting authority, the office for the protection of competition, as well as before administrative courts; public authorities generally adhere to the agreements to which they are party; and arbitration is widely recognised and generally not obstructed.

The five countries that received a “very low” effectiveness rating are: Azerbaijan, Belarus, Kyrgyz Republic, Tajikistan and Uzbekistan. In Azerbaijan, even though several concessions were implemented, in particular in the electricity sector, the implementation thereof was generally not successful (for instance there were early terminations and disputes). The other four countries mentioned above have little or no concessions experience and the general legal, institutional and/or political environments in these countries were not supportive of concession-type arrangements.

Most of the transition countries fell into a middle category.

Although the findings of this survey give an indication of how effective concessions regimes are in the transition countries, the results must be treated with caution. This is because first, they are based on the analysis of only one law firm in each country. Second, they relate to a specific set of circumstances and may not apply to all types of concessions. Thirdly, even though the focus of the survey was limited to concession arrangements, it involved projects of different sizes and scales in different sectors. Lastly, as mentioned above, not all countries have had experience with the types of concessions described in the chosen scenario and, therefore, answers from these countries are speculative.

Chart 2: Effectiveness of concessions laws in transition countries



Note: Effectiveness is measured on the following scale: very high (90 per cent and above); high (70 to 89 per cent); satisfactory (50 to 69 per cent); low (30 to 49 per cent); very low (less than 30 per cent). Data on effectiveness for Turkmenistan were not available. Countries with hatched lines had only implemented one concession project or none at all by July 2006.

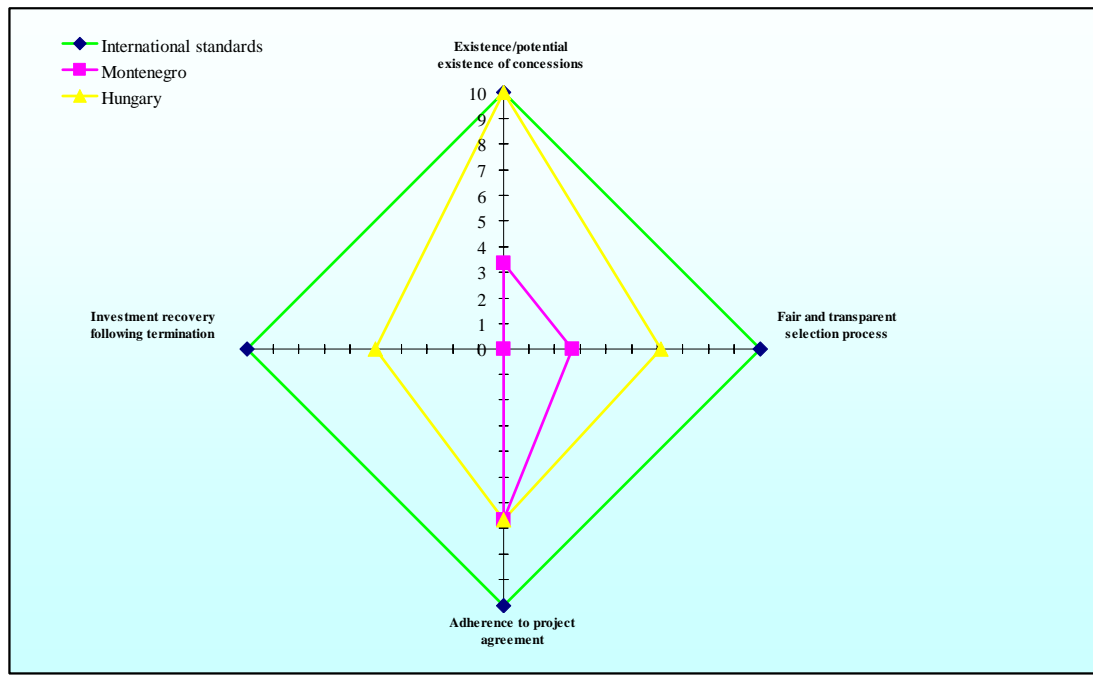
Source: EBRD Legal Indicator Survey 2006

For all countries, the costs incurred in the preparation of proposals by the bidders are generally not recoverable. In the majority of countries, a concession award can be challenged, either on the basis of a specific provision in the concession law (for example in Bulgaria and the Former Yugoslav Republic of (FYR) Macedonia) or on the basis of general laws (for example, in Slovenia). However, local lawyers would not always advise proceeding with such a challenge, mainly because of the partiality of the court system or the length of time involved. In the majority of countries, the contracting authority cannot be forced to comply with the tariff increase mechanism in the project agreement if it refuses to allow such an increase.

The results give a surprisingly positive picture of the overall level of adherence by contracting authorities to contractual terms. Respondents in 16 out of 26 countries have indicated that the contracting authority would abide by the terms of the project agreement or provide adequate compensation despite social and political pressures. Effective enforcement of arbitral awards is regarded as especially difficult in the Kyrgyz Republic, Moldova, Russia, Tajikistan, Ukraine and Uzbekistan.

Some countries scored relatively uniformly in all core areas (for example, Hungary, see Chart 3). In other countries the variation from core areas is significant (for example, Montenegro scored relatively well in the assessment of adherence to the project agreement while performed badly on all other dimensions of the evaluation including the existence of concession projects, and the assessment of the possibility of effectively enforcing an international arbitral award). In fact, Montenegro, scored well below the average for the south-eastern Europe, (SEE), region. The country has a weak legal framework for concessions and is inefficient in implementing concession projects.

Chart 3: Effectiveness of concessions laws/Hungary and Montenegro



Note: The extremity of each axis represents an ideal score. The fuller the web the better the system works.

Source: EBRD Legal Indicator Survey 2006

In the CIS and Mongolia, the results are generally worse than in the rest of the transition region. The number of concession projects implemented by each country differs significantly. In Kazakhstan several concessions have been successfully implemented, but transparency of the award process has not always been respected and several concessions were terminated early/prior to their completion.

Belarus, the Kyrgyz Republic, Tajikistan and Uzbekistan have implemented very few projects (for example a gold deposit concession in the Kyrgyz Republic and an energy concession in Tajikistan) or none at all. The overall framework for the effective implementation of these projects is poor and this is illustrated by a non-competitive award practice, a lack of judicial independence and the impossibility of effective enforcement of arbitral awards.

CONCLUSION

Ideally, any reform aiming to enhance PPP opportunities should start with a well contemplated policy. This will be then complemented by further legal and institutional efforts to allow PPPs to work effectively. Overall, the 2005 Assessment of the quality of concessions legislation and the 2006 LIS on how these laws work in practice have produced generally corresponding results in that most countries with a sound legal framework for concessions have effective mechanisms in place for enforcing the law although with some exceptions.

There are some countries where in spite of significant restrictions in the concessions legal framework, concession projects can still be implemented fairly successfully. Clear examples of such countries are Hungary and Croatia. The explanation for this is the existence of several good precedents and a generally efficient institutional framework, which is essential for day-to-day implementation and enforcement.

However, both those countries were rated as satisfactory rather than highly effective, which suggests that there are some restrictions in implementing projects.

Overall, the concessions legal environment in transition countries has much scope for improvement. The majority of countries still need to implement further legal and institutional reforms if they wish to allow complex PPPs to work effectively. Not the least of these is the serious need for training officials on negotiating appropriate arrangements with private sector parties.