

Law in transition *online*

October 2012

Funding public infrastructure: challenges and horizons



The legal framework for public-private partnerships and concessions in transition countries: evolution and trends

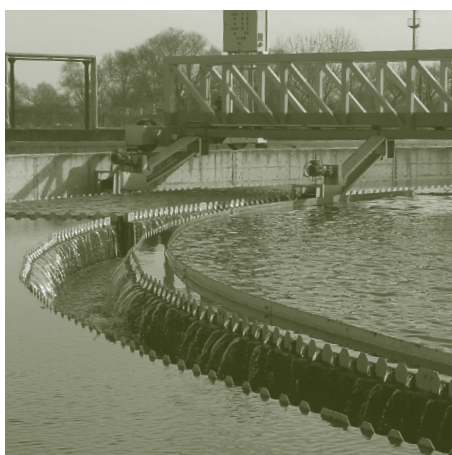
Towards a more effective measurement of the environment for public-private partnerships



Public-private partnerships in Croatia

The legal framework for public –private partnerships and concessions in the SEMED region

Recipe for success in PPP haute cuisine – the EBRD experience



Public-private partnerships in Russia

Public-private partnerships in Bulgaria: legislative initiatives and experience



European Bank
for Reconstruction and Development

It has been five years since *Law in transition* last focused on issues surrounding public-private partnerships (PPPs). Since then nearly 20 EBRD countries of operations have attempted to develop, upgrade and expand the scope of their PPP legislative framework - the latter instrument was largely revived and redesigned some 20 years ago to meet the needs of modern infrastructure requirements. Some states engaged in a process of completely redefining their PPP policies. To complement such efforts institutions specialising in PPP were established in a number of countries in an attempt to facilitate relevant projects, synchronise the application of best practice, assist participants operationally and disseminate know-how.

This issue aims to provide a forum for sharing achievements and failures, raising concerns and comparing notes. Feedback is welcome.

Chapters

- The legal framework for public-private partnerships (PPPs) and concessions in transition countries: evolution and trends
- Towards a more effective measurement of the environment for public-private partnerships
- Public-private partnerships in Croatia
- The legal framework for public –private partnerships (PPPs) and concessions in the SEMED region
- Recipe for success in PPP *haute cuisine* – the EBRD experience
- Public-private partnerships in Russia
- Public-private partnerships (PPPs) in Bulgaria: legislative initiatives and experience

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Foreword

Governments everywhere are making great efforts to bring their infrastructure up to 21st century standards, conscious of the very close links between a productive and efficient infrastructure, high-quality public services and a modern, internationally competitive economy. With their limited resources, however, they cannot meet the challenge of developing world-class, innovative, efficient and socially equitable infrastructure alone. New technologies, especially those mitigating the adverse risk of climate change, are constantly improving but are also becoming increasingly expensive. In undertaking this task, the role of public-private partnerships (PPPs) is of critical importance. Indeed PPPs are the very future of infrastructure in the modern era.

The role of the state is also being transformed by PPPs. From its role as a monopolistic power deciding what its citizens obtain from their energy suppliers, their telecommunications providers and their municipal services, the state has now become a facilitator of partnerships between itself and numerous private sector investors and providers, empowering its citizens with better choice and quality.

The United Nations Economic Commission for Europe (UNECE) is aware of the importance and the challenges governments face in using PPPs to modernise infrastructure and improve public services. It started work in this area around 15 years ago when PPPs were still very much in their infancy and only a few of its Member States had active PPP programmes. Since then, interest in PPPs has grown and become a priority sector within the UNECE's activities.¹

In February 2012, UNECE hosted the premier event in the PPP calendar, the "PPP Days" with the Asian Development Bank and the World Bank Institute, which brought together PPP professionals and practitioners from almost 90 countries around the world.² The key message arising from this event was that the investment needs of countries are increasingly huge and innovative ways must be found to meet these costs as a matter of urgency. However, it is not sufficient to set up PPPs; the challenge now is for countries to undertake the very best PPPs.

How? A good starting point is the compass provided to governments by the [UNECE Guidebook on Promoting Good Governance in Public Private Partnerships](#). I am convinced that the principles contained in these guidelines are an ideal framework for countries undertaking PPPs.

First of all, effective institutions such as PPP units need to be established to spread PPPs throughout the country at all levels. One of the goals of the PPP unit would be to immediately try and lower the transaction costs and create an enabling environment that is stable and predictable. PPPs have a reputation for complexity and expense and so PPP units need to both simplify procedures and lower costs. One need look no further than Canada which has a very successful track record in PPPs that excels in bringing projects speedily to market through effective procurement practices.³

Second, excellence requires high-quality capacity building in PPPs. But frankly, not enough resources are invested in capacity building. When it is seen just how much it costs to develop a PPP project, it is remarkable that so little is invested in the development of the skills officials need to manage and ensure the project's long-term success. One concern is that after the economic crisis there is a trend that governments are leaving it up to others, including the multilateral development banks, to build capacity in PPPs.

Lastly, improving access to information on the best projects undertaken in a specific sector allows countries to benchmark their projects and programmes against the best and most successful. It is disappointing to relate therefore that governments have very little access to the best projects (and how to measure the key performance indicators in specific projects) and even lack basic information about potential private partners themselves.

In response to this situation, the UNECE, with the support of key international partners, has established an International PPP Centre of Excellence. We are confident that the Centre will take countries to the next stage in PPP development, drawing on materials produced to a consistent and high standard by specialist Centres located all over the world that reflect the excellence in PPPs which countries should aspire to. Through readiness assessments and the development of action plans, countries are able to implement these project ideas. The Centre of Excellence consists of a small hub in Geneva and specialist centres located in countries around the world. The specialist centres will be responsible, for example, for identifying and monitoring best practice in specific sectors. The Philippines, for example, has agreed to host the specialist centre on PPPs in the health sector.

The EBRD has been a pioneer in PPPs in many countries, such as Croatia, the Czech Republic, Kazakhstan, Poland, Romania and the Slovak

Republic, and will continue to be a trusted and valued partner in this exciting endeavour. We welcome the EBRD's ideas to deepen our cooperation in developing PPP best practice.

The current issue of *Law in transition online* provides an excellent overview of the important issues related to legislation and financing of PPPs; how these challenges can be addressed by governments; and what measures international organisations and multilateral banks are undertaking. The journal covers transport and municipal and environmental infrastructure and provides readers with in-depth analysis and information on the challenges, perspectives and developments in PPPs and concessions in Bulgaria, Croatia, Russia and the southern and eastern Mediterranean (SEMED) region. In addition, this issue provides the results of the 2011-12 EBRD assessment of the legal framework for PPPs and concessions in all of the EBRD countries of operations. I am confident that readers of this issue will greatly appreciate the experts' contributions on current trends in the PPP world.

Sven Alkalaj

Executive Secretary

United Nations Economic Commission for Europe



¹ The UNECE is based in Geneva, Switzerland and has 56 Member States. It promotes pan-European economic cooperation with a sectoral focus on environment, transport, statistics, economic cooperation and integration, sustainable energy, trade, timber and forestry and housing, land management and population.

² The "PPP Days" event was held from 21-24 February at the Palais des Nations in Geneva.

³ Infrastructure Canada, Partnerships BC and so on are among the several notable PPP units operating nationally and regionally in Canada.

The legal framework for public-private partnerships (PPPs) and concessions in transition countries: evolution and trends

Alexei Zverev, Senior Counsel, EBRD

Over the past few years significant improvements have taken place in numerous EBRD's countries of operations in the policy and legislative framework of public-private partnerships (PPPs) and concessions. The enhancements in the region include a trend towards more pragmatism in law reform with the enactment of PPP legislation in addition to concession legislation; the introduction of a Private Finance Initiative model inherited from the United Kingdom (UK); the creation of PPP units such as those in western Europe; and some new initiatives concerning institutional PPPs.

The 2012 assessment of the legal framework for PPPs and concessions ("the Assessment") is part of the EBRD's exercise to evaluate the legal and institutional framework of member countries compared with best international practice developed since 2004. It also serves as an important tool to measure investors' risk in each country and to identify reform needs and possible technical assistance. The Assessment showed that the average compliance status with best international practice for all relevant countries falls between "high compliance" and "medium compliance", with the larger category (17 countries) now being "highly compliant". It is also worth noting that among the 17 highly compliant countries, most have recently adopted a new concession or PPP law.

The question, therefore, is whether such legislative evolution will be translated into practice by the development of PPP projects that are so needed by many countries.

The 2012 EBRD Assessment¹

The enabling of fair and transparent PPP legislation is vital to the development of a market economy and as such the concession sector has long been recognised by the EBRD as a core area of its Legal Transition Programme and has now been extended to a larger scope regrouping all forms of PPP including but no longer limited to concession legislation.

Many of the EBRD's countries of operations have had major deficiencies in their concession and PPP legal and institutional frameworks and this often acts as a barrier to investment and further economic development. Thus it was important to set the framework for overcoming the limitations of the public budget for infrastructure building by making use of the private sector's resources, including financing and know-how.

The 2012 Assessment of the legal framework for PPPs and concessions is part of the EBRD Legal Transition Team's (LTT's) efforts to improve the legal environment in its countries of operations.² The LTT's ultimate objectives are to encourage and provide guidance to policy and law-makers while developing the concessions and PPP-related legal reform in the region. The 2012 Assessment analyses the PPP legislation in each of the EBRD's countries of operations and benchmarks it to international best practice, including the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects, European Union concession *acquis communautaire* and other related materials.

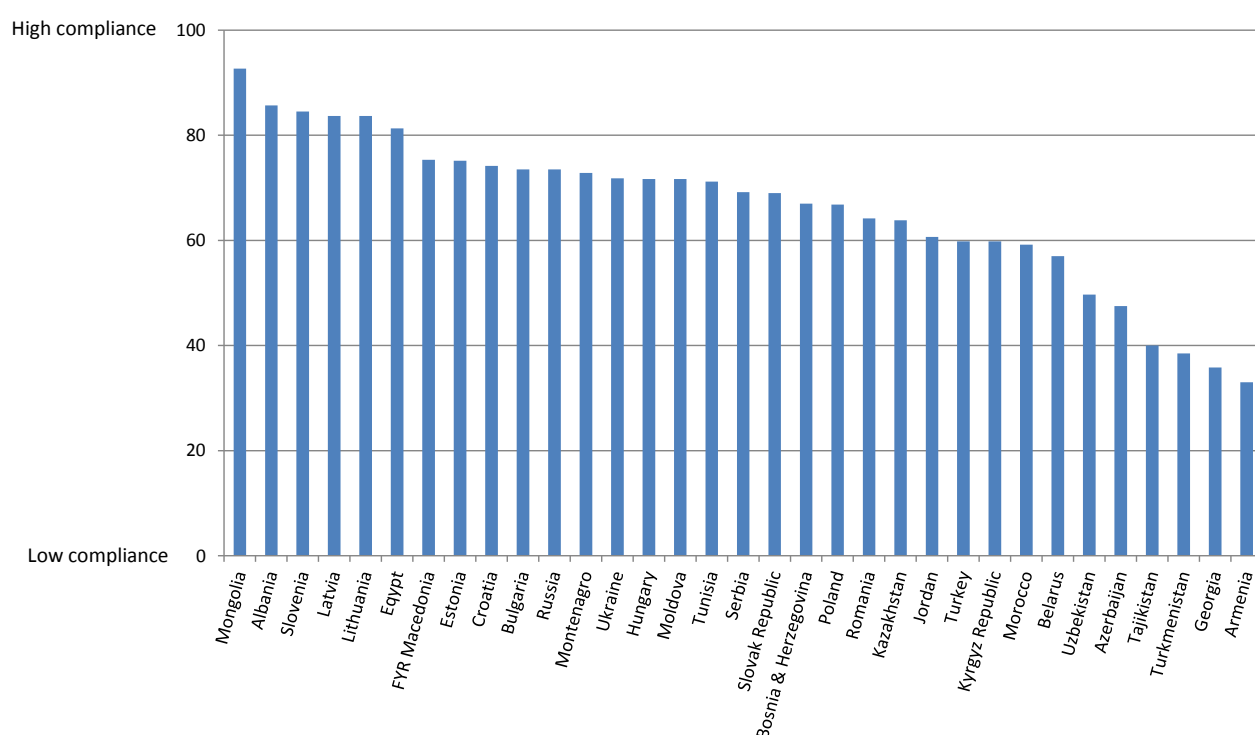
The Assessment combines the two approaches of law assessment that the LTT has undertaken since 2004, studying: (i) the compliance of concession/PPP laws (referring to the laws on the books) and (ii) their effectiveness (analysing the way the laws actually work in practice). The Assessment is contemplated as an upgrade to the last 2008

Concession Law Assessment and 2006 Legal Indicators Survey (LIS 2006) extended to all sorts of PPPs including Private Finance Initiative (PFI) types of contract and as such it applies a similar, and thus compatible, methodology in order to measure each country's progress in improving their concession/PPP legislation compared with international best practice.

The results of the 2012 Assessment are summarised in Charts 1 and 2 with respect to total country compliance and effectiveness, compared with best international practice (100 per cent).

The total figure which is represented in each graph for each country is the sum of the results of numerous questions concerning various core areas. The results shall therefore be studied in more detail as some issues may appear to be deal-breakers, preventing the development of any PPP project even if the total result may appear satisfactory.

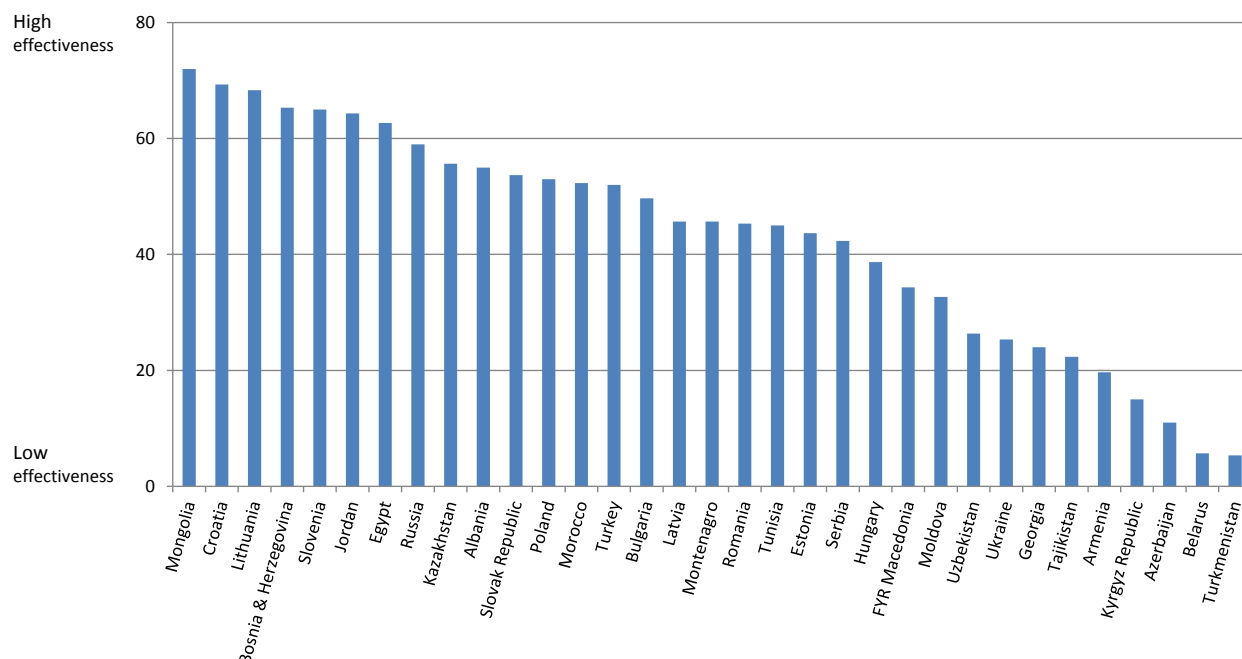
Chart 1
Quality of PPP legislation in transition counties



Note: The chart shows the score for the extensiveness of national PPP laws. The scores have been calculated on the basis of a legislation questionnaire benchmarked against internationally accepted best standards and practices, including the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects, European Union concession *acquis communautaire* and other related materials. Total scores are presented as a percentage, with 100 per cent representing the optimal maximum score for these benchmark indicators. Extensiveness is measured on the following scale: very high (above 90); high (70 to 90); medium (50-70); low (30 to 50). For more details see: www.ebrd.com/concessions

Source: EBRD 2012 PPP Assessment. Legislative Framework Assessment (LFA).

Chart 2

How the PPP laws work in transition countries

Note: Effectiveness is calculated on the basis of a questionnaire measuring policy, institutional and enforcement environment on the following scale: high (70 to 90); medium (50-70); low (30 to 50), very low (below 30). For more details see: www.ebrd.com/concessions

Source: EBRD 2012 PPP Assessment. Legal Indicators Survey (LIS).

Strongest and weakest assessment categories

The Assessment revealed that security and support issues are the most problematic areas in the region. For the purposes of the assessment the security and support issues concentrate on the availability of reliable security instruments to contractually secure the assets and cash flow of the private party in favour of lenders, including "step-in" rights and the possibility of government financial support, or guarantee of, the contracting authority's proper fulfilment of its obligations. Seventeen countries were shown to be below the medium range status, which demonstrated that serious improvement to this core area is required with respect to the security instruments available and the possibility of government support, which is necessary for the private financing of public infrastructure or service projects. Very few countries have a law which provides for "step-in" rights for lenders or for direct agreements between the lenders and the granting authority, which are considered "good standard" bankability provisions in project financing, without which it will be difficult, if not impossible, to arrange for the financing of a project.

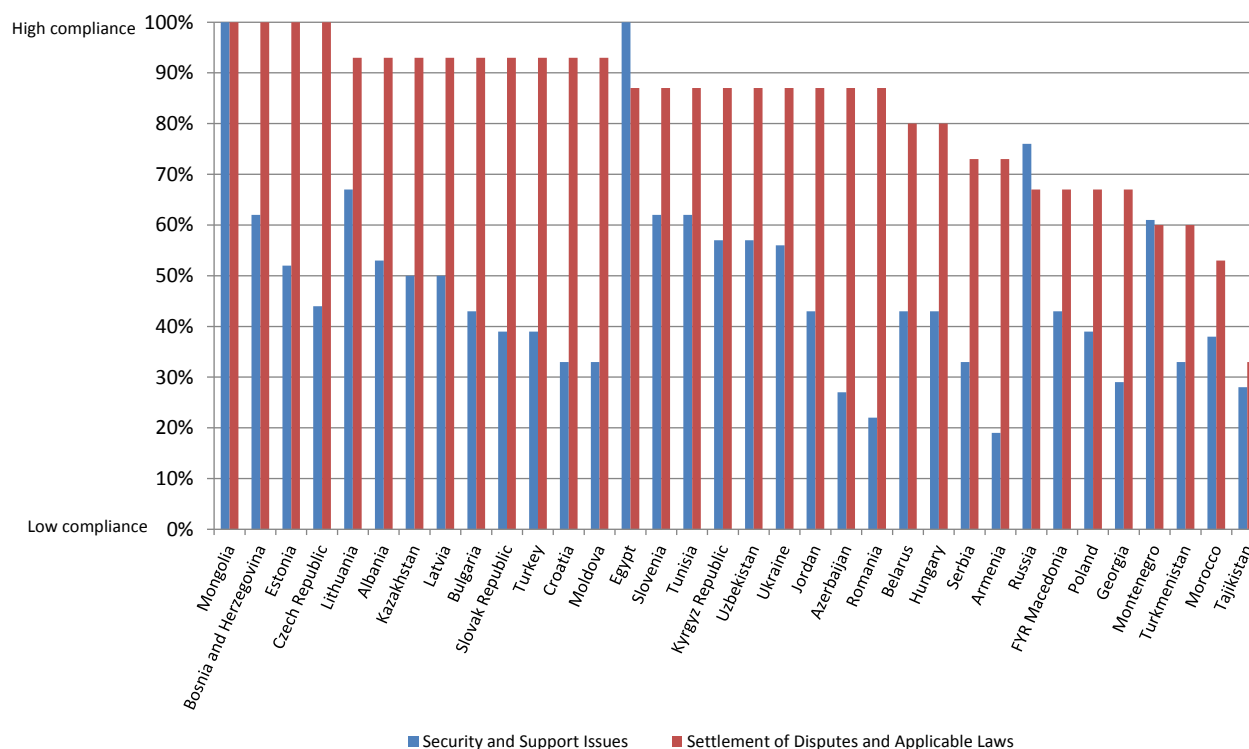
On the other hand, settlement of disputes and applicable law does not appear to be a serious problem as all countries, with one exception, appear to be above the medium range status, but it must be taken into account that some of the questions in this core area, such as the possibility of foreign arbitration, appear to be deal-breaker issues, without which no concession or PPP could be financed in these countries.

The absence of ratifications of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958) and/or of the Washington ICSID Convention on the Settlement of Investment Disputes (ICSID) (1965) is not a good signal to the international business community and financing institutions (and this absence still applies to Belarus, Poland and Tajikistan).

Chart 3 shows how the countries have scored in relation to security and support issues and settlement of disputes and applicable law.

Chart 3

Quality of legislation in relation to (1) security and support issues and (2) settlement of disputes and applicable law



Note: The chart shows the score for the extensiveness of national PPP laws in the two areas above. The scores have been calculated on the basis of a legislation questionnaire, as benchmarked against internationally accepted best standards and practices, including the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects and other related materials. Total scores are presented as a percentage, with 100 per cent representing the maximum. For more details see: www.ebrd.com/concessions

Source: EBRD 2012 PPP Assessment. Legislative Framework Assessment (LFA).

Significant legislative activity

Within three or four years, if we take 2008 as the starting point since the last assessment, no less than 17 EBRD countries, representing roughly half of the EBRD countries of operations, have enacted a new concession or PPP law.³

During the same period numerous other countries have further adopted some significant amendments to their existing legislation, making them more compliant with international best practices. Chart 4 illustrates how the level of compliance of existing legislation with international best practices has evolved since the last Assessment in 2007-08.

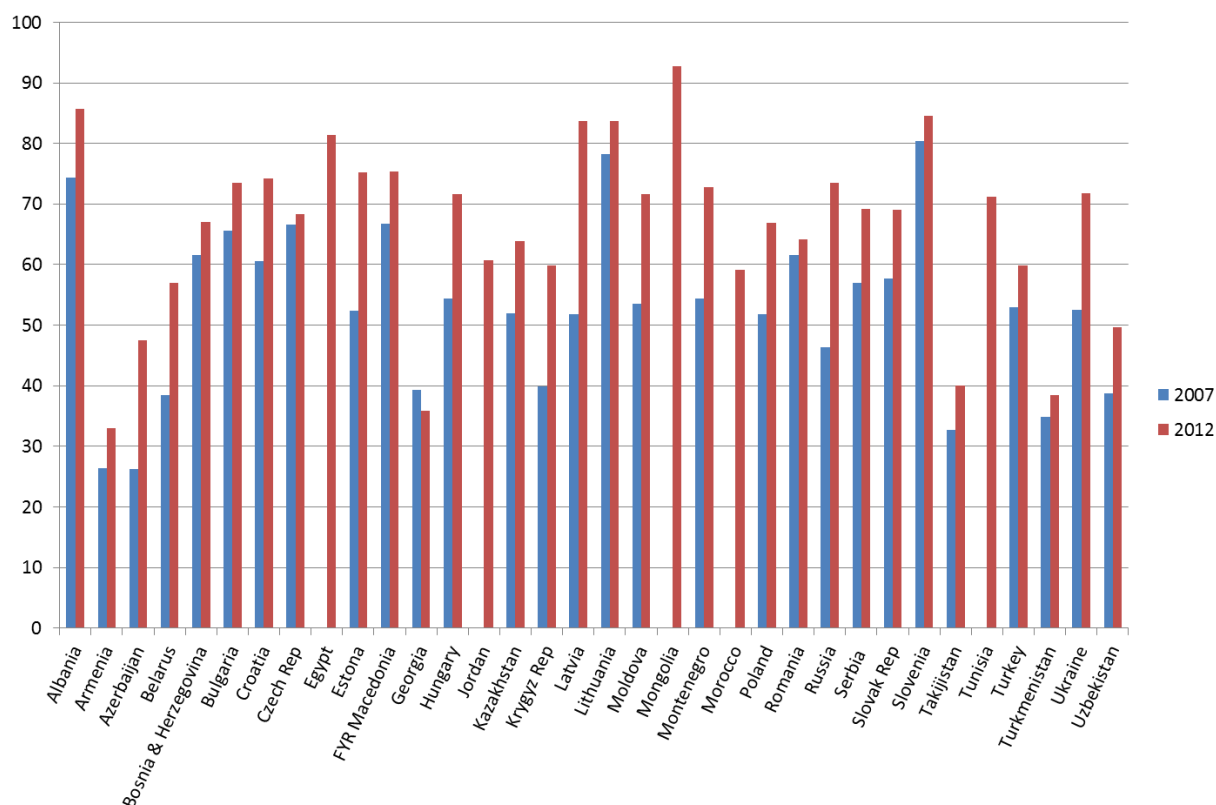
Such a trend is even more remarkable in that it was noted in the 2007-08 Assessment that since the previous concession law assessment in the EBRD's

countries of operations (made in 2004 and 2005), also roughly half of the 28 concerned countries at that time experienced significant changes with respect to their concession legal framework, either through the enactment of a new concession or PPP law or as a result of changes in their public procurement law affecting works or service concessions.

This represents a very significant development in such a short period of time affecting most EBRD countries of operations. The recently proposed geographical extension of the EBRD region to include southern and eastern Mediterranean countries such as Egypt, Jordan, Morocco and Tunisia has shown the same dynamism towards the enactment of new PPP legislation. As in all such countries the drafting of a PPP law is in progress if not yet achieved.

Chart 4

PPP Legislative Framework Assessment: comparison of Assessment results of 2007-08 and 2012



Note that Egypt, Jordan, Mongolia, Morocco and Tunisia were not evaluated during the 2007-08 Assessment.

Source: EBRD 2012 PPP Assessment. Legislative Framework Assessment (LFA)
EBRD 2007-08 Concessions Assessment. Legislative Framework Assessment.

Trend towards regulating PPPs in addition to concessions

Many countries are now aware that they need a PPP law in addition to a concession law. Most of the new laws refer to all types of PPPs including, but not limited to, concessions. Even in the very few cases where the new law is limited to traditional concessions and the Build Operate Transfer (BOT) form of PPP, the drafting of a larger PPP law is under consideration (such as in Turkey, Morocco, Russia, Jordan and Tunisia). Countries without concession laws (for example, Belarus) are also asking for assistance in this respect. This trend clearly shows that most countries today in the area of EBRD operations recognise the necessity of improving and enlarging their concession and PPP framework and adopting the proper instruments necessary to develop PPPs.

For the past decade legislative trends in the EBRD region of operations have slightly changed focus from regulating BOT-type concessions to wider range spectrum PPP arrangements including "lighter" arrangements (those not necessarily involving a construction element or end-user payment) and management contracts of less duration. Procedure-

wise, PPP requires a more flexible and effective mechanism than that of procurement and concessions.

Generally, until 2004-05 most countries used to regulate concessions in their national laws, with PPPs remaining a matter of legal policy and structuring under the existing rules of the law on obligations, or similar, as opposed to a single Act regulation. Accordingly, there have been virtually no definitions of PPP available on either a national or international level. This has recently changed and we have witnessed a new trend whereby countries are developing a separate PPP Act, or an Act including concessions as a type of PPP, among others.

While the majority of the EBRD countries of operations have Concessions Acts, not regulating other forms of PPPs, there are currently 11 countries that have specific PPP Laws/Acts sometimes also including Concessions.⁴

A few of the abovementioned countries have enacted both a PPP Act and a Concession Act and it is therefore important to see exactly the scope of each law, and what arrangements are covered by which law.

Introduction of the PFI model

Following this pragmatic trend many countries are now aware that they need to introduce the Private Finance Initiative model (PFI) of PPP contracts, in particular for relatively small projects in the non-merchant sector. They are looking for a proper framework, not only to allow the traditional large concessions and BOT projects (where financing is based on the proceeds expected from the actual operation of the project) but also to acquire new legal instruments allowing the financing of non-commercial projects, as achieved successfully in most western European countries.

Contrary to the traditional concession with delegation of the associated public services, the PFI model contract usually provides for the financing and construction of the facility together with some maintenance services to the facility during its future operation – but often without the delegation of the public service itself which remains in the hands of the public entity. Such PFI models work in the non-merchant sector, such as in schools, hospitals, prisons and other public buildings or public facilities or non-commercial services.

The remuneration for such a project is based on a rent and/or service fee to be paid by the public authority user of the facility over a long-term operation period starting from the date of delivery and is based on the availability and performance of the new or rehabilitated public facility or services rendered.

Such projects can be of a smaller size than the traditional BOT type of contract, for which project finance-based financing will hardly be available or even considered by financial institutions below US\$ 100 million of investment. Such smaller projects under the PFI model would therefore be more affordable for the states or local communities but require full confidence in the creditworthiness of the public user's signature or of any guarantee to be provided by the state or local government.

Creation of PPP units

It is interesting to note that many new laws provide for the establishment of a specialised institution for assistance in the realisation of PPPs, as well as for promotion, information and consultancy in the field of PPPs. This is the case for Albania, Bosnia and Herzegovina, Croatia, Egypt, Mongolia, Poland, Romania, Serbia and Slovenia as has been the case in most of the western European countries which have developed PPP in the last two decades following the successful British experience.

It is still the case that in the majority of the countries assessed there is still no specialised independent body properly staffed with experts that would be

engaged in all aspects of PPP projects, their development and promotion and assist in the implementation of a PPP project. Often such a role is devoted to a ministerial department, or an institution in charge of promoting investment and responsible for PPPs; often with a mission limited to policy matters or to monitor the enforcement of the law and thus not having the capacity to properly ensure the rapid take-off of PPP investment in the country.

Introduction of IPPP legislation

It is also worth noting that some countries also chose to regulate Institutionalised Public-Private Partnerships ("IPPPs") in their recent PPP laws. During the last three years the emergence of IPPP legislation has resulted from the problems raised by the European Commission on the application of Community law on Public Procurement and Concessions to Institutionalised Public-Private Partnerships (IPPPs).

IPPP is a cooperation between public and private parties involving the establishment of a mixed capital entity which performs public contracts or concessions. The private input to the IPPP consists, apart from the contribution of capital or other assets, in the active participation in the operation of the contracts awarded to the public-private entity and/or the management of the public-private entity. Simple capital injections made by private investors into publicly owned companies do not constitute IPPP.

The European Commission has published guidance on creating IPPPs in order to clarify the rules applicable to the involvement of public and private partners through joint legal entities in the awarding of a PPP project – both to enhance legal certainty and to ensure fair competition through the tender selection of the private partner.

Obviously the involvement of public parties on the side of the private party in a joint venture may be a promising form of PPP in some countries, in particular where the private sector development is very low and where most of the economy remains in the hands of state-owned companies. Such IPPP may generate foreign direct investment and allow some sharing of production or profit but the participation of such mixed public-private joint ventures in any public tender for a PPP project is a serious risk for the transparency and competition process.

This form of IPPP maybe suited to the awarding of a concession already attributed to the special purpose vehicle created by a public party who is looking for a private partner to participate in the equity and to provide its expertise. In such cases the granting of concessions, which is part of the bidding package, is indirectly concerned and the private partner is to be selected through competitive bidding for the sale of

the private part of the share of the joint venture following similar rules to that for the direct selection of concessionaires. Having said that very few PPP laws contain protective provision to that effect.

Pragmatism

It is to be further noted that a significant part of these new concession or PPP laws have been drafted in a more pragmatic way than before and are no longer oriented towards the necessary requirements imposed on EU-acceding countries, as was the case for many countries before as shown in the 2007-08 EBRD Assessment.

Many of the new PPP laws are now very much oriented towards the satisfaction of a specific need for PPP, following best practice and the UNCITRAL *Legislative Guide on Privately Financed Infrastructure Projects* and often with the assistance of international financial institutions. They no longer too dogmatically concentrate on the traditional concession models without any consideration for the financial requirements of potential lenders. Many of the new laws contain the enabling provisions necessary to enlarge the scope of available PPP forms, together with the proper security provisions necessary to make the deals "bankable" and furthermore, many of the new laws provide for the necessary support of specialised PPP institutions such as PPP units.

As an example it is interesting to quote the case of Mongolia which did not even appear in the last 2008 Assessment as no concession legal framework could be identified at that time and which now emerges with a very high compliance mark and high effectiveness. The Mongolian Concession Law of 2010 which is the first adopted by this country without any past experience on concession except in the mining sector, is one of the very few legislations of any EBRD countries of operations which explicitly provides for a full range of PPP deals as well as for all sorts of security instruments. It also provides for the possibility of government support and guarantee, together with a specific chapter on lenders' rights allowing for the possibility of direct agreement as well as so-called "step-in rights – all in accordance with lenders' expectations to ensure the bankability of project finance deals.

The future will show if such "copy and paste" PPP new regulations, although inspired by the best international standards, will be sufficient to allow the rapid take-off of PPP projects in countries with no prior concession expertise such as Mongolia and without the full revision of their existing legal framework and business environment.

It will also be necessary to follow the evolution of some countries with noticeable past experience in the field of PPP such as the Czech Republic, Jordan

and Morocco which are presently facing some political and social challenges from the population.

The reasons for such evolution

Among the reasons for such evolution and trends, the EBRD has identified the following consequences resulting from the changing environment:

- increased demand for infrastructure in the context of scarce financial resources and tougher competition for funds and expertise requiring modern innovative structuring of private sector participation in public infrastructure projects
- dissemination of experience of the first PPP/PFI projects in the UK and Australia
- establishment of specialist PPP institutional infrastructure (that is, PPP units/centres in 1999-2001 to enable implementation in Belgium, Ireland, Italy, Portugal, the Netherlands, and so on)
- the publication for public debate of an EU PPP Green Paper in November 2005 and an Interpretative Communication ruling out the developments of directives and instruments governing PPP on a supranational level.⁵

The above factors accumulated to impact upon and, to a large extent, triggered the development of necessary adequate responses including a series of new PPP laws and national policies.

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¹ For this Assessment the EBRD selected the law firm Gide Loyrette Nouel as consultant. The consultant team was led by Bruno de Cazalet, Senior Counsel at Gide Loyrette Nouel.

² In due course the Bank may implement its expansion and initiate investments in the SEMED region, subject to shareholders' ratification.

³ The Act of Public Private Partnership in Croatia (2008); the Law regulating Partnership in Egypt (2010); the Regulation for implementing Privatization transaction (including PPP) in Jordan (2008); the amendment of Concession law in Kazakhstan creating a PPP Center (2008); the PPP law of the Kyrgyz Republic (2009); the Latvia law on PPP (2009); the Macedonian law on Concession and other type of PPP (2008); the Moldova Concession and PPP law (2008); the Mongolian law on Concession (2010); the law on Concession of Montenegro (2009); the Polish Act on PPP (2008) and the Polish law on Concession of Works and Services (2009); the Romanian PPP Act dealing with IPPP (2010); numerous regional Russian PPP laws; the Serbian Law on PPP (2011); the Tajikistan Concession law (2011); the Tunisian Concession law (2008) and the Ukraine law on State Private Partnership (2010).

⁴ FYR Macedonia: Law on Concession and Public Private Partnership (no.7/2008); Kyrgyz Republic: The Law on PPP (2009); Latvia: Public Private Partnership Law (01.10.2009); Moldova: Law on Public-Private Partnerships (2008); Montenegro: The Law on Private Sector Participation in Performance of Public Services (2002); Poland: Public Private Partnership Act and the Act on Concession on Construction Works and Services (2009); Romania: Law no. 178/2010 concerning the Public-Private Partnership (4/11/2010); Slovenia: The Public Private Partnership Act (ZJZP) of 2007; Ukraine: Law on Public Private Partnership (31/10/2010); Serbia: the PPP Law (November 2011).

⁵ Report on the public consultation on the Green Paper (SEC(2005) 629 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 (Brussels, 15.11.2005. COM (2005) 569).

Towards a more effective measurement of the environment for public-private partnerships

Toshiaki Sakatsume, Senior Economist, EBRD and Alexandru Chirmiciu, Senior Economist, EBRD

This article reviews the key aspects that are relevant for the development of public-private partnerships (PPPs), drawing on lessons from international experience and the countries in transition. After a brief review of the rationale and experience with PPPs, the chapter looks at the key elements needed for the successful development of PPPs. The legal framework, institutional capacity, political will, market size and payment ability, financing and local private sector capabilities are discussed. Lastly the article points to a future in-depth analysis of the PPP environment in the countries in transition using Infrascopes, an index developed by the Economist Intelligence Unit (EIU) with the EBRD.

Over the past two decades, a variety of forms of private sector involvement in infrastructure have been developed across the globe. The premise for this is that the private sector, in partnership with the public sector, has a key role to play in infrastructure development and reforms. The private sector can provide much-needed finance and introduce a commercial approach to financing and management and operate assets cost effectively. Private participation in service provision can promote the establishment of cost-reflective tariffs, the financial autonomy of infrastructure enterprises and the introduction of demand-responsive services. These functions are at the core of the transition process to a market economy in eastern to central Europe.

Much has been written about public-private partnerships and PPP-related theoretical and practical expertise has emerged during the past decades. To date the world experience with PPP projects includes a vast array of outcomes, from highly successful projects to well-known failures. But it is clear that the PPP topic encompasses substantial complexities making it difficult to reach broad conclusions that are universally applicable. Indeed, countries and their PPP environments are very different – be they rich or poor, with an efficient or inefficient public sector, abundant fiscal resources or substantial fiscal constraints, possessing a private sector that is well developed or non-existent, a

banking sector and capital markets that are well-developed or under-developed. Such differences generate a large number of dimensions in assessing a PPP environment and its impact on PPP outcomes to the extent that a simple one-size-fits-all prescription becomes meaningless.

This article illustrates the key factors and constraints, based on the practical experience of the past two decades, for the successful development of commercially and operationally viable PPP projects. It provides some food for thought for policy-makers when considering the development of PPP projects. The article also previews a new product called the Infrascopes index, developed by the Economist Intelligence Unit (EIU) with input and assistance from the Inter-American Development Bank, the Asian Development Bank and the EBRD. The Infrascopes index, aimed at complementing other EBRD efforts towards assessing the PPP environment, provides a detailed description and assessment of the key factors and hints at each country's overall readiness to develop commercially viable PPP projects. The assessments and prescriptions should be useful for policy-makers to further develop the PPP infrastructure.

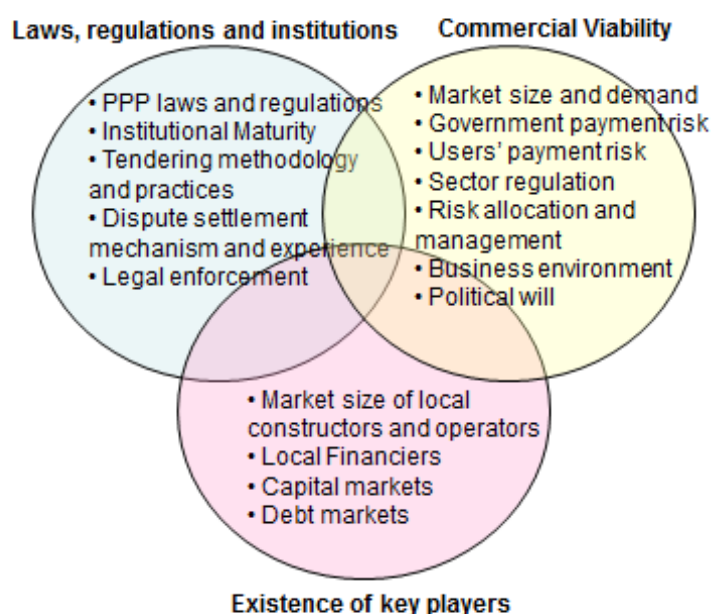
The rationale and objectives for public authorities in developing PPP projects are relatively well understood and include one or a combination of the following factors: (i) to call on private sector know-

how and expertise and improve efficiency (including cost-efficiency) and the quality of infrastructure and its operations; (ii) to capitalise on the financing capacity of the private sector partner and mitigate the short-term fiscal burden; and (iii) to compensate for and transfer the risks that the public sector, due to its very nature and objectives, human resources or expertise shortages within the public authorities, is less well placed to take. Overall, public authorities tend to and need to look for “value for money” when using PPP as a method of procurement. “Value for money” should not be confused with the cheapest solution as financial and non-financial aspects have to be taken into account in determining whether “value for money” has been achieved. Depending on the circumstances, value for money when procuring the service or infrastructure through a PPP may be reflected in a reduced whole lifecycle cost, a better allocation of risk, a faster implementation, an improved service quality or revenue generation. On the other hand, in practice very often the real motivation for pursuing PPPs is to mobilise private capital to deliver the infrastructure service right away (or during the term of the incumbent authority or before the next elections) rather than in the future when fiscal resources will become available to pursue a traditional public procurement approach. There is a tendency to observe more of such motivation in low-income countries where fiscal resources are limited and users’ payment ability is restricted under affordability constraints, but the infrastructure development needs are large. Yet fully fledged PPPs in which the private partner raises capital, constructs the infrastructure and operates it

are practically difficult and not bankable in the absence of adequate fiscal resources or end-user willingness and ability to pay for the full cost of service. Commercial banks are reluctant to lend money under these circumstances as the risk return profile goes above the level that the market accepts and PPPs may never materialise. Or if they do, in the case of an inadequate risk allocation and risk-return profile there is a high risk of failure. However, PPPs would become more sustainable in the long term and less risky by ensuring affordability and a genuine value-for-money approach in selecting projects to be financed on a PPP basis. Lighter forms of PPP can also be considered in the process of building capacity – the government or more often international financial institutions (IFIs) can finance the building of infrastructure on the public sector balance sheet while the private sector can operate under lease or management contracts. Often performance-based contracts or build/operate contracts can also comfortably work with IFI-financed infrastructure projects in low-income countries, subject to the existence of the local private sector and the attractiveness of such contracts to the private sector.

The arrangements and structures for successful PPP implementation are complex. Based on the practical experience in the EBRD region and elsewhere in the world a number of key factors and constraints have emerged, which are analytically summarised in Chart 1, that policy-makers should consider when developing the PPP framework and projects:

Chart 1. The major elements of the PPP environment



PPP legislation

This is widely considered to be a first step. Indeed, it may be advisable to develop dedicated PPP legislation and amend secondary legislation and other regulations to ensure consistency of the PPP legislation with the broader legal environment. It is important to note, however, that some advanced economies with a long track record of PPPs, such as the United Kingdom, do not have a dedicated concessions (PPP) law. Adopting the PPP legislation can be an important support mechanism, but a PPP law must not be considered an objective in itself or a sufficient condition for attracting PPPs. Indeed in the transition region, there are a number of countries with PPP laws which have never been used (for example, the Kyrgyz Republic, Moldova and Ukraine). There are also a number of PPP laws which required a number of amendments (for example, Serbia, Kazakhstan and Russia) before realising PPP projects. There are a number of different reasons why these laws are not used, but as a common feature although the laws describe and permit PPP projects, viable projects have not yet been developed due to the absence of other necessary elements. As with all legal aspects, both the extensiveness and the effectiveness of the law are very important.

PPP institutional capacity

This is a necessary condition, particularly for the long-term sustainability of the PPP model. The precise cover, definition and institutional arrangements for PPP capacity remain subject to debate and analysis. The institutional arrangements for structuring PPP capacity vary substantially and can range from centralised PPP units for all PPPs across sectors, capacity and institutional development within specific line ministries, to attempting to add on PPP capacity within the existing institutions. On the extent and cover of the institutional capacity there is some consensus on a number of elements that need to be included:

- (i) policy-making capacity
- (ii) tendering capacity
- (iii) dispute settlement capacity
- (iv) legal enforcement capacity
- (v) monitoring capacity (including technical supervision and compliance with technical standards)
- (vi) dispute resolution including re-negotiation ability.

Although the extensiveness of cover of the PPP institutional arrangements is very important, the effectiveness aspect is the key for long-term success. Note that some of the capacity could be outsourced if domestic capacity is unavailable, at least as a temporary measure. For example, governments can hire reputable PPP advisers and make use of

international dispute settlement procedures if domestic ones are insufficient. However, in the long term the availability of domestic capacity helps sustainability – a PPP unit could possibly be a good way of consolidating and nurturing PPP capacity and makes it possible to develop PPP projects in different sectors. Nevertheless, the shortcoming may be that in dedicated PPP units it is often difficult to build and retain technical/sector experience and knowledge. Sector-specific PPP institutional capacity also has a good track record in some countries – in Hungary, which has the largest number of PPP projects in the transition region, there is no PPP unit, but there is good PPP capacity in the transport sector.

Political will

As PPPs are a form of outsourcing the operation of what is considered public infrastructure, the political aspects of considering and allowing the private sector to participate are crucial. This is important not just for the initial stages of awarding PPP contracts, but also for the sustainability of private operations over the entire lifecycle of the project. It is the easiest when political conditions are stable and predictable, where business and the economy is separated from the political realm by strong rules and practices and there is a political champion in favour of private sector involvement in delivering infrastructure assets. Often political changes are associated with changes in attitudes towards PPPs. Therefore strong political will and its continuity is an important factor for the success of PPP projects. But it is important to note that the political support for PPP is often independent from the degree of democracy. Fundamentally there is a time-mismatch between typical short political cycles in democracies and the long-term nature of infrastructure PPP projects (mostly over 15+ years).

Market size and payment ability of the government and users

Building and operating infrastructure is expensive and there are fundamentally only two major ways to pay for it – from the budget through taxation or directly from the users. Obviously from an investors' point of view markets with wealthy users of infrastructure services are more attractive than markets with low-income population, as demand is more likely to be there in the first place and sustainable in the longer term. The government's payment ability is also considered an important aspect, as most PPPs in some sectors rely on partial or full government payment for the cost of the PPP. Further, the public authority remains a last resort option for rescue when projects run into difficulties. Therefore where affordability constraints are significant, be they at the level of users who pay for the service or the ability to tax and generate sufficient public resources, PPPs (particularly

involving capital investments) are more difficult to realise. In regulated industries (for example, power generation and distribution), the quality of economic (and technical) regulation is another factor.

Financial markets

In the long term sustainability requires that the local financial market and institutions are capable of financing local PPP projects. This includes a variety of advantages, including a better knowledge of the local market, it avoids the need to resort to multiple jurisdictions and makes it easier to provide local currency financing. Ideally financial terms need to be matched between infrastructure projects (that is, long life) and financiers (for example, pension funds and project bonds). The degree of development of the local capital markets (including contractual saving institutions such as pension funds) influencing the level of availability of long-term financing is an important factor. That said, developing banking and capital markets as well as domestic pension funds cannot be achieved overnight and should not prevent the pursuit of PPP projects. Often international banks, including IFIs and investment funds, play an important role. Sponsors can also gain access to international capital markets by issuing international equity, international bonds or project bonds. This requires the international credibility of companies and requires some corporate standards (for example, audited financial statements and minimum corporate governance standards). In the EBRD region, foreign sponsors often bring such credibility and finance their projects on the international markets.

Local private parties

Although the participation of foreign sponsors may be sufficient, especially for large PPP projects, local participants are always necessary for the long-term sustainability of the PP model. Local private sector involvement and expertise is needed at least in the following areas: (i) local contractors; (ii) raw material providers; (iii) local lawyers and PPP adviser support; (iv) local accountants; and so on. In the less-developed countries some of these functions cannot yet be sustainably fulfilled by local parties.

Although all of these factors are important, their relative weight in building a successful environment for PPPs remains subject to country specificities without a simple one-size-fits-all solution. However, a first step for policy-makers is to understand their current status and conditions on each of these dimensions. The EBRD is working with the Economist Intelligence Unit (EIU) on the Infrascopes index, an assessment of the PPP environment in most of the EBRD countries of operations. This follows similar work of the EIU with the Inter-American Development Bank for Latin America, and with the Asian Development Bank for Asia Pacific. The Infrascopes

index will provide an assessment of country readiness and capacity for developing commercially viable and sustainable PPP projects. Sectoral focus is on transport, electricity and water/sanitation at the national level. Currently the Infrascopes is comprised of 19 sub-indicators in 6 categories so that policy-makers can identify areas of weaknesses and focus on these areas for future improvements.¹

With the expansion of the Infrascopes to new countries and regions the opportunities for benchmarking and comparison are wider. It should make it possible to compare one aspect in one country in Latin America and the same aspect for another country in Europe or Asia, for example. Global ranking would also become possible in future. Therefore, the product is expected to become a useful tool for policy-makers, investors, financiers and academics. The launch of the Infrascopes index for the EBRD region is expected in the second half of 2012.

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¹ For the currently published work on Infrascopes see: http://www.eiu.com/site_info.asp?info_name=2010_Infrascopes&page=noads

Public-private partnerships in Croatia

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Although the institutional framework for public-private partnerships (PPPs) in Croatia was only properly instituted in 2008, Croatian practice has already generated a handful of successful PPP projects. This article provides a brief overview of the institutional framework for PPPs in the country and the role of the Agency for PPPs, as well as other relevant institutions. It also analyses three milestone PPP projects and looks at some of the challenges for PPPs in Croatia.

Introduction

PPPs in Croatia have had a particularly important role in the development of infrastructure projects and the provision of quality public services. Over the last decade, more challenging PPP projects emerged in practice, especially in terms of transportation, education and sciences, sports facilities, public administration buildings and the development of health and social welfare. For local governments, PPPs represent a relatively new opportunity for securing the necessary funds to construct important urban facilities. Moreover, such opportunities have also boosted the development of related legal and institutional frameworks and have resulted in a significant number of activities dedicated to the strengthening of administrative capacities at the national, regional and local levels.

This article describes the legal and strategic framework for PPPs in Croatia. It then describes the role of the Agency for PPPs (“the PPP Agency”) which has been entrusted with the approval of PPP project proposals and supervision of their implementation, and its recent initiatives. Lastly, the article analyses three milestone case studies for PPP’s development in Croatia in the transport and social infrastructure sectors and concludes by discussing some of the challenging issues surrounding PPP projects in Croatia.

Legal and strategic framework

I. Strategic framework

The basic framework and goals of PPPs are set out in the Strategic Framework for the Development of Public-Private Partnerships in the Republic of Croatia (“the Strategic Framework”), which the Croatian government adopted in October 2008,¹ shortly before the Public Private Partnership Act (“the PPP

Act”) came into force in November 2008.² The Strategic Framework recognises that PPPs can have an important positive role in raising the level of public services and accelerating economic development and public administration reforms through the transfer of special knowledge concerning the management of PPPs from the private to the public sector.³ While noting that the principles which define a successful application of PPP models are based on the political and development priorities of the Croatian government,⁴ the Strategic Framework goes on to say that the key to the successful establishment and application of PPPs is the best value for money, which includes: (a) risk distribution (in a way that the responsibility for a particular risk is allocated to the party more capable of supervising the risk and managing it); (b) the greatest possible gain from the efficiency, expertise, knowledge, skills, flexibility and innovation of the private sector for both the public and private sectors; (c) the principle of preserving the integrity of the provision of public services and the availability of the public good; and (d) the principle of transferring expert and professional knowledge from the private to the public partner, with the aim of strengthening the professional and expert capacity of the public partner in the implementation of the PPP project.⁵

Lastly, the Strategic Framework notes that the application of various forms of PPPs should be conditional on: (a) better value for money; (b) long-term budgetary sustainability and acceptable fiscal risks; and (c) readiness of the private sector to participate in a PPP (that is, fiscal profitability of the investment).⁶

II. Public Private Partnership Act

Before the enactment of the PPP Act, PPP-related matters were not covered in a single act, but rather tangentially in other acts (for example, acts on utility

services and concessions) and in the Guidelines for the Implementation of Contractual Forms of PPPs (the “Guidelines”), which did not have the force of law.⁷

The PPP Act regulates: (a) procedures for the preparation, nomination and acceptance of PPP projects; (b) rights and obligations of public-private partners; and (c) establishment and competencies of the PPP Agency.⁸

Rights and obligations of the parties to a PPP project have to be regulated either through the underlying acts of a joint-venture company, in the case of institutional PPPs, or through a PPP contract in the case of contractual PPPs. The term of such a contract should be between five and forty years, allowing for the possibility of renewal at the end of the contractual period.⁹

Public bodies are the only ones authorised to propose the implementation of a PPP project.¹⁰ A public body must submit the project proposal, together with the documentation specified in the Regulation on the Criteria for the Assessment and Approval of PPP Projects (“the Assessment Regulation”),¹¹ following which, the PPP Agency will evaluate the project proposal in accordance with the two main criteria: (i) justifiability of the project and (ii) justifiability of the PPP model.¹²

When evaluating justifiability of the project, the PPP Agency’s assessment will focus on the set of criteria relating primarily to the need for the project, the ability of the public body to implement it, the compliance with the strategies of the competent ministries and the assessment of the fiscal risks of the Ministry of Finance, as well as the profitability of the project. Specifically, the PPP Agency will assess: (a) whether it is in the public interest for the public infrastructure or public service; (b) whether the public body has the necessary authorisations for the implementation of the proposed project; (c) the opinion which, at the PPP Agency’s request, the competent ministry has to issue in connection with the proposed project’s compliance with the relevant development plans and strategies; (d) the consent which, at the PPP Agency’s request, the Ministry of Finance has to issue regarding the proposed project’s compliance with budgetary forecasts and plans, related fiscal risks and limitations, and affordability of the project proposal; and (e) the internal rate of return, whereby the net present value has to equal zero.¹³

When evaluating justifiability of the PPP model, the PPP Agency’s assessment will focus on the set of criteria relating primarily to the allocation of risks and responsibilities between the public and private partners, as well as feasibility and the value for money of the project. Specifically, the PPP Agency will assess: (a) division of obligations between public and

private partners (private partner should (A) in addition to committing to design, construct and/or reconstruct public infrastructure, also assume one or more obligations, such as financing, management and maintenance, for the purposes of providing public services to end-users within the area of public partner’s competencies, or for the purposes of ensuring that the public partner has the necessary preconditions for the provision of public services within the area of its competencies, or (B) undertake to provide public services to end-users within the area of the public partner’s competencies); (b) whether, in addition to the construction risk, the private partner assumes at least one of the following two risks: the availability risk of the constructed or reconstructed building and/or market risk of demand for the relevant services; (c) positive value for money, calculated by comparing public sector costs during the proposed contractual term; and (d) the proposed term of the PPP contract, which – as indicated above – has to be between five and forty years.¹⁴

Although the adoption of special legislation on PPPs is a commendable step, the abovementioned evaluation procedure has often been criticised as unnecessarily lengthy and too demanding, to the point even of being cited as the reason for there not being more PPP projects in Croatia. However, such critiques disregard the fact that well-prepared projects and tender procedures are of clear interest to potential private investors and that, consequently, relaxing the evaluation criteria should be preceded by adoption of higher standards of project preparation. Projects that fail to meet the evaluation criteria typically have not been feasible. Thus the consequence of the prescribed procedure has been to raise the standards and increase the number of well-prepared PPP project proposals.

If the project proposal envisions that the private partner will also engage in business activities, then the PPP Agency will approve the proposal only if such business activity is related to the purpose and goals of the proposed project and if there is no other way for the private partner to achieve the required level of profitability and investment return.¹⁵

Within the period not exceeding 60 days from the day when the project proposal and the accompanying documentation were submitted, the PPP Agency must decide on the approval of the implementation of the proposed project under one of the PPP models.¹⁶ The project proposal will acquire the status of a PPP project solely on the basis of the PPP Agency’s decision.¹⁷

Before initiating the procedure for the selection of a private partner, the public body must submit to the PPP Agency, for its assessment and approval, tender documentation and all accompanying annexes.¹⁸ The PPP Agency will then issue a decision on whether these documents comply with the approved project

proposal within 30 days from the date on which it received the relevant documents.¹⁹

Before reaching a decision on the selection of the private partner, the public body must submit to the PPP Agency, for its assessment and approval, the final draft of the PPP contract, including all annexes thereto, and must also obtain consent from the Ministry of Finance to the final draft of the PPP contract.²⁰ Within 30 days from the date of receipt of the final draft of the PPP contract, the PPP Agency must grant consent to the text of the draft.²¹ The PPP Agency will issue its decision on the basis of the assessment of compliance of the draft PPP contract with the tender documents and provisions of the Regulation on the Content of PPP Contracts.²²

The abovementioned deadlines have been criticised as overly generous and not conducive to the swift functioning of the administrative machinery. Notably, however, the PPP Agency typically completes each of the steps in less than two weeks. It can also be argued that the abovementioned deadlines are entirely justified considering a strategic, long-term horizon of PPP projects. Still, an attempt has been made to simplify the project approval procedure, as a result of which the new PPP Law Proposal and related regulation (see Box below), with simplified approval procedures, is expected to be enacted by September 2012. The major change of this new law will be the introduction of a single-step approval procedure, requiring just the approval of the project proposal, after which the PPP Agency will have only an advisory role, with no formal approvals required. The major changes reflected in the new PPP Law Proposal are illustrated in the Box below.

Major changes to the proposed, new PPP Act, launched in an official approval procedure by the Parliament of the Republic of Croatia on 27 June 2012

Approval of the PPP Agency and the Ministry of Finance is needed only for the PPP project proposal with the contract draft included, before the tendering procedure is launched (now a one-step, instead of the previous three-step approval procedure).

Shortening of the approval procedure from 120 days to 30 days due to the introduction of the one-step, as opposed to the three-step approval procedure by excluding the 60-day deadline for an approval of an initial PPP project proposal; and the 30-day deadline for the approval of the final contract draft; while keeping just the 30-day deadline for a detailed project proposal approval, which corresponds to a previous tendering documentation approval.

The PPP Agency to be given a more active task concerning cooperation with public bodies regarding

interpretation of best international practice and related solutions in the implementation of PPP projects.

The PPP Agency remains obliged to publish guides and manuals for the preparation, contracting and implementation of PPP projects, as well as to give instructions and explanations related to PPP, but is no longer in charge of organising training and education programmes.

Public bodies are obliged to publish an intention in advance to launch a PPP project on the PPP Agency web site.

Criteria for the approval of the PPP project proposal by the PPP Agency are defined more precisely.

Roles and risks of the private and public partners are defined more closely.

The only public procurement criteria applicable for the selection of a private partner for a PPP project is the most economically advantageous offer.

Content of PPP project proposal documentation, as well as the content of the PPP contract are determined by the PPP Act, instead of by related regulations.

So long as they are logged in the Register of PPP contracts, obligations of public bodies concerning reporting as well as the procedure to be applied in case of significant changes to the contract are the same for all PPP contracts, regardless of when they are signed, before the PPP Act is enforced, or thereafter.

Concerning related by-laws, the previous three regulations (Regulation on the Criteria for the Assessment and the Approval of PPP Projects, Regulation on the Content of the Contract, Regulation on Supervision of Implementation of PPP Projects) are replaced by just one (Regulation on the Implementation of PPP Projects), while the fourth previous regulation (Regulation on Training of Participants in Procedures for the Preparation and Implementation of PPP Projects) is no longer needed, so that the previous four regulations and one ordinance are replaced by just one regulation and a new version of the same ordinance (Ordinance on the Establishment and Maintenance of the Register of PPP Contracts).

The maximum contracted period may be beyond the 40-year limit if the PPP project is based on a concession and applicable sectorial law prescribes that a related concession may be awarded for more than 40 years.

The selection procedure of the private partner must be carried out in accordance with the Public Procurement Act and, if the implementation of the PPP project requires the granting of a concession, in accordance with the Concession Act.²³

The final version of the concluded PPP contract must be submitted to the PPP Agency, which keeps a public Register of all PPP contracts entered into in Croatia in accordance with the Ordinance on the Establishment and Maintenance of the Register of PPP Contracts (“the PPP Register”).²⁴

PPP Agency

Mission and tasks

As described above, the PPP Agency was entrusted with the selection and approval of PPP projects proposed by Croatian administration on the national, regional and local level. It acts in close collaboration with the Ministry of Finance. The PPP Agency’s key tasks specified in the PPP Act are as follows:

- (a) appraisal and approval of PPP project proposals, tender documents and final drafts of PPP contracts
- (b) publication of the list of the approved PPP projects
- (c) establishment and maintenance of the PPP Register
- (d) supervision of the implementation of PPP projects
- (e) proposal of amendments to the PPP Act and related regulations
- (f) issuing of implementing instructions under the PPP Act
- (g) decision-making on the performance of tasks within its purview, as prescribed by the PPP Act
- (h) giving expert opinions and interpretations on certain PPP-related matters
- (i) organisation of training and education programmes of participants in the preparation and implementation of PPP projects
- (j) analysis of national and foreign PPP practices and promotion of the implementation of best practices
- (k) international cooperation.²⁵

As the sole evaluator of PPP projects, the PPP Agency has been granted tremendous clout in the decision-making process over the proposed projects and, in that context, the PPP Act has been criticised as unnecessarily centralising the decision-making process. As a result and thanks to the growth of the Croatian PPP market, stronger involvement of other institutions may be an anticipated and welcome development. Recent establishment of the Centre for Follow-up of Energy Sector and Investments²⁶ in charge of supporting public sector contracting authorities in the preparation and execution of tender procedures is exactly the sort of step which indicates a further possible development in that direction.

International cooperation programme

International cooperation is an important part of the PPP Agency’s activities, its main goal being the acquisition and sharing of knowledge and expertise, as well as the promotion of best practices in the PPP implementation.

One of the key aspects of international cooperation has been the strengthening of the administrative capacities of the PPP Agency itself, mostly through the support of the EU Instrument of Pre-accession Assistance (“the IPA”). Key activities were 24 workshops with the OECD/SIGMA experts in the period between 2007-11, as well as the IPA project titled “Strengthening of the Administrative Capacity of the Agency for the Public-Private Partnership in the Republic of Croatia in Relation to the Implementation of the New Public-Private Partnership Legislation”, which was successfully implemented in 2010 with Greek partners, the Centre of International and European Economic Law (CIEEL) and the Special Secretariat for Public Private Partnerships of the Hellenic Ministry of Economy, Competitiveness and Shipping. The overall objective of the project was to develop a sound and transparent public procurement system in the area of PPPs in Croatia, in relation to the implementation of the relevant EU standards.

Other important aspects of the PPP Agency’s international cooperation include membership and participation in activities of international PPP centres of knowledge, such as the European PPP Expertise Centre and the team of specialists on PPP of the Committee for Economic Cooperation and Integration of the United Nations Commission for Economic Cooperation with Europe, as well as cooperation with a number of leading international financial institutions such as the EBRD, the World Bank Institute and the European Investment Bank.

Lastly, yet another important focus of the PPP Agency’s international cooperation is regional as well as bilateral cooperation with leading national PPP units in other countries. Generally, the goal of such cooperation is to share knowledge and specific experiences in the implementation of certain types of PPP projects, as well as information concerning national regulation and practices.

Case studies: lessons learned

This section describes three landmark PPP projects in Croatia and lessons learned from them.

Istrian “Y” Highway

The Istrian “Y” highway is considered the first PPP project in Croatia. In the 1994 tender, the French company, Bouygues Travaux Publics, won a 32-year concession to build and operate a 131 km “Y”-shape highway in Istria, the outermost north-west part of Croatia. The concession agreement with the special-purpose vehicle (SPV) Bina Istra was signed in 1995 and the financial closing for over €500 million was completed in 1997.

The concessionaire’s obligations were to design, finance, build, operate and hand over the infrastructure at the end of the 32-year concession period. Traffic and revenue risks were mitigated by the fact that significant toll revenue was generated by the tunnel itself.

The initially accepted estimates of the traffic growth proved to be too conservative. Thus, as a result of higher-than-anticipated traffic growth, after just six years of the completion of phase I, phase II had to be launched in order to upgrade the full lengths of the highway to a full two-line highway in order to accommodate faster-than-anticipated traffic needs. Consequently, while on the one hand, the increased traffic growth generated additional income, on the other it also generated the unanticipated costs of a sooner-than-planned highway upgrade.

There are two key lessons to be learned from this project: the need for realistic traffic forecasts during the project planning stage and, even more important, a flexible approach which takes into account the need for possible major upgrade investments.

Schools and sports halls in the Varaždinsko-Križevačka county

Another significant milestone project in Croatia’s PPP development was the simultaneous construction of two new schools, reconstruction of 27 existing schools and construction of 15 school sports halls in the Varaždinsko-Križevačka county, based on the availability model.

The tender was launched at the beginning of 2006 and, by the end of the same year, contracts for a total investment amount of over €40 million were awarded mostly to Croatian companies. Their obligations were to design, finance, construct/reconstruct, operate and hand over all schools and sports halls after three years of the construction period plus 25 years of the operational period.

The project developed as planned, without any delays or additional costs. What is more, it contributed to much higher education standards, as glibly summarised in a statement by one of the school governors that, as a result of the PPP approach, he could now focus on education, rather than school administration and operation issues. Such change has also manifested itself through students’ achievements in a number of national competitions.

However, this project also pinpointed the need for the adoption of legal and institutional frameworks in order to better control related fiscal risks and ensure that adequate administrative capacities were in place. As a result, by the end of 2005, the government adopted the Guidelines, and these, in turn, paved the way for the establishment of the PPP Agency by the end of 2008, as well as for the establishment of an effective legal framework on PPPs. What is more, this project and lessons learned therefrom are being used as a precedent for other PPP projects in different sectors.

New Passenger Terminal of Zagreb Airport

On 11 April 2012, the Croatian Ministry of Maritime Affairs, Transport signed a PPP contract with ZAIC, an SPV formed by the French companies, Bouygues and Aéroport de Paris and the construction company, Viaduct, as the Croatian partner. The approximate investment value is €236 million and the concession was awarded for the construction of the new passenger terminal and 30 years of operation of the Zagreb Airport following the terminal construction.

The entire project preparation process commenced in May 2010 and represents the first major project launched and approved by the PPP Agency in accordance with the procedures set forth in the PPP Act. The real importance of this project lies primarily in its expected positive economic impact, as well as in the envisioned positioning of Zagreb Airport as a regional hub on the map of air carriers. Notably, the preparation and contracting phases have demonstrated that the Croatian PPP framework and practices are compliant with the related EU directives and best practices.

	Highway Istrian Epsilon	29 schools (2 new, 27 reconstructed) and 15 new school sports halls in the Varaždinsko-Križevačka county	New passenger terminal at Zagreb Airport
Total investment amount	€680 million	€41 million	€236 million
PPP model used	Service based (32-year concession)	Availability based (PFI, 25 years)	Service based (30-year concession)
Year of the main agreement	1995	2006	April 2012
Year of the financial agreement	1997	2006	2012 (expected)
Year of the construction completion	2005 phase I 2011 phase II (extension to full profile in full length)	2009	2015 (expected)

Future challenges

Croatia's PPP market is reaching new levels of maturity with a substantial project pipeline.

In that context, on 19 April 2012 the Croatian government adopted the Framework Programme for the Construction, Reconstruction and Upgrade of Public Buildings Using Contractual PPP Model ("the Framework Programme") for the next four years. The Framework Programme envisions PPP projects based on the availability scheme model in the field of sciences, education, health, justice, culture, social welfare and defence, with a total estimated investment value of €2 billion. Furthermore, additional PPP projects based on the service scheme are in preparation in the field of energy production and transportation.

Nevertheless, this foreseen increase in the number of PPP projects also represents a new challenge and requires further improvements of the existing institutional and legal frameworks.

As the first step in that direction, in February 2012 the Croatian government adopted the Act on the Centre for Monitoring of Energy Sector and Investments.²⁷ The Act stipulates the establishment of the Centre for Monitoring of Energy Business and Investments ("the Centre"), which will be the central authority for managing state-owned companies and PPPs in the energy sector.²⁸ The Centre's main goals are to enhance the financial efficiency and transparency of the state-owned energy sector to direct investments into projects which ensure the best long-term economic outcomes, and to speed up the decision-making process.²⁹ The Centre will be financed by contributions from investment project stakeholders and from other resources gained in the course of performing its tasks. In addition, donations, EU funds and so on may also be additional sources of income for the Centre.³⁰

Further, on 27 June 2012 the Croatian government adopted and submitted to the Croatian parliament the proposed new PPP Act, in order to ensure the efficiency of procedures and involved institutions, as well as the clarity of criteria applied in the assessment and approval of PPP projects. What is more, Croatia's forthcoming EU membership is also likely to foster development of the Croatian PPP market by increasing its potential on both the supply and demand fronts. Therefore, the forthcoming years may, in fact, provide opportunities for the Croatian PPP market.

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¹ *Strateški okvir za razvoj javno-privatnog partnerstva u Republici Hrvatskoj* [hereinafter: the Strategic Framework], available at:

http://www.javnabavara.hr/userfiles/file/STRATE%C5%A0KI%20DOKUMENTI/Strateski_okvir_za_razvoj_JPP.pdf (last visited on 24 March 2012).

² *Zakon o javno-privatnom partnerstvu*, Official Gazette Numbers 129/08 and 55/11 [hereinafter: the PPP Act].

³ The Strategic Framework, *supra* note 1, at 3.

⁴ *Id.*, at 6.

⁵ *Id.*

⁶ *Id.*

⁷ See *Smjernice za primjenu ugovornih oblika javno-privatnog partnerstva*, Official Gazette No. 98/06.

⁸ The PPP Act, *supra* note 2, Article 1.

⁹ *Id.*, Article 6(1).

¹⁰ *Id.*, Article 10.

¹¹ *Uredba o kriterijima ocjene i odobravanja projekata javno-privatnog partnerstva*, Official Gazette 56/09, Article 3.

¹² *Id.*, Article 4(2).

¹³ *Id.*, Article 6.

¹⁴ *Id.*, Article 7.

¹⁵ *Id.*, Article 8.

¹⁶ The PPP Act, *supra* note 2, Article 12(1).

¹⁷ *Id.*, Article 12(2).

¹⁸ *Id.*, Article 13(1).

¹⁹ *Id.*, Article 13(2).

²⁰ *Id.*, Article 14(1).

²¹ *Id.*, Article 14(2).

²² *Id.*, Article 14(3).

²³ *Id.*, Articles 15(1) and 15(2).

²⁴ See *Pravilnik o ustroju i vođenju Registra ugovora o javno-privatnom partnerstvu*, Official Gazette No. 147/10.

²⁵ The PPP Act, *supra* note 2, Article 24(1).

²⁶ See *Zakon o Centru za praćenje poslovanja energetskeg sektora i investicija*, Official Gazette No. 25/12.

²⁷ *Zakon o Centru za praćenje poslovanja energetskeg sektora i investicija*, Official Gazette No. 25/12.

²⁸ *Id.*, Article 5.

²⁹ *Id.*, Article 6.

³⁰ *Id.*, Articles 11(2) and (3).

The legal framework for public-private partnerships (PPPs) and concessions in the SEMED region

Bruno de Cazalet, Senior Counsel, Gide Loyrette Nouel

For the first time the countries of the southern and eastern Mediterranean (SEMED) region, namely Egypt, Jordan, Morocco and Tunisia, which are potential EBRD countries of operations,¹ have been evaluated as part of the EBRD's assessment of the legal and institutional frameworks for PPPs and concessions. This evaluation serves as an important tool to measure the investors' risk in each country and to identify reform needs and possible technical assistance to be provided.

It was important to assess the position of these countries with respect to concession and public-private partnership (PPP) legislation, thereby setting the framework for overcoming the limitations of the public infrastructure budgets by making use of private sector resources, including financing and know-how. Many of the countries in which the EBRD operates have major deficiencies in their concession framework and this often acts as a barrier to investment and further economic development.

It was also crucial to assess the effects of the political events which occurred in these four countries as far as concessions and PPPs are concerned and to analyse whether PPP still appears to be a politically acceptable development solution, or whether new social priorities generated by the Arab uprising have created uncertainty as to the future of PPPs.

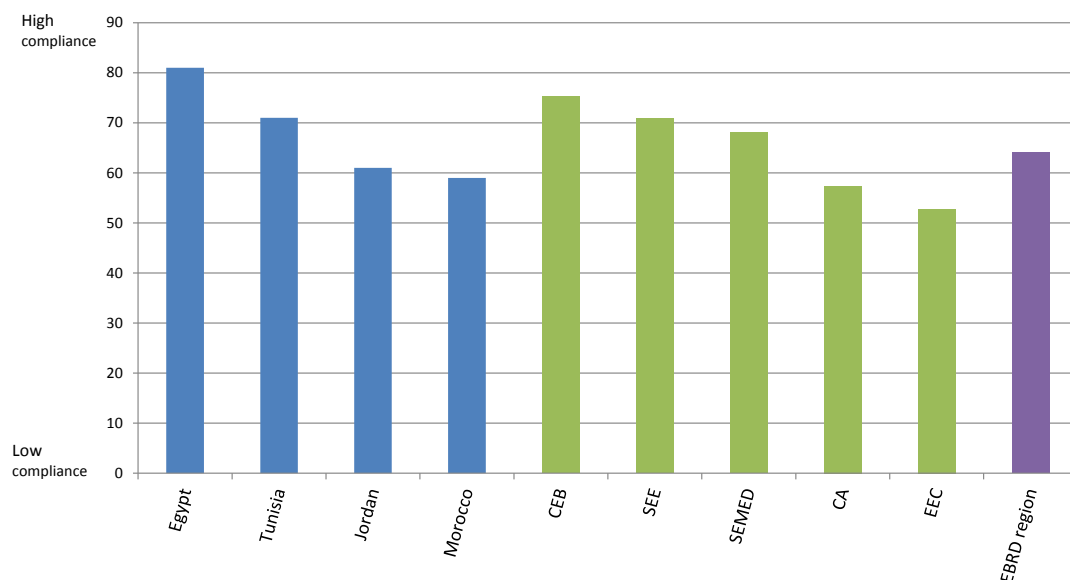
The Assessment

It is first worth noting that these four SEMED countries are civil law jurisdictions with long-standing and sophisticated legal structures, and with eminent jurists and Islamic legal schools, which first originated in Egypt. The influence of these schools spread far beyond their own boundaries towards the rest of North Africa at the beginning of the last century, bringing an "Islamic touch" to the civil codes of Morocco and Tunisia inherited from France. This influence later reached Jordan, and from Jordan has extended to the judicial systems of many Gulf countries over the three last decades.

For the first assessment of the SEMED countries, it was important not only to evaluate the compliance of existing concession/PPP legislation (that is, "the law on the books"), and to benchmark it against international best practice including the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects, European Union legislation applicable to concessions and related European Union materials (the EU *acquires*) and other such international standards, but also to measure the effectiveness of such legislation through an analysis of the way in which such laws are applied in practice (which refers to "how it works").

The results of the 2012 assessment of the SEMED countries' compliance and effectiveness ("the Assessment") are summarised in the two graphs below. The graphs compare the Assessment results for the SEMED region to the Assessment results for the EBRD region as a whole and to other sub-regions such as central Europe and the Baltic states (CEB), south eastern Europe (SEE), Central Asia (CA) and Eastern Europe and Caucasus (EEC).

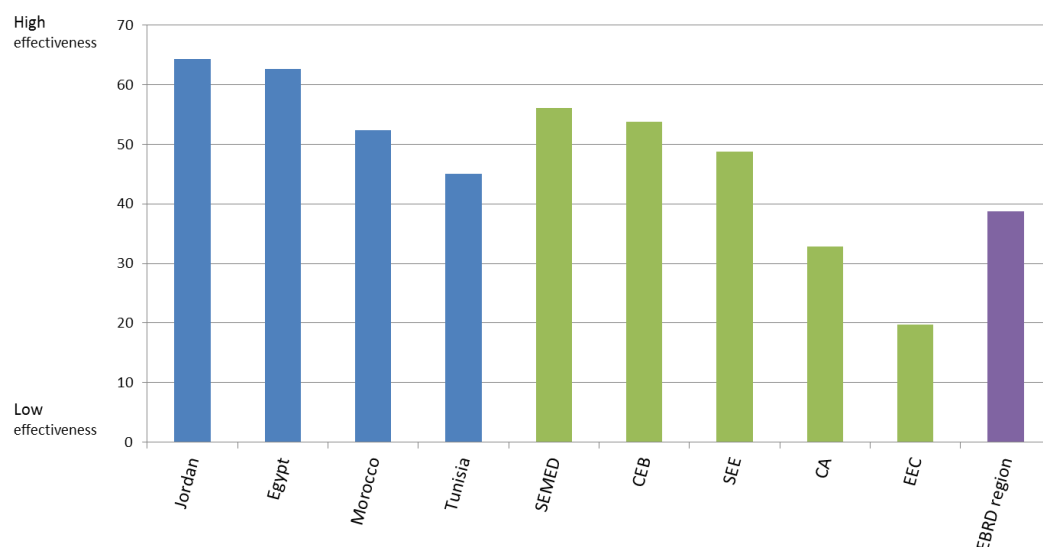
Quality of PPP legislation in SEMED countries



Note: The chart shows the score for the extensiveness of national PPP laws. The scores have been calculated on the basis of a legislation questionnaire benchmarked against internationally accepted best standards and practices, including the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects, European Union concession *acquis communautaire* and other related materials. Total scores are presented as a percentage, with 100 per cent representing the optimal maximum score for these benchmark indicators. Extensiveness is measured on the following scale: high (70 to 90); medium (50-70); low (30 to 50). CEB – Central Europe and the Baltics; SEE – South East Europe; CA – Central Asia. For more details see: www.ebrd.com/concessions

Source: EBRD 2012 PPP Assessment. Legislative Framework Assessment (LFA).

How PPP laws work in practice in SEMED countries



Note: Effectiveness is calculated on the basis of a questionnaire measuring policy, institutional and enforcement environment on the following scale: high (70 to 90); medium (50-70); low (30 to 50), very low (below 30). For more details see: www.ebrd.com/concessions

Source: EBRD 2012 PPP Assessment. Legal Indicators Survey (LIS).

Egypt

Egypt also has a tradition of concessions, starting with the famous concession of the Suez Canal in 1854 and developed through the country's concession legislation of 1947 (Law N° 129 of 1947; revised in 1958) which still exists today, but contains severe restrictions that make it unworkable, such as a maximum profit of 10 per cent of the capital. This is the reason why, in the late 1990s, when Egypt decided to reassess the possibility of private sector provision of public services – which had been prohibited for nearly half a century – it was necessary to enact sector-specific laws. By derogation to the 1947 concession law, such laws have been enacted for electricity, airports, specialised ports, the railway and roads sectors, allowing more flexibility in the drafting of related concession agreements. These exceptions have allowed for the construction of three power plants, as well as a number of airports, ports and road projects, although such projects have faced controversial policy issues. BOT financing has been abandoned in recent years in favour of a PPP policy.

A special PPP central unit was established within the Ministry of Finance in 2006. It has conducted the drafting of a general PPP law and the initiation of a PPP project in parallel. The New Cairo Wastewater Treatment Plant was the first PPP project awarded in Egypt by the Egyptian Ministry of Housing, Utilities & Urban Development in June 2009, before the PPP law was even enacted.

Egypt was the first of the SEMED countries to adopt PPP specific legislation (Law N° 67 of 2010) which, without repealing the former Concession law, has provided for a wide scope of PPP contracts to be implemented including the delegation of public services according to the PFI model. As such, the Egyptian legal framework for concessions and PPPs has been ranked as "highly compliant" in the Assessment, and is the most compliant of all SEMED countries when compared with the international best practice.

The law further made official the establishment of the central PPP unit, which was headed at the time by a very dynamic director, Mrs Rania Zayed, with most of the officials coming from the private sector.

Following the revolution, conflicting signals are being given in relation to the development of PPPs in Egypt. The Alexandria Hospital project reached contractual closing and is now looking to secure financial close, which is a positive sign, whereas the central PPP unit has decided to cancel the "6 October" wastewater PPP project that had reached the pre-qualification stage, officially for technical and financial reasons. There is therefore some remaining uncertainty as to the future of PPPs in Egypt following the revolution although, for the time being, following a year on hold,

the PPP development policy is apparently still in place.

Jordan

In Jordan the status of the legal framework is quite different. PPPs and concessions are governed by the provisions of the Privatization Regulation Number (80) of 2008 for Implementing Privatization Transactions Issued under Article (20) of The Privatization Law Number (25) of 2000 ("the Privatization Law").

The Privatization Law (Article 4) provides that the restructuring and privatisation of public institutions or enterprises owned by the public sector can be carried out by adopting the following type of agreement or license in addition to traditional methods of privatisation: BOT, BOO, build-operate-own-transfer (BOOT), as well as granting the private sector the right to build a particular enterprise with a monopolistic and exclusive right to exploit it under a licence or an agreement signed with the government for this purpose, or any other method not specified in the law as decided by the Council of Ministers.

Although designed for the development of the private sector participation in public services and infrastructure and not specifically for PPPs, it is nonetheless the Privatization Law that has provided the legal framework for PPPs. Jordan officially launched its PPP programme on 23 June 2008, and assigned the implementation of this programme to the Executive Privatization Commission as a way to maintain its privatisation programme.

The current legislation does allow for all types of PPP, although there is no specific legislation or regulation dealing in detail with PPP procurement, and no regulation at all concerning PFI or PPP which is applicable to the non-merchant sector.

Numerous successful PPP projects in Jordan, but also the withdrawal of several projects which could not be achieved on a project finance basis, have led the government to enlarge the scope of PPP and to open the PFI route to smaller projects. A new PPP law has now been under consideration for some time and, when enacted (possibly in the near future), will become the legal framework applicable specifically to concessions and PPPs in Jordan. There are, however, currently a number of social and political obstacles to PPPs in Jordan.

Morocco

Morocco's longstanding tradition of PPP projects was revived in the 1990s with the first North African Jorf Lasfar build-operate-transfer (BOT) power plant project which achieved successful financial closing in 1997. During the same period, management of the distribution of drinking water and electricity as well as sewage management for the Greater Casablanca area was delegated to a private company. This was followed by similar delegations in Rabat and Tangier-Tetouan along with various other concession projects such as the El Guerdane irrigation project which received interest from the global PPP industry.

The law n° 54-05 pertaining to contracts for the delegation of the management of public services or infrastructure concluded by municipal authorities or public enterprises was enacted in 2006, and was based on the state's past experiences. The scope of the law is, however, very restrictive and does not apply to concessions by ministries or other government entities, nor does it apply to companies even if they are fully owned by the state and, as such, are no longer considered to be public enterprises.

This limitation in scope has contributed to the ranking of this law as "medium compliant" under the Assessment, which is below the average level of the EBRD's countries of operations. The 2006 Moroccan law allows for the carrying out of different forms of PPP, but major international institutions working on PPP development agree that the legal framework for concessions and PPP in Morocco would benefit from a number of improvements, or even the adoption of a new PPP-specific law.

A new PPP unit was created within the Ministry of Economy and Finance last September and is already in operation, cooperating closely with a number of international institutions such as the European Investment Bank (EIB) and the International Finance Corporation (IFC). This unit has started work on a new PPP law which we understand will cover all types of PPP including government and public company concessions. It will, however, only provide the main principles, leaving the implementing rules to determine the detail of the procurement process. The PPP unit may also play a significant role in the development of PPP pilot projects within the country.

If the new PPP law, which is currently at the final study stage, is accurately drafted, its enactment would further contribute to the development of PPP in Morocco. It is also worth noting that the Moroccan PPP development policy does not seem to have been affected by the recent change in government. Some social and political resistance is, however, periodically experienced with respect to the existing delegation of management of municipal utility

services, and this may jeopardise the prompt development of PPP in Morocco in the future.

Tunisia

During much the same period as Morocco, Tunisia also saw the negotiation of a build-operate-own (BOO) power plant project in Rades achieving its financial closing in the late 1990s following the enactment of an electricity law in 1996 which allowed derogations from the state company STEG production monopoly. This project did not, however, trigger much further development of PPP projects, except for the Enfidha airport concession which was inaugurated in 2007 – and a few other project attempts in the field of water treatment and desalination. This lack of activity explains the "low effectiveness" ranking of Tunisia in the Assessment.

Tunisia's law on concession was enacted in 2008, and was also based on the state's previous experience. It incorporates principles of administrative law including some notable advantages such as the step-in right and the right of mortgage of construction on public land, as well as provision for the modification of contracts in the event that the financial/economic balance of the contract is disrupted by unforeseen circumstances. This law appears to be a great achievement in facilitating the understanding of the existing legal framework for concession in Tunisia and is intended to provide the general framework for numerous sector-specific laws which existed previously. As such, this law has led to a "high compliance" notation in the Assessment.

The Tunisian concession law has been supplemented by Concession Procurement Decree N° 2010- 1753 dated 19 July 2010, which fixes the modalities and procedure for the award of concessions, and Decree N° 2008- 2965 which creates the unit in charge of the follow-up of concessions. As a result of the late publication of these implementing regulations, no concession agreement was ever implemented under the new law before the revolution of January 2011; the projects which were awarded under this law have been suspended pending the audit of the awarding process. An example of such a situation is the Djerba desalination plant.

The revolution has not, contrary to appearances, affected the determination of the Tunisian government to proceed with PPP projects. At the conclusion of the 9th Facility for Euro-Mediterranean Investment and Partnership (FEMIP) Conference held on 30 May 2011 in Casablanca, the PPP potential within the region was reaffirmed in a joint statement by the EIB and the Ministers of Finance of Tunisia and Morocco. Mindful of the potential for regional initiatives to promote PPP in the Mediterranean region, the EIB and the Ministers invited Mediterranean partner countries to: "(i) assess and

review their legal and financial ability to engage with PPP, and enhance, the legislative, regulatory and institutional frameworks as appropriate, as well as the financial environment required to meet the funding needs of PPP projects; (ii) strengthen expertise on the processes and procedures for implementing PPP programs and projects; and (iii) reinforce especially with the involvement of existing PPP units, regional cooperation and knowledge-sharing on PPP issues."

Following the same pragmatic trend towards extending the scope of potential PPPs noticed in most of the EBRD's countries of operations, Tunisia began to review its 2008 Concession law soon after the revolution. The changes to the law (which have been assessed as highly compliant with international best practice despite there being room for improvement) do not seem to be prompting the development of any sort of PPP in the country. What is really needed in Tunisia is a new instrument that would respond specifically and simply to the need for Private Finance Initiative (PFI)-type projects without having to reopen the debate or redraft the 2008 Concession law.

Unfortunately the Concession law is oriented towards traditional concessions and the delegation of public services with payment being due by end-users in consideration of the service provided as opposed to payment being made by the public authority as sole user for the availability of a facility or services. The law further excludes the non-merchant sectors which renders its application more difficult, especially in relation to the PFI form of PPP.

This is precisely the form of PPP which would be very useful for the development of small- and medium-sized social projects such as hospitals or schools in remote areas, which are a priority for the Tunisian government. Such projects are not exposed to commercial or traffic risk related to ensuring the proceeds necessary for a return on investment and could be financed by the private sector based on the still-creditworthy signature of the Tunisian government entities. Despite its recent downgrading to "BB" by certain credit rating institutions, the bankability of Tunisian PFI projects could be enhanced by the support promised by international financial institutions following the Deauville conference.

In Tunisia, as in most civil law countries, passing a law on concession where public services and public wealth are involved is invariably socially and politically sensitive. In such circumstances, the enactment of an additional PPP instrument may be a simpler and quicker approach.

The new draft PPP law is expected to be available soon but there is still no clear view of what it may contain. In addition to this new law, which will

hopefully respond to Tunisia's needs, it would be advisable to develop the Concession Unit into a PPP central unit – as is the case in Egypt – in order to maximise existing resources and increase PPP expertise.

General comments and conclusion

The Assessment shows that traditional concessions have existed in all of the SEMED countries for a long time, even though the Concession law in two of these four countries (Morocco and Tunisia) is quite recent. The legal frameworks of Egypt and Tunisia are both deemed highly compliant in relation to best international practice, whereas Morocco and Jordan are only rated as medium compliant. The effectiveness of concession law in Jordan, Morocco and Egypt is higher (although still in the medium range) than in Tunisia (low effectiveness), which shows that the situation with respect to concession and PPP development in all four SEMED countries is not bad, although further progress must still be made.

The same dynamic attitude towards the enactment of new PPP legislation has been observed in all four countries in recent years as compared with the other EBRD countries of operations. The four SEMED countries have all actively followed the various trends detected in the overall assessment, including the move towards a greater use of PPP in addition to concession, the introduction of the PFI model and the creation of PPP units; in short, a trend towards pragmatism.

This can be seen through the enactment in Egypt and in the preparation in Morocco, Tunisia and Jordan of new PPP legislation, in addition to the existing legal frameworks for concession, allowing the introduction of the PFI model inherited from the United Kingdom and the creation of PPP units observed in Western Europe.

Over the past year, all four SEMED countries have, however, been affected by the political events of 2011, and it is not yet clear, despite some positive signs from each of the four countries as best seen in the dynamic approach to the abovementioned legislative reforms, that they will all continue their trend toward liberalisation, or that their PPP development policy will survive the plans for reform of the countries' political and economic systems.

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¹ In due course the Bank may implement its expansion and initiate investments in the SEMED region, subject to shareholders' ratification.

Recipe for success in PPP *haute cuisine* – the EBRD experience

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With customary limitations on state budgetary funding, PPPs have become necessary funding alternatives for infrastructure projects across the EBRD region. Based on the EBRD experience to date, a number of key ingredients are necessary for the successful application of PPP structures in infrastructure financing. The first part of this article outlines the recipe for a successful PPP, while the second part illustrates the concept with practical cases.

Introduction

As an institution set up to support the transition to a market economy in the countries of central and eastern Europe and now in the southern and eastern Mediterranean region, the EBRD has been actively involved in promoting the application of public-private partnership (PPP) funding structures across many sectors, with a strong focus on the use of PPPs as a mechanism to support the large-scale sector investment needs in all of its countries of operations.

Having the right ingredients

While cookbooks may look discouraging, with a myriad of base ingredients, spices, tools and utensils needed to follow the scripted recipe, a successful PPP requires only five major components of a legal, institutional and practical nature.

(i) Legal framework

To allow a PPP infrastructure programme to be implemented successfully, there must be no undue legal constraints that would prevent, or make very difficult, that successful implementation. The specific legal framework requirements are:

- the legislation under which PPPs are prepared needs to be clear and consistent, avoiding loopholes and conflicts with other legislation
- flexibility is recommended to allow for a tailoring of the approach project-by-project, as appropriate
- the legal framework must be predictable, stable and fair

- there should be a clear regulatory environment, especially for tariff-setting, or alternatively a clearly defined and enforceable contractual revenue stream.

The above can be achieved either through the adoption of a dedicated PPP law or specific sector legislation at the national level or development of secondary legislation at the regional level. The regional legislation approach has been applied successfully in Russia, with the government of St Petersburg demonstrating how a regional approach can complement or, even in certain aspects, improve the national legislation. In this respect, the EBRD, through its dedicated Legal Transition Team, has been working with public authorities across our region to provide the necessary support in defining the legal base for PPP operations, taking advantage of all available options under local law.

However, a reasonable PPP legal and regulatory framework is not enough. The government also needs to define and execute a credible strategy towards PPPs as well as build the necessary institutional capacity (in-house and through advisers) to deliver PPPs successfully.

(ii) Public-side preparation – strategy

The public side of the PPP transaction must start the preparation of any PPP investment well in advance of testing private sector interest to ensure that there are adequate economic, technical and financial reasons for the application of the PPP mechanism. The key checklist of preparation goals for the public side can be summarised as follows:

- The project should be feasible, with a sound economic basis – preparation of a detailed

economic internal rate of return (EIRR) analysis and rigorous cost/benefit analysis is a must, as is a positive and acceptable EIRR result at the end of the process.

- The project is to be consistent with the government's development objectives and PPP strategy, to validate alignment of interests.
- There is to be a political champion leading the effort with the ability to achieve political consensus, ideally across-party – too many PPPs disappear following government changes.
- The right balance between environmental concerns and development needs can be demonstrably argued.

The availability of internal expertise within the public institutions in the EBRD region has been limited. The biggest success stories in terms of PPP application have been in those EBRD countries that appointed experienced, well-known international consultants to provide comprehensive PPP assistance (for example, Albania, Hungary and the Slovak Republic).

The EBRD has encouraged the use of international expertise to ensure that the PPP process in our region would meet the expectations of international investors. In selected project cases, the EBRD has provided extensive hands-on support in the organisation of the PPP preparatory work. In the case of the Mother Teresa Airport in Tirana, Albania, the Bank helped with the advisers' terms of reference and provided comments and guidance on their deliverables (introducing the use of "Chinese walls" internally to eliminate the conflict of interest in subsequent funding of the selected bidder).

Box 1. A well-designed and executed privatisation: ⁴in the privatisation of Istanbul's municipally owned passenger ferry company in 2011, the EBRD's ability to structure long-term senior debt and a flexible junior debt tranche played a critical role in ensuring that a suitable financing package would be completed for Turkey's first privatisation in the municipal transport sector. Specifically, the Bank's investment enabled the winning private consortium to make ferry operations more efficient and help commercialise this key municipal service. Given Greater Istanbul's unique geographic layout as a sprawling urban agglomeration formed around the Bosphorus Strait, the Golden Horn and the northern part of the Marmara Sea, the development of a commercially oriented, efficient, clean and safe ferry system is an essential element of the city's ability to meet its future mobility needs as defined within its broader urban transport strategy.

(iii) Project preparation – specific requirements

To ensure an adequate market response and interest, it is vital that the PPP preparation includes specific requirements above and beyond the typical national legal requirements in the following two areas:

- **PPP procurement process** – while it is self-evident that the procedures need to follow specific national legislation, it may be advisable for the public authorities to expand and adjust the PPP procurement process so as to meet internationally recognised standards of open and transparent selection. This is of particular importance where project financing is expected to come from international financial institutions (IFIs) and international commercial lenders, as neither will want to bear the risk of potential procurement challenges.
- **Environmental preparation** – notwithstanding local environmental and social legislation which varies significantly in the EBRD region, an internationally attractive PPP will need to comply with the "gold standard" for environmental and social due diligence. This would typically encompass the environmental requirements of IFIs. Indeed many infrastructure PPPs require land acquisition and impact on the quality of life of nearby residents (noise, pollution), thus significant local opposition and protests from residents and civil society organisations often ensue. In this respect high standards of project preparation and a robust and open consultation process to engage with stakeholders are key elements to address the issues of concern for all parties involved. Unless a broad consensus can be established, environmental concerns negatively affect the appetite of commercial and IFI lenders.

Box. 2. Environmental and social issues: in the Pulkovo Airport transaction, the EBRD's ability to help with the design of stakeholder engagement, the public consultation process and the environmental mitigants was a key determinant making the financial close possible. Public consultations were carried out in January 2010 and involved three public meetings in and around St Petersburg. The exercise demonstrated significant interest from the residents in the project and its architectural and technical characteristics. The main concerns expressed were related to potential disruption to flights during construction, changes in the composition of the workforce potentially associated with the project, noise and air pollution. The public consultation process allowed the airport concessionaire to

develop the necessary mitigation measures to ensure broad scale cooperation with the residents of the neighbouring districts. It was the first consultation of this nature in Russia prepared and carried out in accordance with the internationally expected standards and was one of the key factors which allowed the Pulkovo transaction to close with the participation of international lenders.

The EBRD's ability to step in, work together with the public authorities, their advisers and ultimately the preferred bidder, and address environmental and social issues has been fundamental in achieving successful close, with a particular effort needed in countries outside of the EU regulatory framework.

(iv) PPP units

Establishment of a dedicated PPP unit within the public authority is not a necessary prerequisite for success. However, the EBRD's experience shows that effective PPP units have allowed PPP transactions to close within a shorter time period and, more importantly, to replicate the initial success quickly – under the tested PPP model (for example, a series of motorway PPPs in Hungary).²

The PPP units on the public authority side also seem to ensure a smoother PPP implementation allowing for continuity of expertise and knowledge of the complex transaction documentation on the public authority side and thus a quick and informative response to any implementation issues which might arise post-concession agreement signing.

(v) The core of any PPP: balance of risk

Beyond legislative and institutional ingredients, it is ultimately the practical negotiation of the terms that will make a PPP successful. The EBRD's track record shows that behind each successful PPP transaction there was a government/public authority that understood and accepted the core concept of a PPP: a structure where the two parties – public and private – take responsibility for the investment risks which they are best equipped to handle and mitigate. Conversely, all PPPs prepared in a one-sided manner where the public side was able to leave the full risk profile of the investment on the shoulders of the private sector partner failed. A PPP is and has to be structured as a true partnership:

- It is universally acknowledged that in PPP transactions the private sector will not accept risks which are considered political, unless insurance is available at a reasonable cost to cover them. Examples of such risks would include the exchange rate risk, nationalisation/currency expropriation restrictions, or changes in law.
- Other risks are commonly shared in the PPP practice such as, among others, uninsurability/insurance market risk,

permits, *force majeure* consequences or inflation risk (through a pre-agreed index system).

Well-balanced PPP: the Apa Nova Bucharest concession in Romania was one of the first major PPPs in the Bank's region in the water sector. This concession benefits from a well-defined concession agreement specifying service levels, but also giving incentives to the concessionaire to find efficiency savings. Key to this success is the ability to charge tariffs which allow a reasonable return to Apa Nova. Due to a clear tariff-setting mechanism embedded in the concession agreement, Apa Nova was able to attain the necessary tariff increases. At the same time, the incentive mechanism triggered efficiency savings allowing the maintenance of low tariffs remaining below the average for other Romanian cities.

- As always the area of most controversy is the traffic risk, where the EBRD's experience shows that PPP projects involving traffic risks carry a much higher casualty risk. Especially in the context of an unproven PPP market, it is strongly advisable to start with PPP structures which include satisfactory traffic risk mitigation provisions (with options ranging from the availability payments to various forms of revenue support for the concessionaire).

Box 3. Traffic risk: the first attempt by the EBRD to encourage PPP application in our region – the M1-M15 project in Hungary – had to be nationalised and the subsequent M5 PPP project required fundamental restructuring. In both cases, the traffic risk affected the bankability of the transactions. In the case of the M5 transaction the EBRD was able to step in to provide intermediate financing to allow for the transaction to be restructured on the basis of the availability fee structure. The elimination of the traffic risk by the application of the availability fee structure in subsequent road concessions allowed Hungary to develop a successful pipeline of subsequent road PPPs. The well-structured R1 motorway PPP in the Slovak Republic, based on an availability payment mechanism, was able to close in the height of the financial crisis in 2009.

The proof is in the pudding

As the case studies below demonstrate, infrastructure PPPs in the EBRD region have provided a much-needed complementary funding base for infrastructure network development in our countries of operations. The successful ingredients – in

different combinations – have been present in all projects which reached financial close. PPP financing is not yet as widely used in the EBRD region as in other parts of the world and thus the EBRD will continue its efforts to assist both public and private partners in advancing this method of cooperation in the infrastructure sector in the future.

Case study: municipal infrastructure		Case study: transport	
Turkey: Istanbul Ferries privatisation		Slovak Republic: R1 Motorway	
			
Client	TASS, a special purpose company, established by three Turkish companies (Tepe, Akfen, Sera) and the UK's Souter Investments	Client	Granvia, A.S a special purpose vehicle owned by Vinci Concessions S.A. and Meridiam Infrastructure Fund
EBRD financing	US\$ 150 million	EBRD financing	€250 million
Type	US\$ 100 million – long-term senior loan US\$ 50 million – mid-term junior loan	Type	Senior term loan facility of €1,050 million
Total project	US\$ 860 million	Total project	€1.3 billion
Description	Financing acquisition of IDO, the world's largest municipal ferry operator, by TASS	Description	Design, construction, financing, operation and maintenance of three sections of the R1 Expressway
Impact	Demonstration effect of the private sector value-added: introduction of new demand-driven ticket tariffs, creation of new routes and intermodal passenger transportation services	Impact	First concession contract awarded for a PPP structure for motorway projects in the Slovak Republic
	Flexible financing structure with a sufficient grace period which allowed the sponsors to introduce measures to turn around the company		Supporting the private sector in the provision of transportation services
	Introduction of a gender action plan as a tool for inclusiveness.		Introducing the efficiencies of the private sector in the provision of large-scale infrastructure
			Support of implementation of innovative approaches to environmental, health and safety issues including wildlife protection, stakeholder engagement and effective grievance mechanisms.

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¹ Although legally beyond the PPP scope, but economically fairly similar, our example of a “privatisation” would be relevant for financing issues.

² The PPP unit in Hungary has now been abandoned and has become a loose task force.

Public-private partnerships in Russia

Maria Yarmalchuk, Head of Public Private Partnership Development Section, Ministry of Economic Development of the Russian Federation

This article reviews the key aspects that are relevant for the development of public-private partnerships (PPPs) in Russia. There is information about the main PPP mechanisms currently in operation, such as concessions and the Investment Fund. In addition we present the key elements of the legal framework, institutional capacity, market size and information and examples of current projects. Lastly the article points to the future plans of the Russian government in PPP development and implementation.

1. Establishment of public-private partnerships in Russia

Depreciation in infrastructure funds and low rates of establishment in any new funds are the main obstacles to Russia's economic development. The public utilities sector (which has depreciated over 80 per cent), and the transport and social sectors are suffering the most. Considering the latest budget constraints and the capability of public-private partnership (PPP) mechanisms to raise private funds

for infrastructure investment, PPPs are needed more than ever before.

According to an assessment carried out by Gazprombank, the amount of infrastructure funding in the next 10 years in Russia, not including the social sphere, will amount to approximately US\$ 753 billion – 75 per cent of which will go towards road investment. Table 1 details the current investment needs of Russia's infrastructure sector.

Table 1: Current investment needs of Russia's infrastructure sector

Infrastructure type	Volume of investment needed, US\$ billion	Details of investment
Motorways	559	Required for: construction of 451,000 km of new motorways reconstruction of 14,600 km of federal (approximately US\$ 5 million per km) and 35,400 km of regional motorways (approximately US\$ 1 million per km) despite the above due to materialise in 2020, motorway density in Russia (0.07 km per km ²) will be lower than in Canada (0.14 km per km ²) and China (0.19 km per km ²).
Railroads	80	Required for: construction of 16,605 km of new roads (approximately US\$ 1.5 million per km) reconstruction of 44,200 km of the roads (52% of the total length, approximately US\$ 0.75 million per km) development of 659 km high-speed railroad sections (approximately US\$ 32 million per km).
Energy	70	For energy efficiency programmes and development of social infrastructure, the sector needs approximately US\$ 5 billion a year.
Ports	33	Current forecasts envisage 5% year-on-year growth of total sea and river port capacity, which amounts to a 620 million tonne increase by 2020.
Airports	11	The Ministry of Transportation has selected 24 airports as priority investment objectives. The reconstruction programme needs US\$ 440 million for each of these investments.
Total	753	

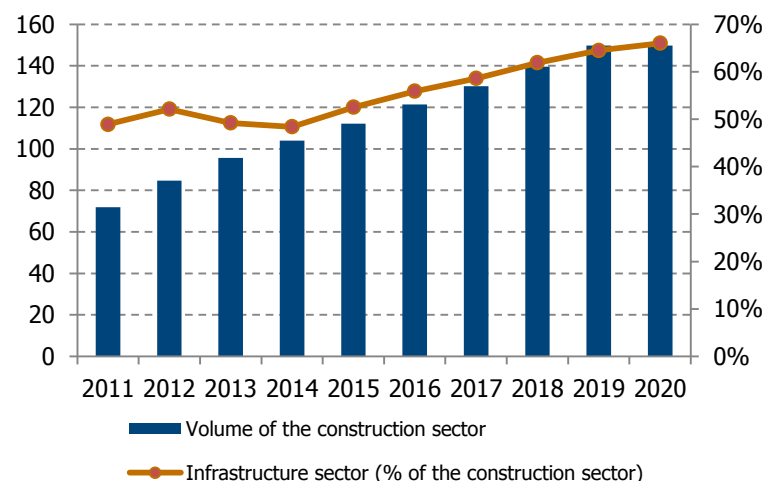
Source: Gazprombank

Taking into account the current budget constraints, meeting the above funding needs solely through public investment is impossible. The need to develop infrastructure incentivises the government to actively implement new instruments, including PPPs. According to Business Monitor International's assessment, the infrastructure sector (energy,

housing and transport) in Russia will grow from US\$ 39 billion in 2011 to US\$ 110 billion in 2020; that is, in the medium term (until 2015), growth of the infrastructure sector may amount to about 18 per cent per year, half of which will be spent on transportation.

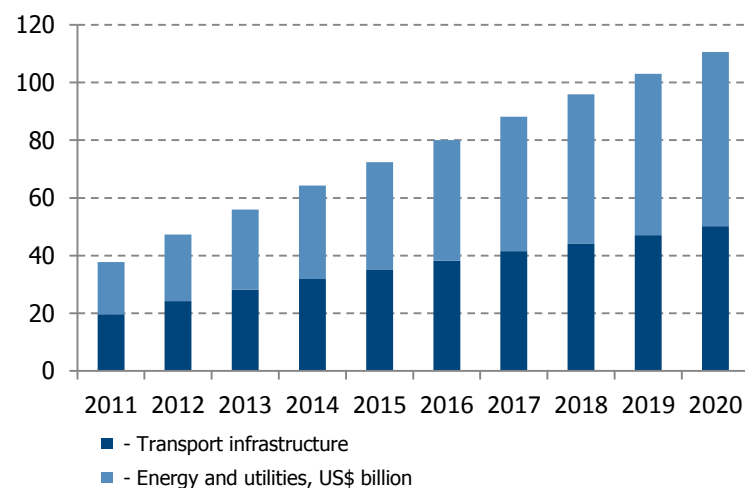
Chart 1: Sector potential

Infrastructure expenditures against total construction expenditures, US\$ billion



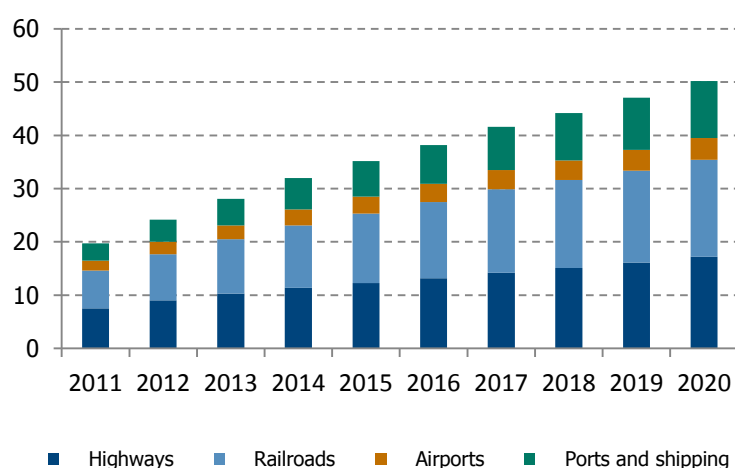
Source: Business Monitor International

Chart 2: Energy versus transport expenditures, US\$ billion



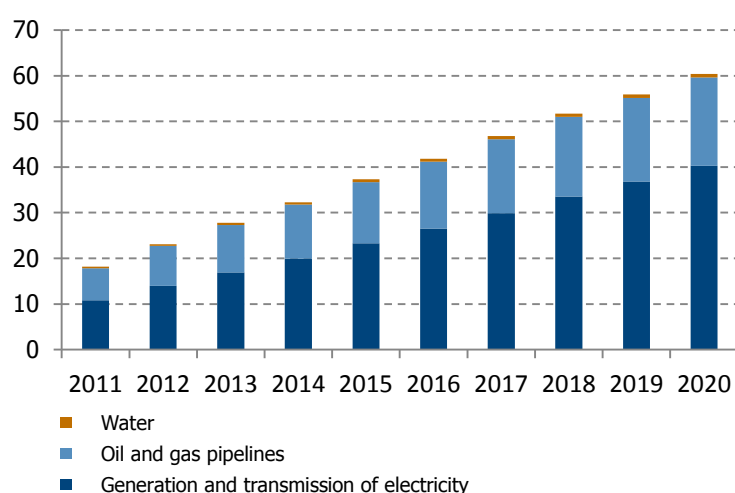
Source: Business Monitor International

Chart 3: Transport infrastructure expenditure breakdown, US\$ billion



Source: Business Monitor International

Chart 4: Energy and social infrastructure breakdown, US\$ billion



Source: Business Monitor International

Improvement of the investment climate in Russia and as a result, the increase in international investment and implementation of PPP projects are the main aspects of government investment policy.

PPPs in Russia were mainly launched in 2005 after the passing of the federal PPP law, followed by the establishment of the Investment Fund of Russian Federation and the development of regional PPP legislation. Lastly, the mechanisms of investment support with state guarantees on invested funds were launched. First place in PPP project implementation in Russia is held by the St Petersburg region, (where the law was passed in 2006).¹ The region has the greatest number of projects in both the transport and social sectors.

2. Main instruments and institutions

Concessions²

Until 2012 the concession law had been following project implementation strictly according to the Build-Transfer-Operate model. Moreover, the list of contract objects from transport infrastructure (roads, ports, railroads and so on), the social sphere (health, education and so on), energy and public utilities has been set.

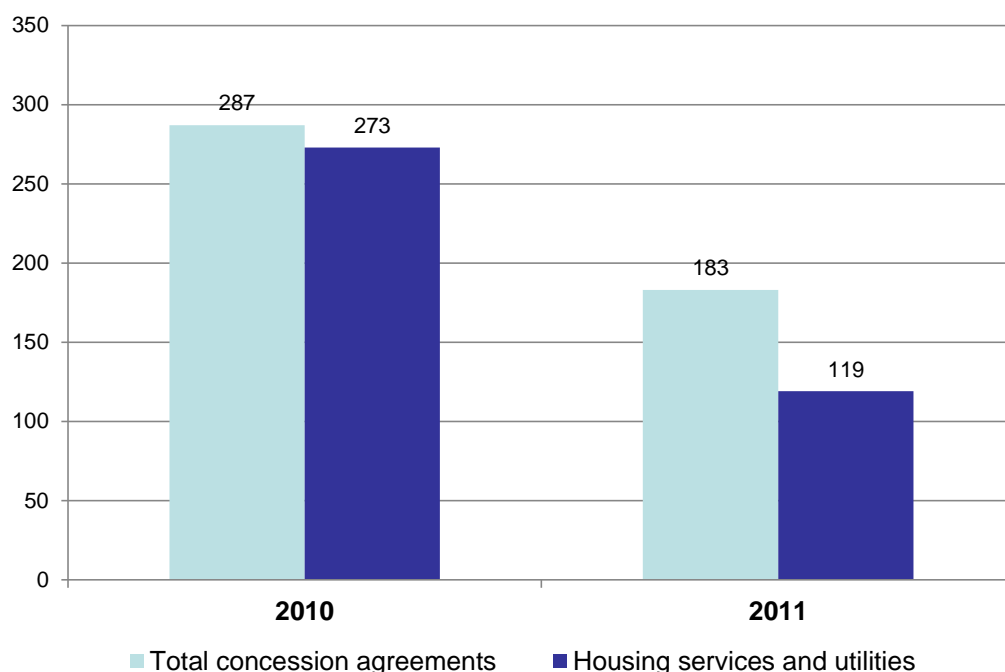
In order to simplify and unify the mechanisms of concession implementation, the government provided 12 typical concessions. Concessions are used at the federal, regional and local levels, depending on the amount of financing and risk-taking. By the end of 2011, at the stage of preparation, conclusion and implementation there

were five federal investment projects, eight regional and 168 municipal.

Concessions at a federal level are implemented in the sector of transport infrastructure. At the municipal level concessions are implemented in the

sector of public utilities (for example, water supply and sanitation, power generation and supply, gas supply); roads and engineering structures (for example, bridges); waste recycling facilities (recycling plants and landfills); cultural property; sports infrastructure; educational and medical facilities.

Chart 5: Concessions in Russia



Source: Ministry of Economic Development of Russia.

Within the implementation of concession projects it is now possible to attract debt financing from the open market by issuing bonds of the concessionaire. The law provides special provisions for the regulation of such bonds. In particular, in accordance with the order of the Federal Financial Markets Service of Russia of 28 December 2010 No. 10-78/pz-n "On Approval of the activities related to the organisation of trading in the securities market" (paragraph 4.10.7), the inclusion of these bonds in quotation lists of the trade organisers is conducted under a simplified procedure (along with the bonds secured by state guarantees, surety or bank guarantee of the State Corporation Bank for Development and Foreign

Economic Affairs (Vnesheconombank)) without complying with a number of formal requirements. To date, the issuer-concessionaires have issued bonds amounting to US\$ 19.7 billion roubles with maturities from 1 to 20 years.

At the same time the concessionaire must comply with a number of additional conditions. For example, the decision on the issuance (additional issuance) of bonds must be approved after the conclusion of the concession agreement and targeted issuance of bonds shall be provided. Also, the right of the bond owner to present the bond for early redemption in the case of delisting of the bonds at all stock exchanges shall be provided.

Table 2: Examples of financing concessions projects

Concession issuer	JJSC "Glavnaya doroga"	JSC "Glavnaya doroga"	LTD "North-West Concession Company"	JSC "Western Hi-Speed Diameter"	CJSC "Volga-Sport"	LLC "Waste Management-Volgograd"	CJSC "Waste Management – NN"
Issue number	04	03	04	01	01	Planning to issue	Planning to issue
Issue total, million roubles	300	8,000	5,000	5,000	1,400	1,200	1,000
Issue period	1 year	18 years	20 years	20 years	11 years	10 years	10 years
Coupon period	Half year	1 year	Half year	Half year	1 year	-	-
Issue date	4 June 2010	22 November 2010	21 October 2011	7 June 2011	4 April 2011	Planning to issue in 2012	Planning to issue in 2012
Issue price, % on nominal	100	90	100	100	100	100	100
Coupon fee on issue date, % per year	10.2	5, the rest depends on the growth of consumption prices and GDP in Russia	11.46	8.93	9.76	-	-
Listing on MICEX	B	A1	A1	A1	A1	-	-
Security			Ministry of Finance of Russia guarantee	Ministry of Finance of Russia guarantee	Unsecured bonds	Unsecured bonds	Unsecured bonds

Investment fund

Activity of the Investment Fund of the Russian Federation ("the Fund") is regulated by law 1 March 2008 No. 134 "On principles of Investment Fund of Russian Federation budget financing". The Fund receives financing annually from the federal budget.³ The Fund itself is able to take part in the implementation of major, national concession projects.

The Fund invests in projects in the following ways:

- budget investments in the construction of objects, which will be transferred to the ownership of the government
- providing a subsidy for Russian region budgets
- participating in capital co-founding of public corporations
- providing a subsidy for the government company "Russian roads" for the purposes of road reconstruction and building.

At present, 43 Fund projects have been approved:

- 18 national projects
- 25 regional projects.

The total value of national projects is more than Rb 1.3 trillion, and the Fund invests Rb 380 billion. At present, 13 projects are at the stage of implementation, with a total value of Rb 971.7 billion, with Rb 267.7 billion from the Fund.

Sixty out of 83 regions have already passed the PPP laws. The regional laws, however, are not uniform (for example, some laws do not provide a comprehensive legal framework to protect investor interests). Moreover, laws do not provide conditions to launch more regional and municipal projects. A pipeline of infrastructure projects in the regions of Russia would be beneficial. Actual activity in infrastructure development is focused on launching federal major projects that cost heavily but benefit locally.

A good example of a nation-wide project is the strategic investment project – the Western High Speed Diameter (WHSD). The project promotes the development of the city of St Petersburg as a major world-class transport hub.

The Western High Speed Diameter project

The WHSD is a paid municipal highway for the transportation of passengers and cargo, and connects the transportation hub of St Petersburg, including the Grand Port, to the country's road network.

The total length of the route is 46.6 km. The route is designed to include sections with four, six and eight lanes. Elevated areas make up 55 per cent of the length of the highway and the sections in the subgrade make up 45 per cent of the highway. The construction of WHSD envisages 14 interchanges at different levels and structures with unique bridge clearances over the ship fairway of 55 metres and 35 metres, construction of which will take place for the first time in Russia.

The project is implemented on the basis of St Petersburg Law on PPP, with a total value of Rb 212.725 billion, of which Rb 50.7 billion is from the Investment Fund, Rb 54.2 billion from the budget of St Petersburg and Rb 107.9 billion from the personal and borrowed funds of the concessionaire.

A paid fare was introduced in the previously free area of the WHSD on the intersection from the Ring Road to Blagodatnaya Street on 14 May 2011.

Establishment of two tollpoints is envisaged on this part of the route: on the street Automobilnaya and on the transport interchange at the intersection with Blagodatnaya Street.



Paid travel on other routes of the WHSD will be implemented once the routes start working

3. Current situation

In order to activate PPPs in the regions, the Ministry of Economic Development has carried out expertise assessments concerning law enforcement in regions during project implementation.

The main issues are listed below.

- Regulations in regional PPP law conflict with 94-FZ federal law. So there is a risk that the regional PPP contract may be declared invalid (land, procurement regulations and so on). De jure in Russia when a public partner needs to attract a private entity on a charitable contract basis, it should be done in respect of the 94-FZ federal law requirements.
- There is a lack of legislation within the budget sector, with no mechanism to assign budget funds in order to fulfil government/municipal obligations during major project implementation (longer than five-year contracts).
- A number of amendments in tariff regulation are needed. Amendments should ensure that stated tariffs in PPP project contracts are exempt from further changes in legislation.
- During regional PPP project implementation, federal law makes no provision for special legal orders in different regions for PPPs, by analogy with the federal law provisions for concessions (land, tax and tariff regulations).
- There is no standardised identification of the PPP model in Russian regions.

Moreover, there are other obstacles for PPP development in Russia:

- insufficiency of well-qualified PPP specialists in the regions of Russia
- lack of expertise in PPP project preparation and realisation at the local level
- institutional unwillingness of the state and municipal owners to delegate certain infrastructure rights to the business
- lack of systematisation (or standardisation) in project identification and preparation, as well as in the process of tendering
- lack of understanding as to when certain PPP mechanisms can be used
- high price of consultant services
- lack of developed PPP model documentation, oriented on private investment attraction and risk-sharing between partners
- lack of companies doing business in infrastructure management

- lack of well-prepared PPP projects.

In order to succeed with PPPs and attract investment in infrastructure projects, certain amendments in federal legislation are needed, in particular: budget, investment, land and tax legislation. To that end, the Ministry of Economic Development has developed two bills “On public-private partnerships” and “On amendments to legislation in connection with the ‘On public-private partnerships bill’”.

Introduction of the law regulations of PPPs at a federal level will allow the development of unified terminology, principles, tender procedures and even set the creation of regulatory Acts in the regions. The bill sets out essential conditions and guarantees legal rights for PPP participants by maintaining the authority to control the activity of the private partner during project implementation regarding contractual commitments.

Moreover, the improvement of “On concessions” law is taking place. In 2012 a number of amendments have been passed. New forms of concessions have been added, for example, the possibility to conclude the Life Cycle Contracts (Design/Built/Finance/Maintain).

4. Future plans

These include:

- improvement of the PPP legislative framework
- adaptation of international experience of PPP project preparation and implementation
- analysis of current PPP models stated in legislation and improvement in order to adapt to regional needs
- analysis and introduction of planning methods of PPP development in the regions.

As a result, the following operating instructions will be introduced:

- assessment of the PPP project's profitability
- assessment of the PPP project's risks
- assessment of the PPP project's social and economic effectiveness
- assessment of the final result post-PPP project implementation.

The above mentioned measures should assist in the creation of a positive environment for PPP project implementation in the regions of Russia and, in the medium term, increase the investment in infrastructure.

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¹ Saint Petersburg law 25.12.2006 № 627-100.

² Federal Law 21.07.2005 № 115-ФЗ «On
Concessions».

³ The Budget Code of the Russian Federation, Article
179.

Public-private partnerships (PPPs) in Bulgaria: legislative initiatives and experience

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Bulgaria's experience in the field of PPP dates back after the fall of the communist regime in 1989. The relevant legal framework has undergone a series of transformations, the most noticeable of which is being influenced by the need to align Bulgarian legislation with the *acquis communautaire* in view of the country's accession to the European Union. The PPP practice under the new Concessions Act of 2006 has shown good progress but has also revealed some deficiencies in terms of the range of possible PPP mechanisms and administrative coordination and monitoring of the projects. To address these issues and to create a feasible business and legislative environment for the implementation of large-scale infrastructure projects, a legislative initiative was undertaken in 2010 resulting in the adoption of a new PPP Act (in force as of 1 January 2013).

I: Abstract

Steps towards a private initiative in financing infrastructure and the provision of services of public interest were first taken after the fall of the communist regime in Bulgaria in 1989.

Concessions were first introduced to the country's legislation in 1995 with the first Concessions Act. Since then, there has been a continuous and complex process of reforms and transformations in this field, leading to the adoption of a new Concessions Act in 2006 (entirely replacing the previous one) and to subsequent significant amendments in the said new law in 2008 aimed at aligning Bulgarian concession legislation with the *acquis communautaire* and more particularly with Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004.

A review of the country's experience in delegating activities of public interest to private operators shows that the main mechanisms through which public authorities delegate their powers to build, manage, operate and maintain public assets and to provide public services are the concessions and public procurement. Another specific mechanism for involving a private partner in these activities, particularly used at the municipal level, is the awarding of construction rights over municipal properties.

Therefore, until very recently, the only operative form of PPP under the active Bulgarian legislation applicable to infrastructure projects was the concession and although a good level of compliance with EU Directives had been achieved, a clear need was established for expanding the scope of Bulgarian PPP legislation in order to provide for implementation of a wider range of PPP mechanisms. In addition, the concession practice to date has revealed various deficiencies in the legislation obstructing the smooth implementation (and quite often the successful completion) of PPP projects.

To address these issues and more importantly, to create a feasible business and legislative environment for attracting private investments and for the implementation of large-scale infrastructure projects, a legislative initiative was undertaken in 2010 and a new PPP Act was recently adopted by the Parliament (in force as of 1 January 2013).

II: The current PPP legislation¹

Under the 2006 Concessions Act a concession was defined as the right to exploit a facility and/or services of public interest, awarded by the contracting authority to a merchant-concessionaire, in exchange for the concessionaire's obligation to build, manage and maintain the facility object of the concession or to manage the services at its own risk.

There are two main types of concessions: works concession and services concession.²

The works concession includes the whole or partial construction of the object of concession and the management and maintenance of the completed object after it is put into operation at the risk of the concessionaire for a consideration consisting of the right of the concessionaire to exploit the object of the concession, or of that right in addition to a compensation on the part of the contracting authority.

The services concession is the management and maintenance of a service of public interest at the risk of the concessionaire for a consideration consisting of the concessionaire's right to exploit the services, or of that right in addition to compensation on the part of the contracting authority. The service concession may also include the execution of partial additional construction works in cases where there is a need for partial extension, partial reconstruction, partial rehabilitation or renovation of the object of the concession.

The right to exploit is defined as the provision of services in the public interest and/or performance of other commercial activities for which revenues are received. The Concessions Act currently does not specify if the revenues may include the collection of fees that are commonly collected by the state or the municipalities.³

The compensation on the other hand is envisaged in the Concessions Act for the following cases only for exceptional circumstances where it is necessary to:

- ensure a socially acceptable price of the services provided through the object of concession, when such a price is determined by an act of legislation⁴ or
- reconstruct the object of the concession after the impact of *force majeure*.

Compensation can only be paid as part of the expenses for construction, management and maintenance of the concession object or for the management of the service in the public interest. No particular percentage is fixed limiting the amount of compensation, but in any case it cannot cover the whole amount of the expenses. Further, the Concessions Act expressly states that the compensation cannot release the concessionaire from the obligation to assume the risk pertinent to the construction and/or the management and maintenance. Therefore, the strict definition of the Concessions Act transfers the whole risk of the building, management and maintenance to the concessionaire under any circumstances.

In addition to this strict regulation, the concession may also include an obligation for the concessionaire to make a payment to the contracting authority. The

introduction of such a condition under the concession has become the usual practice in Bulgaria and the default approach of the contracting authorities, regardless of the political climate.

There is only one type of procedure applicable to the award of concessions: the open procedure. With the amendments promulgated in the State Gazette issue No 67 as of 29 July 2008, the procedures of restricted procedure, competitive dialogue and electronic auction – the latter being a supplementary procedure with open and restricted procedures – were revoked.

A requirement was also introduced that final negotiations cannot be conducted for specifying particular terms of the concession. The concessionaire is bound by the terms of the concession agreement which is part of the tender documentation. Negotiations are only possible if the first-ranked candidate in the procedure refuses to conclude the concession contract. In such cases negotiations are allowed with the second candidate only in view of improving the submitted offer.

This regulation, albeit being generally in compliance with the EU Directives governing concessions,⁵ does not reflect the best practices established in the countries with significant experience in the field of PPP. Also, until recently, there was a clear lack of understanding among public stakeholders of the nature of concessions and PPP, especially in terms of risk sharing and economic balance. The general idea of the Bulgarian authorities regarding the concession was that all risks were to be assumed by the private partner, in addition to which the latter was often required to pay concession fees.

This resulted in a lack of large-scale investment projects (with very few exceptions) and in the premature, unsuccessful termination of numerous concession initiatives. Further, no regulation had been provided for PPP structures where the private partner does not receive income from the end-users (such as the partnership agreement, as established in France and Spain and so on, or the Public Finance Initiative in the United Kingdom).

Clearly, there was a need for improvement in the Bulgarian legal framework, an attempt at which was made with the new PPP Act recently adopted by the Parliament.

III: The new PPP Act

In 2010 a firm legislative initiative was undertaken to expand the scope of PPP regulation in Bulgaria. The process began with the drafting of a concept for amendment of the active Concessions Act by including provisions governing the partnership agreements, and evolved into the preparation and adoption of a separate PPP Act.

Before its adoption, the Act was subject to many discussions and continuous redrafting. As one of the main criticisms of the Act was its unclear scope of application interfering with both the concessions and the public procurement regulations, in the final version of the Act (that was eventually adopted by Parliament) the legislative authority has applied an unconventional approach explicitly excluding concessions from the PPP legal framework, leaving only partnership agreements within its scope. The partnership agreement was introduced as an exception – and is applicable where neither concession nor public procurement can be implemented.

The types of infrastructure awarded through partnership agreements are explicitly enumerated and are thus restricted, including all basic types of social infrastructure (health care, education, culture, sports facilities and so on), as well as several types of technical infrastructure (parking lots, garages, street lighting, parks and green areas and surveillance and security systems). This means that the only applicable PPP form for the other types of technical facilities, including transport, water supply and sewerage, energy, heat supply, waste treatment, remains the concession.

The Act provides that the private partner shall carry out activities in the public interest and shall procure the funding therefor, while the public partner shall participate in the project through the so-called “financial support” to be awarded in the form of payments towards the private operator or granting of real estate rights to the latter.

Lastly, part of the Transitional and Final Provisions of the PPP Act addresses the existing Concessions Act in order to ensure coherence with the new PPP legislation. One of the most important amendments contemplated in the Concessions Act is the introduction of the principles of economic balance and risk allocation between the partners. Thus the overall effect of expanding the PPP regulation in Bulgaria will be achieved, with sufficient legislative grounds for implementation of both concessions and partnership agreements.

IV: The Bulgarian PPP experience to date

(i) General remarks

The currently active concessions legal framework allows for the implementation of different PPP structures (build-operate-transfer and its derivative facilities: build-operate-own or build-operate-own-transfer) as well as the delegation of public services.

Further, the regulation under the abovementioned sector-specific acts generally does not contain any restrictions on the possibilities for the award of technical or social infrastructure on concession.

However, the practice accrued in Bulgaria so far shows that most of the PPP projects implemented in the country are mainly small- to middle-scale municipal service concessions and that no major works projects have been successfully delivered.⁶ The figures of the works and services concessions awarded in Bulgaria since 2006 have been presented below.⁷

Chart 1: Number of works and services concessions awarded in the period 2006-12

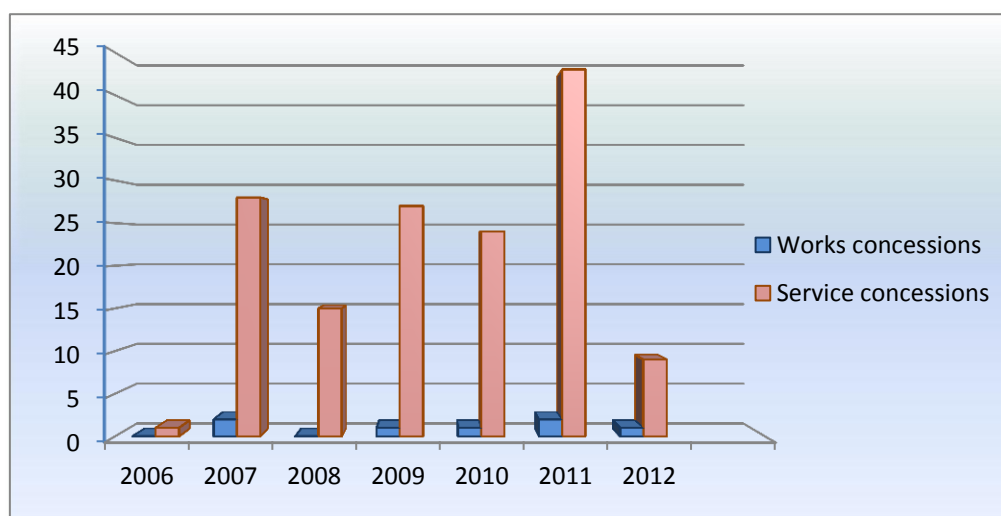


Chart 2: Number of state and municipal concessions awarded in the period 2006-12

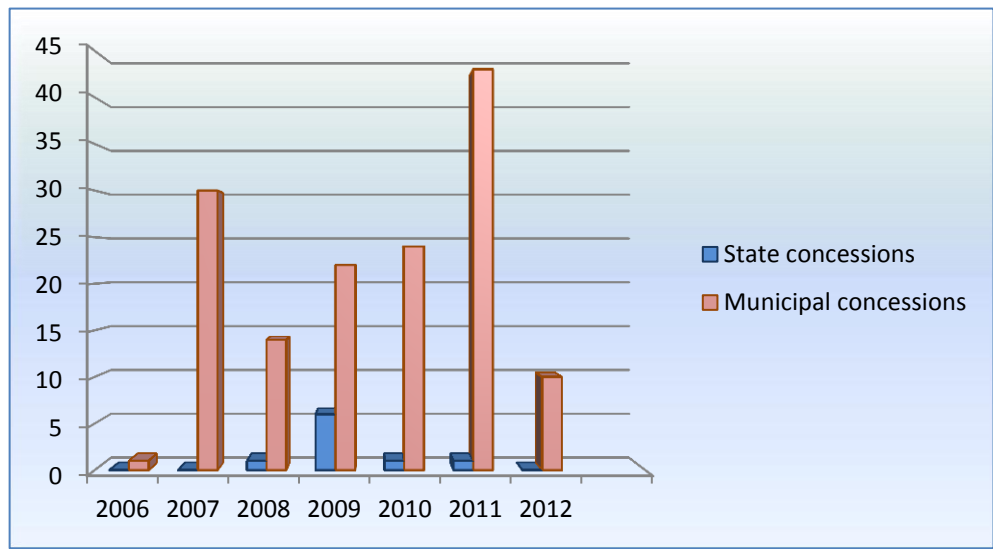
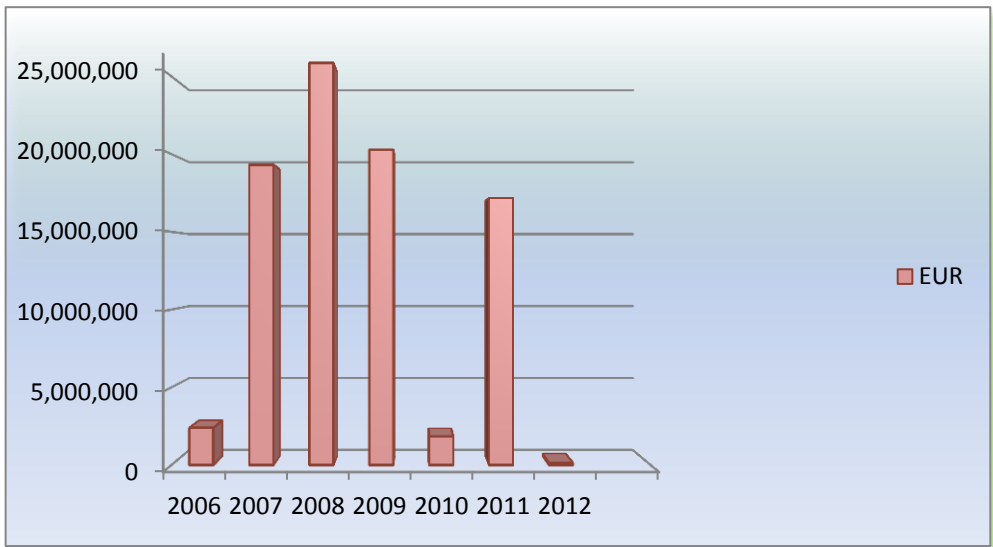


Chart 3: Total value of awarded concession contracts for the period 2006-12



The most significant PPP projects have been awarded in the areas of airport and port infrastructure, as well as water and wastewater infrastructure and services, while construction of urban technical and social infrastructure (and provision of related services) is most often awarded through public procurement. The most commonly applied form of concession remains the concession for extraction of mineral water and underground natural resources.

(ii) Technical infrastructure

(a) Roads

Currently, it is the common practice in Bulgaria that the construction and maintenance of roads is usually realised by public procurement. There have been no successful concessions in the field of road infrastructure. The only project having ended with a granting of a concession over the Trakiya motorway to the Bulgarian-Portuguese consortium Magistrala Trakiya AD, failed as the concession agreement was terminated by the Bulgarian government on 22 May 2008. It must be noted that it is the general practice of Bulgarian authorities to implement road infrastructure projects using European Union (EU) funding; therefore concessions are generally not applicable for this type of project.

(b) Railway transport

The management and operation of railway transport infrastructure is conducted by the National Railway Infrastructure Company. The carrying out of the transport itself is entrusted to the public company Bulgarski Durzhavni Zheleznitsi EAD, which presently holds a monopolistic position in the railway transport sector. At the same time, the law explicitly provides for the option of the award of railway infrastructure facilities on concession; therefore this option is available subject to future initiatives.

(c) Ports

Port infrastructure at public transport ports of national significance is public state property and may be awarded for exploitation only by means of a concession, as a concession may be granted for one or more terminals of the port. Ports of regional significance which may be property of the state, the municipalities or other natural or legal persons, may also be subject to other forms of exploitation.

Presently, there are several ongoing concessions of port terminals. They are the state concession over the Port terminal Lesport, part of the Varna public transport port of national significance, awarded to BM PORT AD for a period of 30 years as from 8 June 2005; the concession on Baltchik Port terminal, awarded to Port – Baltchik AD for a period of 25 years from 14 February 2005; concession over the Silistra Ferryboat terminal – part of which will be

constructed with funds provided by the concessionaire; the concession being awarded to Dunavski Industrialen Park AD for a period of 35 years as from 3 February 2006; as well as the concession over the cargo terminal of the Bourgas port, awarded to Balgarski morski flot for 35 years in 2011. This most recent concession agreement stipulates over €100 million investment undertaking for the concessionaire, half of which shall be disbursed during the first seven years of the project.

(d) Airports

The applicable legislation provides that civil airports may be public or private property regardless of their category (airport for public use, for flight handling, for paid aviation services or technological airports). Civil airports – public state property – are run by airport operators – merchants, having been awarded a concession under the Concessions Act, or by a sole trade company where the state is the sole proprietor of the capital. The Bourgas and Varna airports were awarded on concession in 2006 and are currently being operated by private operators. Further, there have been several unsuccessful initiatives for the award of concession over smaller civil airports such as Rousse, Gorna Oryahovitsa and Plovdiv.

(e) Water supply and sewerage systems

Bulgaria's concession experience in the area of water supply and sewerage is very specific. A concession was awarded in 1999 over the water supply and sewerage system of the city of Sofia. The Concession agreement was concluded for 25 years and envisaged investments of about US\$ 150 million. Unlike the general practice, no concession payment was provided for on behalf of the private operator.

The only other concession agreement was concluded in 2004 in the Municipality of Panaguyurishte for 35 years.

(f) Other types of urban infrastructure

Street lighting, parking lots and garages, waste treatment, urban transport are awarded by municipal authorities through public procurement procedures.

(iii) Social infrastructure

Likewise, most types of social infrastructure and services, including education, health care, cultural facilities (museums, galleries and so on), are awarded through public procurement.

The only type of social infrastructure where PPP (concession) is commonly implemented is the sports facilities, that is, sports halls, stadiums and so on.

V: Lessons learned and future initiatives

The experience of Bulgaria so far in the field of PPP has shown that the primary obstacle hindering the

implementation of significant, large-scale infrastructure projects, has been the lack of political will and the reluctance of the authorities to accept the concept of risk sharing between the public and the private partner, which is one of the primary features inherent in PPP.

Hopefully, this understanding has now been overcome and the new amendments in the Bulgarian PPP regulatory framework will create a more favourable environment and will provide the sufficient legal prerequisites for the successful implementation of large-scale projects, such as the upcoming concession of the Sofia Airport.

This project is aimed at drawing significant private investments for the modernisation and renovation of the facility in order to develop its infrastructure and make it competitive with neighbouring international airports and would thus be the most notable concession project in Bulgarian history both in terms of scale and national importance.

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¹ Before entry into force of the new PPP Act.

² The Concessions Act introduces a third type of concession, that is, the mining concession, but it concerns extraction of mineral water and underground resources and is regulated in specific laws.

³ The issue is clarified in the contemplated amendments of the Concessions Act to be introduced with the Transitional and Final provisions of the new PPP Act – see section III below.

⁴ The phrase “when such price is determined by an act of legislation” shall likely be revoked with the new PPP Act.

⁵ Directive 17 and 18.

⁶ An interesting note in this regard is that regardless of the lack of a specific PPP Act, many municipalities have established their own Municipal Ordinances on PPP and have established their own practice at a municipal level.

⁷ The statistics are available at the official web site of the Bulgarian Concession Registrar at:
www.nkr.government.bg/app

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The EBRD Legal Transition Programme

The EBRD is investing in changing people's lives from central Europe to central Asia and the southern and eastern Mediterranean. Working together with the private sector, we invest in projects, engage in policy dialogue and provide technical advice that fosters innovation and builds sustainable and open market economies.

The EBRD's recipient countries are: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Estonia, FYR Macedonia, Georgia, Hungary, Kazakhstan, Kyrgyz Republic, Latvia, Lithuania, Moldova, Mongolia, Montenegro, Poland, Romania, Russia, Serbia, Slovak Republic, Slovenia, Tajikistan, Turkey, Turkmenistan, Ukraine and Uzbekistan.

The EBRD works through the Legal Transition Programme, which is administered by the Office of the General Counsel, to improve the legal environment of the countries in which the Bank operates. The purpose of the Legal Transition Programme is to foster interest in, and help to define, legal reform throughout the region. The EBRD supports this goal by providing or mobilising technical assistance for specific legal assistance projects which are requested or supported by governments of the region. Legal reform activities focus on the development of the legal rules, institutions and culture on which a vibrant market-oriented economy depends.

Information about the EBRD's Legal Transition Programme can be found at

www.ebrd.com/law

www.ebrd.com/lawintransition