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Key Issues on Creating Legal Framework for Infrastructure Concessions

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This paper has been prepared for the Congress “Modern Law for Global Commerce” to celebrate the 40th anniversary of UNCITRAL, Vienna 9 – 12 July 2007. It is based on the results of various evaluations that the EBRD has conducted in the past few years and complements the slide presentation by the author at the Congress and addresses with the following points:

- Core elements of effective PPP framework
- To what extent legal and policy environment facilitate PPP in some European emerging markets: EBRD evaluations and surveys
- Legislative trends in the EBRD countries of operations and challenges they face

Further information is available at www.ebrd.com/law/concess.

FOREWORD

Amongst the numerous ways in which the private sector may invest in public infrastructure arguably, the most interesting and sophisticated arrangements lie in the area somewhere between procurement and privatisation. Such options are generally considered to be more effective than those at the extremes of the spectrum.

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

The EBRD Legal Transition Programme focuses on a particular category of PPPs - concession type and Build Operate Transfer (BOT)/Design Build Finance Operate (DBFO) type arrangements - and does not address privatisation or procurement contracts. The selected category is regarded as the most complex since it involves more sophisticated legal and financial arrangements as well as risk sharing. The legal environment for concessions is vital to the implementation of many types of public-private partnerships (PPPs). For a number of years, the EBRD has been evaluating both the quality of national concessions laws and their workability throughout its countries of operations. Recent evaluations were devoted to concessions legislation and practices.

RESULTS OF THE EBRD 2004/5 CONCESSION LAWS ASSESSMENT

In 2004-05, the EBRD undertook an assessment of concessions laws (the 2005 Assessment) in transition countries. This involved a detailed analysis of concessions laws in selected core areas: (i) the general policy framework; (ii) the general concession legal framework; (iii) definitions and scope of the concessions law; (iv) selection of the concessionaire (the entity to which a concession has been awarded);

(v) the project agreement; (vi) availability of security instruments and state support; and (vii) settlement of disputes and applicable law.

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

In the course of developing the rating methodology it was thought appropriate to develop a separate list of questions for countries where rules governing concessions are contained in various contract laws and/or sector-specific legislation. Rules in these countries were benchmarked against internationally accepted principles only. Using the answers provided by lawyers in the transition countries, the relevant laws were assigned a rating of their compliance with internationally accepted standards (or principles, as applicable), ranging from very high to very low. As illustrated by the Figure below, only one country, Lithuania achieved a “very high” rating. Three countries were rated “very low”, while the majority achieved the “medium” category. This illustrates the need for reform of concessions legislation in virtually every transition country.

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

Compliance with internationally accepted standards or principles				
Very high compliance/ Fully conforms	High compliance/ Largely conforms	Medium compliance/ Generally conforms	Low compliance/ Partly conforms	Very low compliance/ Does not conform
Lithuania	Bulgaria Czech Republic Slovenia	Bosnia and Herzegovina FYR Macedonia Moldova Romania Russia Serbia and Montenegro Slovak Republic Ukraine Armenia Azerbaijan Estonia Kazakhstan	Albania Croatia Hungary Kyrgyz Republic Latvia Poland Turkmenistan Uzbekistan	Belarus Georgia Tajikistan

Source: EBRD Assessment of Concessions Laws 2005.
 Note: Countries in blue did not have a law on general concessions when the assessment was undertaken in 2005. For these countries, the assessment rated the level of conformity of other relevant laws – such as contract law or sector-specific legislation – With internationally accepted principles.

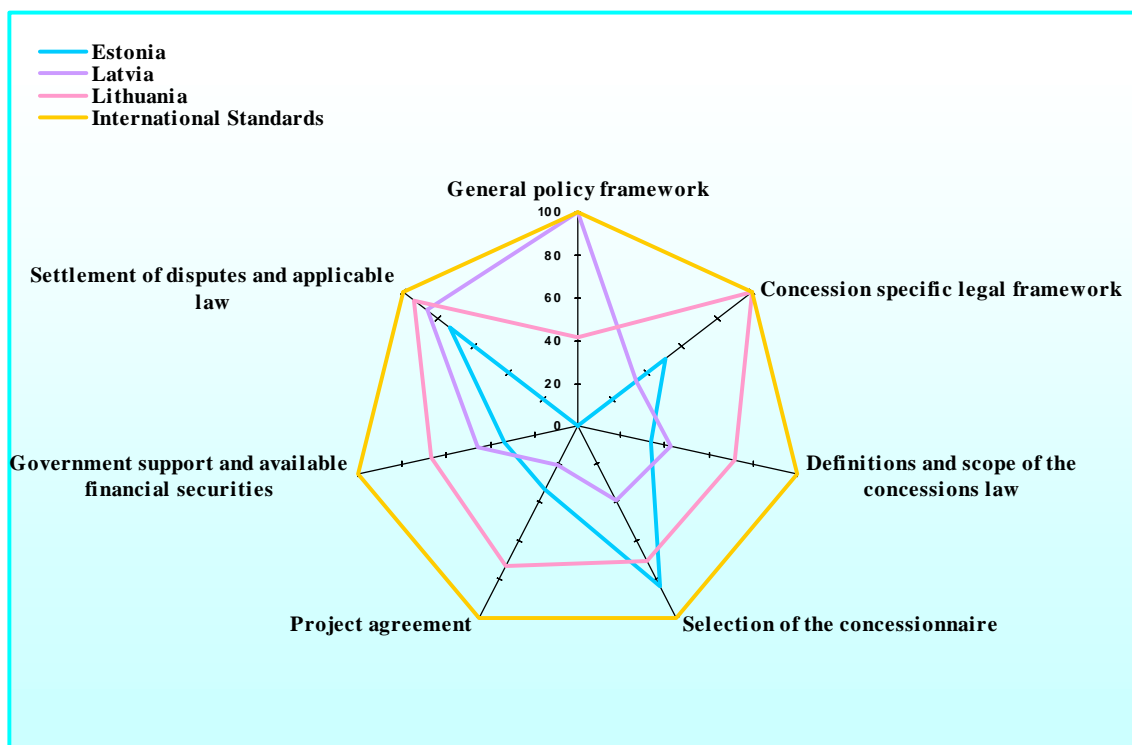
Policy framework plays an essential role in a PPP enabling regime. A clear, well-spelled policy, habitually, will be found in the form of a governmental resolution or endorsement. It will typically state the Government’s vision of PPP development in the country, its objectives, the principle that it will promote, including the legal and regulatory regime, institutional framework and possibly training policy and educational campaign. In setting out the institutional framework, a policy paper will be expected to proclaim the delineation of policy formulation from regulatory responsibilities and operational functions.

In many transition countries a general policy framework for PPPs has not been identified. The results of the evaluation revealed that the existence of such a framework is not necessarily linked to a good quality law. For example Latvia scored strongly for policy framework, but did poorly in the overall assessment. Conversely, Lithuania does not have an extensive general policy framework, but its concessions law is very close to best international standards (see Chart 1).

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

Estonian laws are reasonably strong in terms of the selection of a concessionaire and dispute resolution, but rather weak in all other core areas. Estonia, generally, represent a rare case of a country where concessions are regulated by a combination of sector laws and general laws; Estonian authorities do not envisage the wide use of PPPs.

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



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

Source: EBRD Concessions Sector Assessment 2005.

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

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

Croatia, Hungary, Latvia and Poland, contrary to general perceptions regarding the relatively good quality of their investment climate and private sector development legislation, were rated as having a low level of compliance. However, in most of those countries there has been progress in the reform of concessions legal and/or policy frameworks since the completion of the 2005 Assessment and the EBRD team works

in Hungary on a number of elements aiming to improve further its PPP allowing regime. A number of other countries in the region have undertaken similar efforts, upgrading elements of their respective framework, be it policy, institutional or legal/regulatory one.

RESULTS OF THE EBRD'S 2006 LEGAL INDICATOR SURVEY

The EBRD's 2006 Legal Indicator Survey (2006 LIS) measured the effectiveness of concessions laws in the transition countries and complements the 2005 Assessment. The 2006 LIS is based on a case study and assesses how a country's legal and institutional framework for concessions works in practice. Lawyers in each country were presented with a typical scenario for the award and implementation of a concession and were asked a series of questions about how the legal and institutional framework in their country would operate in such a situation (for a full case study and detail results of the survey see www.ebrd.com/law). Scores for effectiveness were based on four core dimensions of the concessions legal and institutional framework:

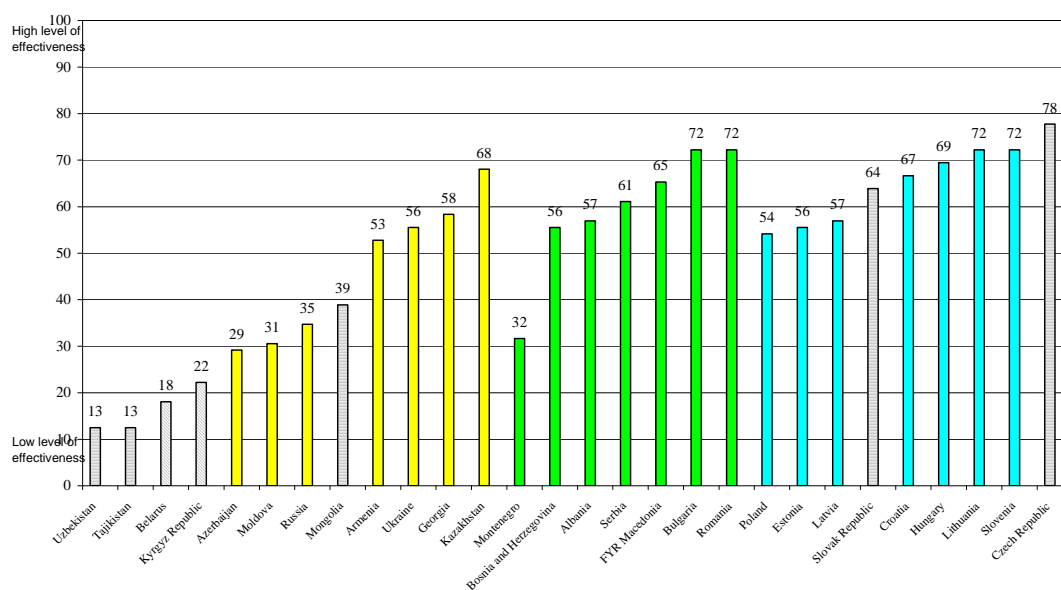
- *Presence/potential* – whether concessions have been implemented successfully and/or whether there is a potential for such implementation;
- *Process* – whether there is a fair and transparent selection process, measured by the possibility of challenging a concession award effectively;
- *Implementation*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

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

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

For countries that had only implemented one concession project or none at all by July 2006 (Belarus, the Czech Republic, the Kyrgyz Republic, Mongolia, the Slovak Republic, Tajikistan and Uzbekistan) the *potential* for an effective regime and any recent developments towards establishing one were assessed. The Czech Republic was rated as potentially highly effective as its survey was based on a hypothetical implementation rather than any actual experience of concessions. In this country, even though many public services are carried out by private entities, such exercises are not based on concessions, but rather on licenses. After the creation of a PPP Centrum in 2004, a new concessions law was adopted in the Czech Republic in 2006 and several concession-based pilot projects have been launched by various ministries, including for prisons, hospitals and motorways. The Czech Republic scored highly due to the following: concessions in discussion currently benefit from strong political support; concession awards can be challenged before the contracting authority, the office for the protection of competition, as well as before administrative courts; public authorities generally adhere to the agreements to which they are party; and arbitration is widely recognised and generally not obstructed.

Chart 2: Effectiveness of concessions laws in transition countries



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

Source: EBRD Legal Indicator Survey 2006

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

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

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

CONCLUSION

Overall, the 2005 Assessment of the quality of concessions legislation and the 2006 LIS on how these laws work in practice have produced generally corresponding results in that most countries with a sound legal framework for concessions have effective mechanisms in place for enforcing the law although with some exceptions.

There are, however, some countries, where concessions legal frameworks generally conform to relevant international standards, but policy, institutional framework and the general rule of law climate do not permit projects to be implemented effectively. The reasons for that include the inefficient court system and poorly trained public officials, negative attitude towards international arbitration, etc. In some countries in spite of significant restrictions in the concessions legal framework, projects can still be implemented fairly successfully (e.g. in Hungary and Croatia). The explanation for this is the existence of several good precedents and a generally efficient institutional framework, which is essential for day-to-day implementation and enforcement.

Generally, the concessions legal environment in transition countries has much scope for improvement. Ideally, any reform aiming to enhance PPP opportunities should start with a well contemplated policy. This will be then complemented by further legal and institutional efforts to allow PPPs to work effectively. The majority of countries still need to implement further legal and institutional reforms if they wish to allow complex PPPs to work effectively.