

## **EBRD Assessment of Concession Laws throughout countries of Central and Eastern Europe and the former Soviet Union**

### *Introduction*

Public Private Partnerships ("PPPs") are a powerful tool for non-budgetary financing of infrastructure and municipal development. They provide a variety of options for authorities to attract large-scale investment to meet public needs in infrastructure development and operations, municipal projects, education, health and other public services. Since the early 1990s, there has been a large increase both in the volume of finance arranged by way of PPPs and the number of projects being developed on the basis of PPPs throughout the world.

The European Bank for Reconstruction and Development (the "**EBRD**") promotes PPPs as powerful arrangements for attracting private sector participation in public projects and as a source of alternative finance. As part of its activities under the Legal Transition Programme, the EBRD has been conducting its Sector Law Assessment Project<sup>1</sup> since mid-nineties. Concession law or legislation enabling PPPs however, has not until recently been a subject of such an assessment. In view of a significant increase in PPP volume and the importance that PPPs play in the development of local economies, the EBRD concluded it was necessary to perform a comparative assessment of how legislatures of different countries are equipped to implement these partnerships. The EBRD Assessment of Concession Laws<sup>2</sup>, while providing a platform for reflection on PPP international standards, demonstrated that there is still progress to be made in the concession legal environment in the countries of Central and Eastern Europe and former Soviet Union.

### *EBRD Sector Law Assessment*

The EBRD Assessment of Concession Laws is part of the EBRD's efforts to improve the legal environment in its countries of operations. Through such projects, the EBRD aims to encourage, influence and provide guidance to policy and law makers, while developing the concessions related legal reform in the region.

The legal sector assessments benchmark the development of key commercial or financial laws in the EBRD's 27 countries of operation against international standards (discussed in more detail further on in this article) and provide an analysis of the existing legislative framework. The assessments are based on a questionnaire put together by EBRD specialists with further comments from external consultants and then further commented and filled out in respect of each of the EBRD's 27 countries of operations by external consultants.

Assessing country law in the region is a colossal undertaking that requires substantial resources, both in terms of human and financial resources. Why does the EBRD engage in this huge effort? The rationale is four-fold:

- Firstly, the EBRD can make use of its knowledge of local law in formulating its own investment decisions by providing an invaluable tool to assist EBRD bankers and lawyers in understanding better the legal environment;
- Secondly, by publishing country ratings and related information, the Bank can encourage other investors to venture into this part of the world by providing them with the information necessary to make informed decisions;
- Thirdly, it provides a snapshot of current trends in PPP/Concession laws development in the EBRD's countries of operations;

---

<sup>1</sup> [www.ebrd.com/country/sector/law](http://www.ebrd.com/country/sector/law)

<sup>2</sup> <http://www.ebrd.com/country/sector/law/concess/assess/main.htm>

- Fourthly, and most importantly, legal transition assessments can be a formidable tool for policy dialogue with local governments. In other words, the publication of studies on legal systems is likely to encourage national governments to address the issues highlighted in the assessments and take appropriate steps.

The EBRD Assessment of Concession Laws is the fifth assessment of this type led by the EBRD. Previous assessments examined secured transactions, corporate governance, bankruptcy and securities markets legal environment in the EBRD region. These assessment projects concern legal areas that the EBRD considers essential to the investment climate and private sector development. The aim is to compare the legislation applicable in the above-mentioned areas to international standards and, in so doing, identify the reforms needed. The projects emphasise written legislation or law on the books ("extensiveness"), whereas its application ("effectiveness") is measured by the use of other tools.

The EBRD concessions specialist has designed the project and developed a draft checklist on the basis of which laws in the EBRD's 27 countries of operations were to be assessed.

Gide Loyrette Nouel<sup>3</sup> ("GLN"), as international legal consultants engaged for the project, was required to: assist the EBRD in finalising the EBRD concession checklist, develop a database of relevant concession laws, undertake initial assessments of each law, develop jointly with the EBRD a methodology for rating concession laws and arrange for verification of the initial assessments by experts from each of the 27 countries. During the summer of 2005 the consultants undertook an update of the EBRD Assessment of Concession Laws.

#### *Challenges / Dilemmas*

An effective PPP regime does not only depend on a modern legal framework. It should also comprise a combination of a clear policy framework, an adequate institutional infrastructure and a well spelled out promotion policy, including measures to raise public awareness and specialist training. However, legal environment is the cornerstone of a well functioning PPP enabling system and a major role in this system is played by the rules and procedures as they appear on the books. This understanding has led the EBRD and GLN to define a set of 10 core principles for a modern concession law (the "MCL"). By virtue of being "core" principles, these cannot be exhaustive but, rather, are intended to form the foundation of an MCL.<sup>4</sup>

The focus of the assessment was narrowed down from all forms of PPP to concession-type and BOT/DBFO-type arrangements, not addressing privatisation as an outright assets sale, or procurement law contracts. This spectrum of PPP is regarded as the most complex since it involves risk responsibility, risk sharing and financing. In contrast, some other forms of PPP are relatively straightforward. In addition, various international standard setting institutions in the area of PPP/PFI have recently developed a number of guidelines by that focus mainly on these types of arrangements.

The EBRD Assessment of Concession Laws aimed to cover just laws on the books as opposed to how they work in practice. It did not generally look into details of institutional elements of the legal infrastructure. This will be the subject of a forthcoming project that the EBRD plans to undertake in 2007 focusing on how (and whether) the laws work in practice and on their effectiveness.

---

<sup>3</sup> The project team comprised: Alexei Zverev, EBRD Senior Counsel and Operation Leader; GLN team: Bruno de Cazalet, John D. Crothers, Milica Zatezalo.

<sup>4</sup> <http://www.ebrd.com/country/sector/law/concess/core/main.htm>

In the course of implementing the project, a number of challenges emerged.

- Deciding what should and should not be included in a concession law and the creation of a questionnaire/checklist enabling at the same time to assess whether the law is over-prescriptive or whether it contains problematic omissions required thorough analysis of the relevant international standards and numerous concession laws. For example, the existence of a "model concession agreement" or model provisions is not in itself considered a positive element but this may be the case where use of such models is not compulsory. More generally, the selection of core areas<sup>5</sup> and the drafting of questions were accomplished on the basis of international standards developed in the concession field (notably the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects adopted in 2000<sup>6</sup>) and experience in implementing private sector participation projects in EBRD countries of operations.
- The elaboration of the rating methodology revealed other dilemmas. For example, should there be a weighting of questions and/or core areas and how should countries that do not have a general concession law be assessed (8 in 2004, 7 in 2005)?

Regarding the first question, it was decided neither to weight the questions nor to weight the core areas (i.e. each question and core area being assigned equal importance). In fact, the evaluation of the importance of a particular question/core area is a "subjective" task, depending in particular on the party involved (for example, a lender to a PPP project would probably not accord the same weight to a question related to "step-in" rights as would a public entity representative). However, given that a negative answer to certain questions could be considered as a "deal breaker", the overall appreciation of the law refers to the existence of such difficulty.

Regarding the second dilemma, several options were considered. The first option was to exclude countries without a general concession law from the concession assessment process, given that, strictly speaking, the basis for the assessment was missing. The second option was to base the evaluation solely on the answers to the questions of the first two core areas, as these questions did not directly concern the general concession law. The third option was to create a revised concession checklist, for the purposes of assessing these countries. The last option was selected, as being the best-suited for the purposes of the Project (i.e. identifying the reforms needed).

Thus, it was decided to use a separate checklist of questions for those countries that do not have a specialist single-act concession law where rules governing concessions are contained in contract laws and/or sector specific legislation. Rules in these countries were benchmarked against internationally accepted principles only and the checklist for them is not as detailed as the one designed for those countries having a specialist single-act concession law.

---

<sup>5</sup> (i) general policy framework, (ii) general concession legal framework, (iii) definitions and scope of the concession law, (vi) selection of the concessionaire, (v) project agreement, (vi) security and support issues and (vii) settlement of disputes and applicable law.

<sup>6</sup> Other international standards used:

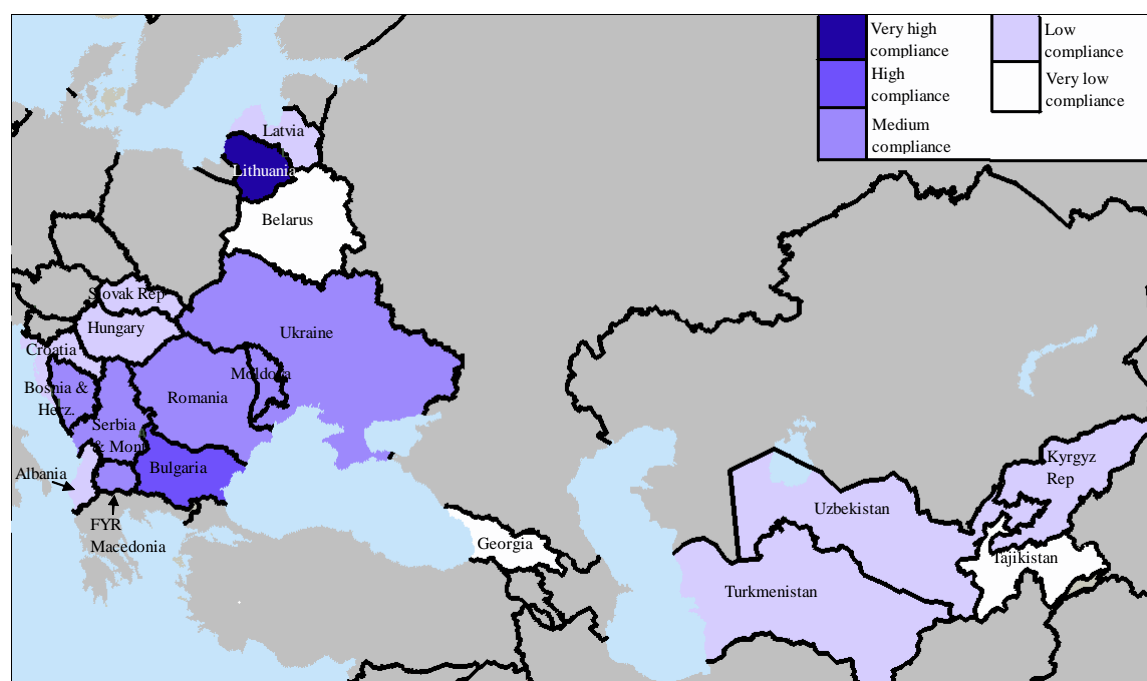
UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects, 2003; Commission Interpretative Communication on Concessions Under Community Law, 2000; UNIDO BOT Guidelines, 1996; European Commission Guidelines for Successful Public-Private Partnerships, 2003; and OECD Basic Elements of a Law on Concession Agreements, 1999-2000

### Assessment Results

The main part of the Project was conducted in the second half of 2004 and the annual update was finalised in July 2005.

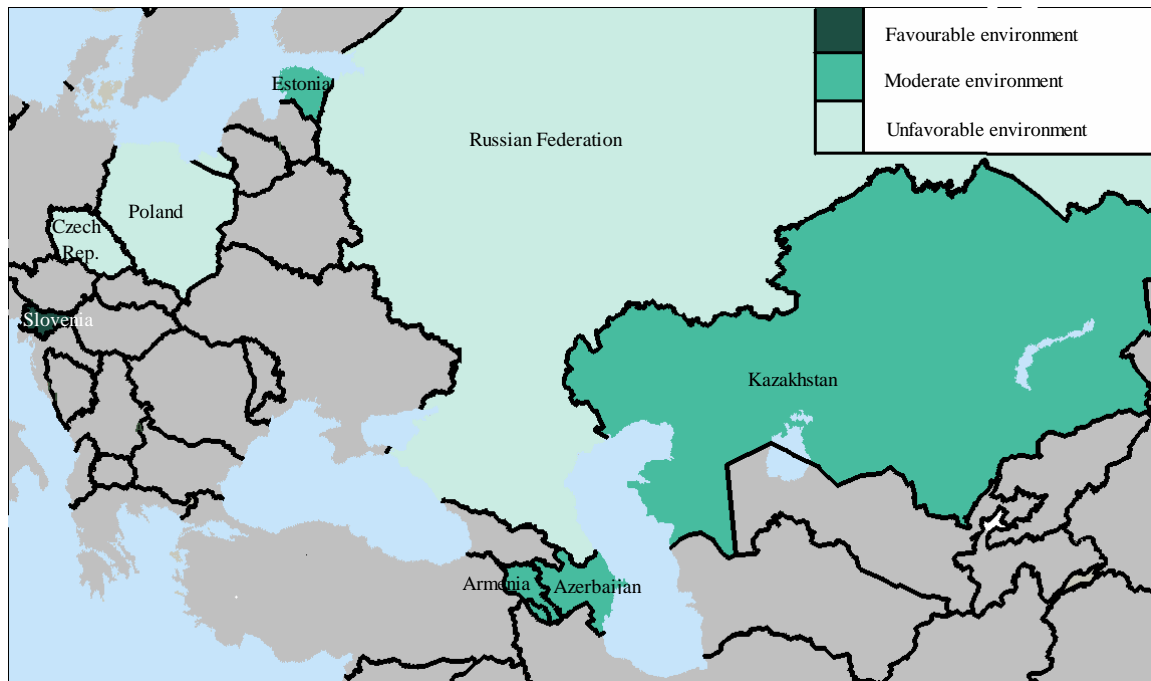
The Project comprises a detailed analysis of the concession laws benchmarked against selected core areas: (i) general policy framework, (ii) general concession legal framework, (iii) definitions and scope of the concession law, (iv) selection of the concessionaire, (v) project agreement, (vi) security and support issues and (vii) settlement of disputes and applicable law. Below are two charts representing the state of concession legislation in countries with the special concession act and in countries without such an act where concession granting rules and procedures are governed based on general contract laws and/or sector laws.

### Quality of Concessions Legislation in the EBRD Countries of Operations with a Specific Law(s) on Concessions (2004)



*Note: The various categories represent the level of compliance of a given country's legislation (the laws on the books) with international standards.*

### Quality of Concessions Legislation in the EBRD Countries of Operations without a Specific Law(s) on Concessions (2004)

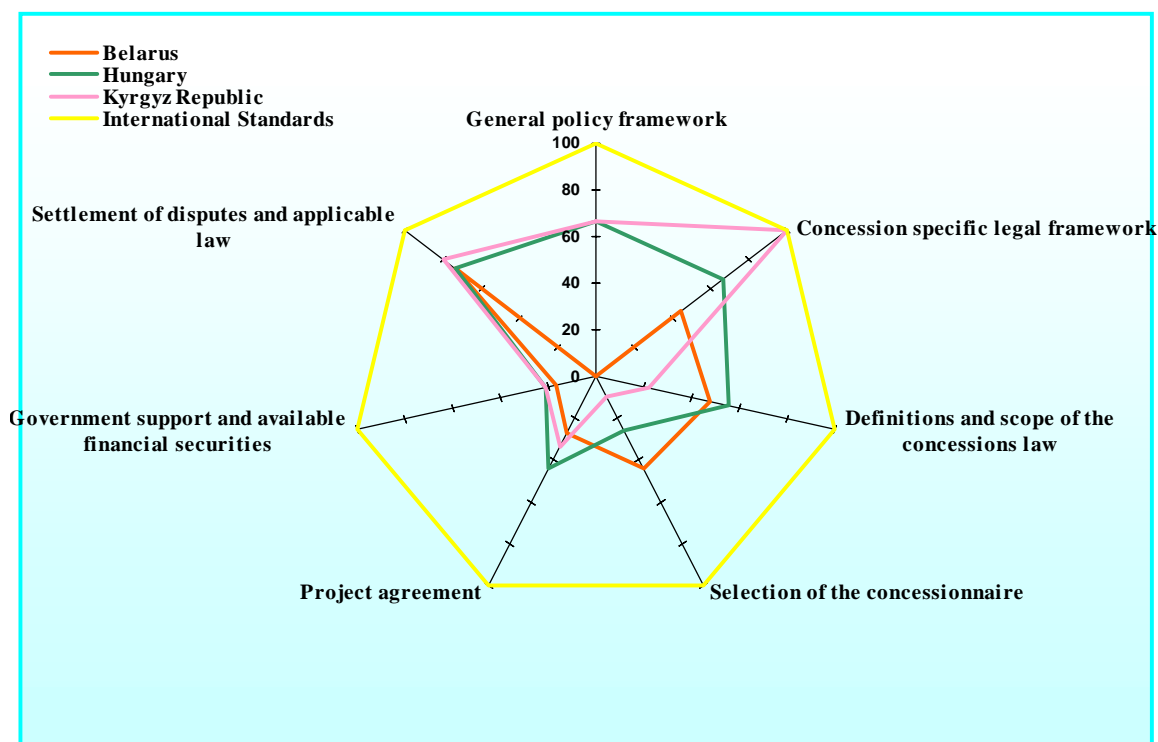


*Note:* The various categories represent the level of compliance of a given country's legislation (the laws on the books) with international standards.

As can be seen from the above charts, only one country, Lithuania, was rated "very high compliance with internationally accepted standards". A few countries were rated very low, while the majority fell into the middle category (medium compliance/moderate environment), illustrating the need for reform of concession legislation in virtually every EBRD country of operations.

While the overall score represents an aggregate result, spider graphs such as the one below, showing results for the Kyrgyz Republic, Belarus and Hungary, clearly illustrate the differences in law development per core area.

## Quality of Concessions Legislation in Belarus, Hungary and Kyrgyz Republic (2004)



*Note:* the extremity of each axis in yellow 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 concessions laws of the country approximate these standards.

As one can see from the charts some results per core area do not coincide with the general perception of a country's laws or with the overall score. This is particularly true of an area such as Policy framework.

### *Why is Policy framework important?*

Clear policies together with a modern, fair, transparent and predictable legal framework underpin successful implementation of PPPs. While the legal and regulatory framework in a particular country largely depends on its legal traditions, PPP policy is more a translation of political will and commitment, coupled with the experience available to draw upon. Well conceived policy therefore, is **as** important for successful PPPs **as** well drafted legislation.

In the course of the project we noted very interesting patterns and contradictions and made some intriguing findings too. For example, a particular country's laws may be well developed as far as one or two core areas are concerned and virtually silent on other extremely important issues. Another observation: The existence of a clear policy framework is not necessarily linked to the quality of the law. Lithuania was rated best overall and for special concession legal framework but was rated as having "low compliance for Policy Framework.

Latvia and the Czech Republic are both at the very top of the table for policy framework. However, for both overall scoring and for legal framework are at the bottom of the table.

Settlement of Disputes and Applicable Law was the Core Area with the best compliance rate with one country having a "very high compliance" rating and 22 rated as "high compliance"/"Largely conforms". The Security and Support Issues Core Area obtained the worst compliance rating [followed by General Policy Framework]. This set of questions

addresses the availability of reliable security instruments on the assets and cash flow of the concessionaire in favour of lenders, including "step-in" rights and the possibility of government financial support or the guarantee by the contracting authority of proper fulfilment of its obligations. In these two Core Areas 12 and 11, countries were rated as "very low compliance"/"Does not conform" respectively.

The assessment results reveal that the average compliance in 2005 falls into the medium compliance category. In 2004 the average compliance was low compliance. Changes in the Slovak concession legal environment and the adoption of the Russian concession law have contributed to this improvement. If we look at the core areas, "security and support issues" Core Area obtained the worst compliance rating, followed by "general policy framework". "Settlement of disputes and applicable law" was the Core Area with the best compliance rate. The relatively good score in this core area comes from the ratification by numerous countries of the relevant international treaties (on arbitration and protection of foreign investments).

In many of the countries assessed, a general policy framework for PPPs has not been identified. Moreover, the existence of such a framework is not necessarily linked to the quality of the law. Very few countries have clear elements permitting the identification of a piece of legislation regulating the granting of concessions in a particular sector, infrastructure or service. Certain laws do not define the word "concession", and most laws contain unsatisfactory definitions (such as for example, "the right to use"). Even though the majority of laws refer to competitive procedures for the selection of the concessionaire and include provisions in this respect, very few contain sufficient guidance for the selection procedures (e.g. Lithuania). The majority of laws contain provisions on the project agreement but only a few countries have a model project agreement, like that of Ukraine. However, the provisions regarding the terms of the project agreement are often prescribed too narrowly, giving rise both to inflexibility and to uncertainty as to what can be included. The "Securities and support issues" Core Area is generally either entirely omitted, or contains inflexible elements. There are a few exceptions (Lithuanian and Albanian Law), which contain specific reference to a concessionaire's power to create securities and to obtain government support.

#### *Some conclusions*

The main conclusion of the assessment results is that the concession legal environment in the EBRD countries of operations has much room for improvement. Most countries still need to contemplate and implement further law reform to modernise their legal framework if they wish to enable PPPs.

As a complement to the Project, the EBRD and GLN organised a half-day workshop in April 2005 in Paris, exploring concession financing and PPPs in central and Eastern Europe and the CIS. This workshop was a unique opportunity to gather together key players in the field of PPPs and those wishing to gain first hand experience by discussing their ideas and understanding of PPPs basics with leading experts.

Such workshops, together with the recent European Commission initiatives in the area of PPPs (publication of the *Green Paper on Public-Private Partnerships and Community Law on Public Contracts and Concessions* and the Report on its results), by developing international legal standards in the PPP area and analysing precedents will certainly help transition countries to improve their concession legal environment.