

**EUROPEAN BANK  
FOR RECONSTRUCTION AND DEVELOPMENT**

**2006 CONCESSION LIS  
FINAL REPORT  
DECEMBER 2006**



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## **INTRODUCTION**

Gide Loyrette Nouel ("GLN")<sup>1</sup> has been selected by the European Bank for Reconstruction and Development ("EBRD")<sup>2</sup> to assist it in the implementation of the 2006 Legal Indicator Survey on concessions (the "2006 LIS" or the "Project").

The 2006 LIS measures the effectiveness of concession laws in the transition countries. Lawyers in each country were presented with a case study 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.

The Project is the fourth mission of this type led by EBRD after secured transactions, corporate governance and bankruptcy.

This report is structured as follows: after a brief presentation of the scope of the Project (Section 1), the case study will be analysed (Section 2) and the rating methodology presented (Section 3). The survey process will then be presented as well as the "limits" of the final results (Section 4). Such results will then be analysed and compared with results from the 2005 Concession Assessment Project (the "2005 CAS") (Section 5).

### **1. SCOPE OF THE PROJECT**

GLN, as international legal consultant engaged for the Project, was required to:

- Assist the EBRD in finalising the case study: ✓ ✓ ✓
- Develop the 2006 LIS methodology: ✓ ✓ ✓
- Review the initial survey by experts from each of the twenty-eight countries: ✓ ✓ ✓
- Present the results of the 2006 LIS: ✓ ✓ ✓

### **2. CASE STUDY**

#### **2.1 General**

The main objective of 2006 LIS is to measure "*laws in action*" i.e. the extent to which a particular legal regime provides an efficient result in a given practical situation.

With this objective in mind, we have designed a Preliminary Questionnaire and Case Study.

More particularly, our aim was to create an instrument that would assess in the best possible way how a particular concession legal and institutional framework functions in practice.

Following the approach taken in previous EBRD LIS, a case study method was again suggested. Such case study was preceded by a "preliminary questionnaire" and terminology section. The rationale for such recommendations is provided in sections 2.2 and 2.3 below.

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## 2.2 Terminology

A short section containing an explanation of the terminology used in the preliminary questionnaire and case study was included in an effort to keep answers consistent and avoid ambiguity (see **Box 1**). The goal was not to define the selected terms *per se*.

### **Box 1.**

**Concession/PPP:** act attributable to the State whereby a Contracting Authority entrusts to a third party the total or partial management of services for which that authority would normally be responsible and for which the third party assumes all or part of the risk. Concession/PPP include all forms of cooperation between public authorities and a world of business which aim to ensure the funding, construction, renovation, management or maintenance of an infrastructure or the provision of a service, except the sale of assets/privatisation.

**Concession Law:** law regulating Concessions.

**Concessionaire:** entity to which a Concession has been awarded.

**Contracting Authority:** public authority empowered to award concessions and enter into Project Agreements.

**Financial Close:** the date when the Concession Agreement and other agreements related to the Concession implementation became unconditional and all conditions precedent to disbursement contained in the financing agreement are satisfied or waived.

**Project Agreement:** agreement between Concessionaire and Contracting Authority regulating Concession rights and obligations.

**Year N:** The year when your client first engages you. **Year N+3:** three years later.

## 2.3 Preliminary questionnaire

The reason for having a "preliminary questionnaire" is threefold:

- provide an *objective* general overview on concessions in a particular country covering three main aspects: (i) existence/obstacles: questions 1 and 3, (ii) procedural aspects: question 2 (a) to (c), and (iii) contractual aspects: question 2 (d) to (g);
- understand the reason why concessions are absent in certain countries (question 3 (b)) and any recent developments (question 3 (a)); and
- provide a useful background for the case study. In this respect, practitioners were asked to provide examples and describe any reservations, obstacles and recent experience related to questions that are raised. This makes the reader better understand answers to a number of *subjective-perception* questions in the Case Study.

The questions asked in the preliminary questionnaire are presented in the **Box 2**.

### **Box 2**

1. Have Concessions ever been awarded in your country (successfully)?
2. If the answer to 1 is yes:

### **Concession Award**

- (a) have such Concessions been awarded on the basis of a Concession Law?
- (b) have such Concessions been awarded following a transparent competitive selection procedure<sup>3</sup>? If the answer is yes, please explain how such transparency has been achieved (on the basis of a Concession Law, following the requirements of an international financial institution, other)? If you have reservations in answering 'yes' to this question, please specify what these are.
- (c) was there a possibility to challenge the Concession Award? If the answer is yes, how many challenges have there been to your knowledge and how many of them were successful?

### **Project Agreement**

- (d) has a Project Agreement ever been signed / reached Financial Close? How long was the period from the project launch until Financial Close and what were the approximate development costs related thereto?
- (e) have Project Agreements been carried by the parties without serious claims by the Concessionaire or Contracting Authority either (i) Concessionaire bringing a claim against the Contracting Authority concerning the performance of the Concession Agreement or (ii) Contracting Authority bringing a claim against the Concessionaire concerning the performance of the Concession Agreement)? Have such claims been successful?
- (f) if a Project Agreement has been terminated prior to the end of the contractual period by the Contracting Authority, has fair compensation been proposed to the Concessionaire? How many terminations have there been to your knowledge?

*For information:*

*in what sectors have Concessions been awarded?*

*have such Concessions been granted by (i) central, (ii) sub-sovereign/regional (if applicable) or (iii) municipal government as Contracting Authority?*

*when did Concessions begin to be awarded in your country: (i) in the last 10 years or before, (ii) in the last 5 years or (iii) within the past few years only?*

3 If the answer to 1 is no:

- (a) is there a Concession/Project Agreement in discussion?
- (b) are you of the opinion that there are no legal/social/political obstacles to implementing Concessions in your country (e.g. grass roots opposition, policy measures against private sector participation in public infrastructure/services, non-publication of a decree provided under the Concession Law and necessary for such law to become effective, etc.)?

## **2.4 Case study**

The proposed case study presents a "real-life" case that can be encountered in practice and is followed by a series of questions relating to how the legal and institutional framework might operate in such case.

<sup>3</sup> Transparency consists in ensuring, for the benefit of any potential tenderer, a degree of advertising sufficient to enable the services market to be opened up to competition and the impartiality of selection procedure to be reviewed.

Given the nature of concessions and project agreements related thereto (involving long-term partnership between a "public" and a "private" party), it was determined that the case study should be divided in two scenarios, one taking place at one moment (Year N) and the other one taking place three years later (Year N+3).

The case study covers **four core areas** of the legal and institutional framework for concessions:

- *presence* – whether concessions have been implemented successfully and/or whether there is a potential for such implementation (covered under question 1).
- *process* – whether there is a fair and transparent selection process, measured by the possibility of challenging a concession award effectively (covered under questions 2 (a) to (c) of the Preliminary Questionnaire and 1 to 3 of the Case Study).

*Best practice summary: mandatory application of fair and transparent selection process and tender rules. Limited exceptions allowing direct negotiations and possibility to challenge illegal awards.*

- *implementation* – whether there is 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 (covered under questions 2 (d) and (e) of the Preliminary Questionnaire and 4 and 5 of the Case Study)

*Best practice summary: respect by the Contracting Authority of the project agreement provisions during the whole concession term without unnecessary or unrealistic/not bankable/compulsory requirement/interference.*

- *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 (covered under question 2(f) of the Preliminary Questionnaire and 5 and 6 of the Case Study).

*Best practice summary: possibility to enforce efficiently an arbitral award and recover the investment costs in case of early termination.*

The Case Study is presented in the **Box 3**.

### **Box 3.**

Your client is an international operator involved in a concessions project in a municipal utility (for example, water distribution, bus transportation, solid waste collection) in your country.

#### *Scenario 1*

Your client has been informed that the concession he is bidding for has been awarded to a local competitor who, to your client's knowledge, did not meet the qualification criteria. Your client considers that his proposal should have won under a fair and transparent selection process and has, moreover, spent more than €100,000 in the preparation of his proposal.

Is there any action that your client can take under Concessions Law or any other applicable law to challenge the award? Would you advise your client to proceed with

the challenge? If the chances of a successful challenge to the award are small, is there a chance to recover a substantial proportion of the client's development costs?

### *Scenario 2*

Your client has been awarded the Concession. Two years later the Project generates the expected cash flow and your client is making the anticipated profit. However, he faces difficulties in getting the Contracting Authority's acceptance of the tariff increase provided for under the project agreement. This is due to political and social opposition to such an increase.

When faced with a complaint by your client, is the Contracting Authority most likely to: (i) refuse to implement the tariff increase without providing compensation to your client; (ii) refuse to implement the increase but provide your client with adequate compensation; or (iii) abide by the terms of the project agreement despite the social and political opposition?

If the Contracting Authority refuses to implement the tariff increase, is there any action that your client can take (outside of the settlement of dispute procedure included in the project agreement) to challenge the Contracting Authority's decision and to oblige the Authority to comply with the tariff increase?

In the event that the tariff issue cannot be resolved and your client decides to terminate the Project Agreement and obtains an international arbitration award entitling him to recover the non-depreciated value of his investment, are there any efficient means of enforcing the arbitral award? Can the Contracting Authority delay or otherwise obstruct the enforcement process?

## **2.5 Case study for countries with no or limited concession experience**

For countries that had only implemented one concession project or none at all by July 2006, the *potential* for an effective concessions regime was assessed by posing questions designed to highlight the reasons for the absence of such a regime and any recent developments towards establishing one.

The countries in this category comprised Belarus, the Czech Republic, the Kyrgyz Republic, Mongolia, the Slovak Republic, Tajikistan and Uzbekistan.

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

## **3. RATING METHODOLOGY**

The questions were designed to leave space for narrative descriptions by local lawyers of each of evaluated countries.

Once the narrative answers were analysed and compared:

- answers were classified into one of the following categories: (i) Yes, (ii) Yes, with reservations, (iii) No, with reservations, (iv) No, and (v) Not applicable;
- the following point system was used to obtain the total score per core area;

✓ ✓ ✓	Yes	3 points
✓ ✓	Yes, with reservations	2 points

××	No, with reservations	1 point
×××	No	0 point
N/A	Non applicable	0 points (and proportional reduction of the maximum number of points)

- the total number of points per core area was then calculated out of 10 and the total out of 40;
- the following categorization was finally used to obtain the degree of effectiveness.

> 90 %	Very High
70%-89%	High
50%-69%	Satisfactory
30%-49%	Low
< 30%	Very Low

For the same reasons as for the 2005 CAS (subjectivity), questions were not weighted (i.e. it was considered that every question and core area are of equal importance).

#### 4. **FROM INITIAL TO FINAL SURVEY, COVERAGE**

Case studies were submitted to local experts in June 2006. Where GLN did not have an office, the EBRD contacted local law firms and consistency of information was ensured through a review of the individual replies and a follow up of any questions that arose. Twenty-eight EBRD countries of operation were assessed; including Mongolia which was not assessed for the 2005 CAS and Montenegro which was assessed together with Serbia for the 2005 CAS, but excluding Turkmenistan.

The majority of the answers were received and analysed in July and August 2006 and results discussed with the EBRD and finalised in September 2006.

Although the findings of this survey give an indication of the status of effectiveness of concession regimes in the transition countries, the results must be treated with some caution. First, they are based on the analysis of only one law firm in each country. Second, they relate to a specific set of circumstances, and may not apply to all types of concessions. Thirdly, even though the focus of the survey was limited to concession arrangements, it involved projects of different size and scale and in different sectors. Lastly, not all countries have had experience with the types of concessions described in the chosen scenario and therefore answers from these countries are speculative. In some countries (for example, Bulgaria, Romania and Hungary), numerous concessions have been implemented, enabling practitioners to treat the case as a real case. In others, the limited number of concession projects implemented (as in Georgia or Estonia) or their absence led necessarily to theoretical/hypothetical answers.

#### 5. **SURVEY RESULTS**

##### 5.1 **General**

No countries were rated very high. Four countries with experience of concessions received a high effectiveness rating: Bulgaria, Lithuania, Romania and Slovenia. In

Bulgaria, according to the National Concession Register, nearly 300 State concessions and more than 500 municipal concessions were awarded since 1997, generally following a transparent selection process and without major difficulties in implementation. However, transparency of the award was sometimes criticised and awards challenged (for example, for Trakia highway, Varna and Bourgas airports as well as Somovit, Svishtov and Oryahovo ports). In Romania, the situation is similar to Bulgaria, with numerous concessions implemented in various sectors in the last decade, most of them successfully and on the basis of a general concession/PPP law. In Slovenia, concessions are awarded on the basis of various general and sector-specific laws, generally following transparent competitive procedures. In Lithuania, concession implementation started recently, with no difficulties encountered to date.

The Czech Republic was rated as a potentially high as its survey was based on a hypothetical implementation rather than actual experience of concessions. In this country, even though many public services are carried out by private entities, such exercise is not based on concessions, but on licenses. After the creation of a “PPP Centrum” in 2004, a new Concession Law was adopted in the Czech Republic in 2006 and several concession-based pilot projects launched by various ministries (for prisons, hospitals, motorways, etc.). The high potential for concessions can be explained by the following: concessions benefit currently from a strong political support, concession award 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 they are party to and arbitration is widely recognized and generally not obstructed in this country.

Five countries received a very low effectiveness rating: Azerbaijan, Belarus, Kyrgyz Republic, Uzbekistan, and Tajikistan. In Azerbaijan, even though several concessions were implemented, in particular in the electricity sector, the implementation thereof was generally not successful (early termination, disputes). Four other countries have no or very limited concession experience and the general legal, institutional and/or political environment is not supportive of concession-type arrangements.

Most countries fell into a middle, satisfactory, category.

## **5.2 Regional**

Central and eastern Europe and the Baltic States were the best rated regions, followed by South-eastern Europe (SEE). Montenegro, however, is well below the norm for the SEE. The country has a weak legal framework for concessions and is inefficient in implementing concession projects. In Bulgaria and Romania, on the other hand, numerous concessions have been successfully implemented since the late 1990s on the basis of concession laws. Given recent reforms of the legal framework in these two countries, they are expected to progress even further.

In the Commonwealth of Independent States and Mongolia, the results are generally worse than in the rest of the transition region. The number of concession projects implemented by each country differs significantly. In Kazakhstan several concessions have been successfully implemented, particularly in the energy and transport sectors, but transparency of the award process has not always been respected and several concessions were terminated early. Belarus, the Kyrgyz Republic, Tajikistan and Uzbekistan have implemented very few projects (for example, a gold deposit concession in the Kyrgyz Republic and an energy concession in Tajikistan) or none at all. The overall framework for the effective implementation

of these projects is poor, evidenced by a non competitive award practice, lack of judicial independence and the impossibility of effective enforcement of arbitral awards.

### **5.3 Per Core Area**

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

However, the results give a surprisingly positive picture of the overall level of adherence by contracting authorities to contractual terms. Respondents in 16 countries out of 26 have responded 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 Kyrgyz Republic, Moldova, Russia, Tajikistan, Ukraine and Uzbekistan.

### **5.4 Comparison with Concession Assessment**

The 2005 CAS of the quality of concessions legislation and the 2006 LIS on how these laws work in practice have produced generally corresponding pictures in that most countries with a sound legal framework for concessions have effective mechanisms in place for enforcing the law. There are, however, exceptions.

For example, in Azerbaijan, Moldova or Russia, the concession legal framework generally conforms with relevant international standards, but policy, institutional and legal reforms do not permit projects to be implemented effectively. This is mainly due to the poor functioning of the court system and a negative attitude towards international arbitration. In Azerbaijan and Moldova, problems encountered in concessions implemented to date may have a negative impact on the development of future projects. In Russia, the success or failure of important projects in the pipeline (for example, a western ring road in Saint Petersburg) will certainly influence the efficiency of the concession-related environment in this country in general.

Conversely, in some countries where there are serious limitations in the concession legal framework, concession projects can be implemented fairly successfully. This is especially true for Hungary and Croatia. The explanation for this may be the existence of several good precedents and a generally efficient institutional framework, essential for day to day implementation and enforcement. However, both those countries were rated as satisfactory rather than highly effective, suggesting some restrictions in implementing projects.

Overall, the legal environment for concession in transition countries has much scope for improvement. Most countries still need to implement further legal and institutional reform if they wish to allow complex PPPs to work effectively.

**SCHEDULE 1.  
ACKNOWLEDGEMENTS**

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