**Management Comments on the Evaluation Department's Operation Performance Evaluation Review (OPER)**

Management would like to establish that this loan did disburse successfully, with 93 new buses purchased by the client at below cost-estimates, which represents an important asset for the borrower that continues to be well-maintained.

Management also acknowledges that the accompanying TI to solidify this operational improvement in the client's asset base was very ambitious, but wishes to state that it has not failed (as the OPER asserts by assigning an "unsuccessful" overall rating to the project) but in fact it has suffered significant delays due to reasons that are explained below.

The TI agenda was based on the elaboration and signing of a Public Service Contract (PSC), a first for a municipality in the region. The PSC approach was based on the model used throughout Europe since the 1990s: a multi-year, gross-cost contract that enshrined performance standards to be operated by a Joint Stock Company (JSC) carrying out its activities in a commercially-oriented manner as regulated by the City Transport Department. Accompanying the PSC were related TI items, such as the transformation of the borrower into a JSC, full cost recovery to be achieved from the PSC-backed public support payments, the adoption of a Business Plan, IFRS adoption, and a new Transport Strategy based on competitive route tendering for all operators.

There are two principal reasons why this loan has not achieved the expected TI to date.

- The original project design was based on expectations of upcoming reforms in the region's urban transport sector to allow PSCs to be signed that were under implementation at the time of the project preparation. At the time, there were good reasons to believe that the project would spearhead implementation of the urban transport reform, and the city, a reasonably well-off, mid-sized city in a progressive region, seemed a good choice as a first test case. MEI, with its TI-focus in line with EBRD's mandate, moved aggressively to promote these reforms in the sector, sustaining a dialogue at national level to assist the policy-makers in the Transport Ministry to push this draft law in parliament. As it happened, the approval of the new law on PSCs was considerably delayed, which made achievement of the original transition covenants difficult.

- The project was also affected by an extended period of political instability within the Municipality administration, which lasted until March of 2008, when a new city administration took over. As the OPER report rightly describes in Section 1.3, this turn of events resulted in a management crisis within the City, a situation that remained until March of 2008 when the new mayoral team came into office. The former Mayor's difficulties stemming from fraud and corruption charges and conviction affected in a very tangible manner the ability of the rest of the City Administration, including the Transport Department and the City Council, from making any concrete progress on urban transport sector regulation. Based on the Team's knowledge, gathered from extensive interaction with mid-level staff and upper management of the City, there is consensus that the charges brought in 2006 against the former Mayor effectively negated the ability of the City to advance on the extensive reform items.

As a consequence of the above, a synthetic approach is needed in the interim. With the entry of the new Mayor in March of 2008, an opportunity has emerged to implement a variation of the original PSC concept, to achieve essentially the same improvements to the sector regulation and operational efficiency, but within the current legal reality of the region's UT sector. In summary, the new approach centres around a Performance-Based Service Agreement (PBSA) [as opposed to the original European-PSC] that will: a) be annually renewable [multi-year contracts with Municipal Enterprises are not allowed yet in the region] up to the duration of the usable life of the asset base of the company, and checked by Service Quality Indicators that ensure operational efficiency; b) clearly defined annual indexation of all support payments; and c) arbitration and termination clauses that are adapted to the region's legal context. The draft PBSA has been developed by MEI and is now being actively refined with outside legal counsel from the region and the City's Legal Department. The Mayoral team and the Company have committed to adopting the PBSA within Q1 of 2009, a milestone that MEI has made very clear to the City that will be considered a pre-condition for approving any additional urban transport financing on the part of the Bank.