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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 EBRD 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.

The European Bank for Reconstruction and Development (EBRD) is an international institution whose members comprise 60 countries, the European Community and the European Investment Bank. The EBRD operates in the countries of central and eastern Europe and the Commonwealth of Independent States committed to multiparty democracy, pluralism, and market economies.

The EBRD’s countries of operations are: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, FR Yugoslavia, FYR Macedonia, Georgia, Hungary, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Poland, Romania, Russian Federation, Slovakia, Slovenia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. 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.

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EBRD’s legal transition assistance: 10 years of evolution

As the EBRD marks its 10th anniversary in April, its first General Counsel looks back at the Bank’s legal reform efforts over the past decade and emphasises the critical role that legal reform plays in the political and economic transition of the EBRD’s countries of operations.

In the past decade the Office of the General Counsel of the EBRD has focused on three principal areas: support of the EBRD’s investment, lending and treasury operations; policy and institutional issues, including interpretation of the Agreement Establishing the Bank; and helping the Bank’s countries of operations in their efforts to create the modern legal framework necessary for their economic and political transition.

From its earliest days, the Bank recognised the fundamental role of a sound and effective legal system in the transformation of the institutions and societies of the countries of central and eastern Europe in accordance with the Bank’s mandate to assist countries “committed to and applying the principles of multiparty democracy, pluralism and market economics”. As early as 1991, within months of the Bank’s inauguration, we convened at the Bank’s headquarters a colloquium of representatives of international institutions and leading technical assistance providers to assess the resources available for law reform and to consider means of cooperation between providers. In 1992 we commenced publication of Law in transition, a newsletter on legal cooperation and training, in an effort to publicise information on legal projects, programmes and developments in the region. Also in 1992, following a legal roundtable at the EBRD’s first annual meeting in Budapest, we began to develop a standard for modern secured transactions laws in the region. The Model Law on Secured Transactions was subsequently published in 1994.

During these early years, we were faced with a growing number of requests from the governments of the EBRD’s countries of operations for various types of assistance in their legal reform efforts. In 1995, John Taylor, my successor as General Counsel, institutionalised the EBRD’s law reform work with the creation of a Legal Transition Team for the specific purpose of delivering legal technical assistance in accordance with a defined programme. In 1998, Law in transition was transformed into a legal journal, with in-depth articles on key aspects of the region’s legal issues.

The present General Counsel, Emmanuel Maurice, has taken the Legal Transition Programme a step further by mainstreaming legal reform into the strategies and policies of the EBRD’s investment operations. The programme now focuses on four key activities: legal assessments, international standard setting, legal reform projects and outreach. This seeks to ensure that the lessons learned from legal reform efforts are taken into account in the EBRD’s investment activities, as well as in ongoing and future legal transition projects.

Ten years is a short period in the transition process and the EBRD’s legal transition work is, of course, far from complete. Major challenges still lie ahead for each of its countries of operations. For the accession countries, harmonisation with European Union directives and regulations continues to be a priority, but additional resources will need to be directed towards the building of more effective implementing institutions, particularly the judiciary. For other transition countries, the focus on improving their investment climate and the international community’s emphasis on international legal standards as a key to crises prevention should motivate continued legal reform. A key concern for all the EBRD’s countries of operations is how to attract their share of the large flows of private capital to help meet the region’s infrastructure needs. In this context, the transition countries are recognising the importance of creating a proper legal foundation for the public-private partnerships that can mobilise this private capital. Concession laws and transparent, competitive tender procedures, the focus of this issue of Law in transition, are essential to this foundation.

I am glad to see that what was started a decade ago with an effort to coordinate legal reform efforts has grown to become a core component of the Bank’s activities and that the EBRD’s Legal Transition Programme and Law in transition have become an important voice for legal reform in the region. As the financial crises in Russia and other emerging markets have demonstrated, we ignore law reform and legal institution-building at our peril. Legal reform must remain a key component of development and transition assistance if we are to help countries to achieve sustainable and equitable economic growth and to ensure that democratic values take deep root.

Andre Newburg, first General Counsel of EBRD
Corporate governance: regulating board-level management of enterprises

Transition countries wishing to attract either capital or business need to ensure that potential investors have confidence in the market. Part of that confidence comes from knowing that the country’s companies are well managed and that there is a legal regime in place that can and will insist that good management practices are enforced. How transition countries select and implement such a regulatory regime varies enormously. However, they all stand to learn from the successes and failures of more developed jurisdictions. The discussion here draws on the experience of the United Kingdom, particularly in relation to boards of directors.
Corporate governance is not a term of art. It encompasses all of the various mechanisms designed to ensure that a corporate organisation pursues only those objectives for which it was set up, and pursues them in a way which embodies best business practices. Here the focus is solely on the legal regulation of corporate management, especially boards of directors. It excludes consideration of the myriad of other options for legal and non-legal regulation of corporate governance. This narrow focus has been adopted in the light of the current attention being devoted to this area by governments and financial markets in major Western democracies. This degree of attention suggests that the area is — or certainly will become — equally important for economies in transition. Moreover, the process of self-assessment and reform being undertaken in Western democracies can perhaps save emerging economies from mistakes already made elsewhere.

Different Western democracies have themselves opted for quite different forms of regulation in this area. Here the focus is on the UK (or Anglo-American) approach. By definition, this is a model forged from liberal, capitalist, free-market practices. Yet this model has not survived without incorporating and accommodating lessons learned from civil law jurisdictions, nor without adopting more interventionist practices in the interests of protecting both the markets and individual players.

The importance of regulating board-level corporate management

The reasons why Western democracies are currently subjecting board-level corporate management to increasingly intense scrutiny are not hard to divine. The corporate form has become the preferred mechanism for conducting business, whatever the size of the enterprise. Companies, both large and small, contribute enormously to the economic and social well-being of a country. Indeed, the largest companies wield enormous economic, social and even political power.1 Few if any individuals are left untouched by their activities. The compelling conclusion is that better-managed companies will produce benefits for all; hence the prevailing focus on corporate management, especially the corporate management function provided by boards of directors.2 This stance views corporate management principally through the eyes of the state; it explains why the state is interested in regulating companies. The state can implement its various regulatory objectives in a number of ways. One of the most common is to enact general laws regulating the activities of companies. Accordingly, companies are invariably obliged to comply with the state’s laws governing issues related to employment, consumer protection, securities regulation, environmental protection and so forth. Of course, these laws will stand for nothing unless the state also has in place sound enforcement mechanisms for ensuring adequate compliance with them.

The regulation of board-level corporate activity also has a much narrower and less ambitious objective. This is the protection of individuals who have an immediate vested interest in the success of the company. The primary focus of this concern has always been the shareholders. With large companies, and even with many smaller ones, the shareholders are not directly involved in the management of the company: although the company is “owned” by the shareholders, it is “controlled” by the board of directors.3 This places the shareholders in a vulnerable position, exposing them to the vagaries of board activities. The position is complicated still further because one of the central tenets of company decision-making is “majority rule”. This has the potential to enable majority shareholders to silence dissenting minorities who express dissatisfaction with the current board. But shareholders are not the only group exposed to potential abuse by deficient board-level management. Employees and corporate creditors are also vulnerable. Accordingly, another objective in the regulation of boards of directors is to offer a balanced regime of protection to these vulnerable groups.

In short, the functioning of a company’s board of directors is perceived as critical. It is seen as the crucial ingredient affecting the wealth and welfare not only of the companies themselves and the individuals directly associated with the company, but also the individuals only remotely associated with the enterprise, and at a more general level the state itself. Companies themselves are certainly aware of this. Few if any of the major corporate players fail to devote time and energy to developing their own corporate governance regimes. They see the importance of these regimes reflected in internal personnel performance as well as in external relationships.

Because of this crucial and central role, all emerging economies — like all Western democracies — are likely to be legitimately concerned about the regulation of boards of directors from both the state and the individual perspectives. A sound financial and capital market demands confidence in the

1 Of the world’s 100 largest economies, 50 are companies and 50 are states.
2 In the United Kingdom alone, the past ten years have seen publication of the Cadbury, Greenbury and Hampel Reports (all reports from government-sponsored private committees). The proposals from these committees are now enshrined in the Combined Code (Appendix to the London Stock Exchange Listing Rules). The Law Commission produced a report on company directors: Law Commission, Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties (No. 261, 1999). The Department of Trade and Industry (DTI) announced a comprehensive review of the whole of company law (DTI, Modern Company Law for a Competitive Economy (1998)) and the Company Law Review Steering Group has, accordingly, produced a number of consultation documents, including Modern Company Law for a Competitive Economy: The Strategic Framework (Feb. 1999); Modern Company Law for a Competitive Economy: Developing the Framework (March 2000); and, most recently, Modern Company Law for a Competitive Economy: Completing the Structure (Nov. 2000).
state’s ability to regulate and enforce its laws; in addition, investors need to know that their interests are protected from abuse by self-interested or uninterested boards of directors. Moreover, it is well recognised that new, fast-moving markets provide both incentives and opportunities for deficient – and even fraudulent – management practices. In these markets, effective, and visibly effective, mechanisms for the regulation of board-level management are critical.

**Different options for the regulation of boards of directors**

If the stated aim is to raise the standard of board-level management within every registered company, then the law seems to have open to it three broad routes: imposing demanding legal duties upon directors and backing those duties by efficient and effective sanctions mechanisms; compelling disclosure of companies’ and directors’ activities; and requiring compliance with particular decision-making structures within the company. All three routes are integral to the most effective functioning of the law in this area, although they are listed here in their perceived order of importance. Of course, non-legal pressures also contribute enormously to the raising – or lowering – of corporate governance standards. Market pressures, including the threat of bad publicity, shareholder and general public activism, and domestic and international competition, can all provide incentives for particular modes of board behaviour, some desirable, others not.

Certain issues are addressed in more detail later, but it ought to be clear from the outset that if regulation is to be effective, then it must recognise national business practices and expectations. Different countries have different ways of doing things. Among Western economies it is well-recognised that Japan and Germany have quite different corporate governance regimes from the United Kingdom and the United States. Notwithstanding this, all four countries have strong and successful economies. Moreover, it is increasingly recognised that if Germany, for example, imported the United Kingdom’s corporate governance practices the practical outcome would not be the same as in this country: German practices would ensure a uniquely German outcome.4 It follows that when transition economies are devising their own corporate governance strategies, they too need to be sensitive to context. There are many models to choose from, and many ways of adapting and refining them.

As well as country differences, corporate governance regimes need to be sensitive to company differences. The same mechanisms are unlikely to work for both large multi-nationals and small local businesses. Furthermore, once all these country and company differences have been accommodated every regulatory regime needs to ensure that its specific rules are clear, comprehensive and comprehensible, and that any breaches will be easily and efficiently remedied.

**Compulsory disclosure regimes**

Whatever the difficulties in articulating the precise obligations which ought to be imposed on directors, the associated benefits of compulsory disclosure are widely and enthusiastically accepted. Instinctively it is appreciated that if both companies and directors are obliged to make full and formal disclosure of their various activities and functions then the occurrence of abuses is likely to be minimised. The fear of discovery is a powerful motivator. Moreover, any breaches which do occur are more likely to be pursued and remedied. If close supervision by independent monitors (e.g., by the stock exchange and the securities market regulator, by non-executive directors, and perhaps also by powerful institutional shareholders) is added to this disclosure regime, then the risk of breach is likely to fall still further. Compulsory disclosure is also likely to inspire “good” behaviour, not just deter the bad. These simple ideas underpin much of the input of corporate governance reformers in the United Kingdom this decade. The general idea is that “forewarned is forearmed”, and the various regimes are all designed to give appropriate information to the relevant interested parties.

The Organisation for Economic Cooperation and Development (OECD) Principles of Corporate Governance recognise the central importance of effective and efficient disclosure regimes.6 Disclosure regimes can be implemented in various guises.7 The stock exchanges of most countries have mandatory rules imposing continuing general disclosure obligations,8 and specific disclosure obligations in relation to new offerings of securities; the US regime is perhaps the most demanding. The aim of these regimes is to maintain confidence in the market, and to create a level playing-field for investors and other market participants. The potential sanctions for non-compliance include de-listing, a very effective threat which creates its own incentive for compliance.

Whether listed or not, all companies are also required to provide the general public with full, accurate and verified information about certain aspects of the company’s operations. The aim is to put those who are about to invest in the company – in any way – in a position to assess the company’s business before they commit themselves, and to enable those who have already invested to keep track of the company’s continuing performance. In the United Kingdom this form of public disclosure is made by registering certain documents at Companies House. Apart from the initial information provided when the company was first registered, the company is obliged to file annual returns8 which include the company’s annual accounts (prepared to conform to specified accounting standards), the directors’ report (containing, among other matters, a fair review by the directors of the development of the business of the company and its subsidiaries during the financial year and their position at the end of it, and the directors’ recommendation for dividend payment),9 and the auditor’s report (confirming that the accounts have been prepared properly and give a true and fair view of the company’s...
Current UK reform proposals are set to increase still further the disclosure required from directors. Directors of all public and large private companies will be required to produce a mandatory Operating and Financial Report (OFR) as part of the company’s annual report. The OFR is designed to be a full account by the directors of the performance and direction of the company’s business, including a review of achievements, trends and strategic direction. In addition, the OFR is to include a report on the company’s wider relationships, risks and opportunities, and social and environmental impacts, where these are relevant to an understanding of the business. This proposal for a mandatory OFR marks a formal recognition of the increasing interest of a wide range of stakeholders in the greater public disclosure of corporate functions and activities. The OECD Principles of Corporate Governance reflect a similar objective.

Clearly there is a powerful and universal intuitive allegiance to the value of disclosure regimes; so much so that it is inconceivable that they could be done away with. Nevertheless, one of the current challenges of modern law reformers is to balance the perceived benefits of a system of compulsory disclosure against the mounting costs of compliance. Already smaller companies have to comply with a reduced spectrum of obligations. In addition, it is recognised that greater efforts are needed to ensure that the information provided is intelligible to those it is intended to assist. The battle is between brevity and simplicity on the one hand, and accuracy on the other. As well as these cost-benefit issues relating to the form and content of mandatory disclosure, transition countries drafting their own regimes need to address the issue of effective enforcement. A well-drafted scheme on the statute books which is routinely ignored or evaded by companies and their boards of directors is probably worse for market confidence than having no scheme at all. Although the disclosure regimes of the United Kingdom and the United States are regarded as tolerably well enforced, the European experience confirms that enforcement can prove problematic.

### Regulation of decision-making structures within the company

There is a widely held perception that some of the problems associated with corporate management can be traced back to the structure of the board. For example, if the board of directors has the power to determine board remuneration, there is an inevitable general suspicion that excessive salaries may be paid. The biases can also be more subtle. In the United Kingdom the shareholders have the right to elect and remove the directors. A reasonable assumption in these circumstances is that directors may be easily persuaded to make corporate decisions which favour the shareholders to the detriment of other interested groups, especially the employees. Even within the general body of shareholders, minority shareholders may feel that their interests are overshadowed by the greater influence of the better-represented majority. Since one of the goals of corporate governance best practice is to ensure the fair treatment of interested groups, the issue demands a considered response.

For a long time Anglo-American corporate law did little or nothing. It left interested parties to negotiate for better representation if they could, and, if they could not, to seek out the few legal remedies available for provable injustices. German corporate law was always perceived to provide a starkly contrasting model. It provided for a two-tier board (a management board and a supervisory board), with compulsory employee representation on the latter and, often, in practice, creditor representation as well (admittedly restricted to large creditors, such as banks). The perception, at least from the outside, was that such a structure was likely to produce a more balanced treatment of the various vested interests in the company, and yet the United Kingdom was not keen to adopt a similar framework.

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2. Supra note 3.
3. OECD, Principles of Corporate Governance, SG/CG (99)5 (1999) (available at www.oecd.org), Principle IV, states that “The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.” Also see Principle V on the responsibilities of the board, and the Annotations to both these Principles.
5. In the United Kingdom these obligations are contained in the Stock Exchange’s Listing Rules. See especially chs 9-16.
6. Companies Act 1985, Part X, ch III.
7. Companies Act 1985 sec.s 234, 234A. Schedule 7 to the Act contains a long list of specific matters to be addressed in the directors’ report.
8. Companies Act 1985, Part VII.
9. The suggested level is an annual turnover of £500 million.
11. OECD, Principles of Corporate Governance, Supra note 6. Annotations to Principle IV A.2 suggest that “in addition to commercial objectives, companies are encouraged to disclose policies relating to business ethics, the environment and other public policy commitments.” Also see Principle III on the role of stakeholders in corporate governance.
12. Responding to criticism of European transparency regimes, the European Commission passed a Transparency Directive in 1993. However, it is widely conceded that this Directive has achieved little, if anything.
13. This right of removal is given by statute, and operates regardless of any private arrangements to the contrary; Companies Act 1985, sec. 303.
15. The statutory “unfair prejudice” provisions were designed to afford relief in the worst of these cases, but the relevant sections have been restrictively interpreted by the courts, so that shareholders in public companies are now unlikely to be successful in pursuing relief: Companies Act 1985, sec. 459.
16. And, similarly, Austrian, Belgian and Netherlands law.
17. Contrast this with the very weak UK legislative provision simply requiring board of directors to “have regard” to the interests of the company’s employees: Companies Act 1985, sec. 309.
Now, however, matters have changed a little – although only a little – in the United Kingdom. There are still no statutory provisions mandating particular forms of board structure. Instead, voluntary codes of practice have been introduced for public companies. These codes were formulated in response to several major corporate collapses in the United Kingdom in the 1980s and 1990s. The collapses were regarded as potentially damaging to the reputation of national financial markets, and several committees were formed to address specific issues. Their work resulted in the Cadbury, Greenbury and Hampel reports, all produced in the 1990s and eventually synthesised to generate a Combined Code, appended to the London Stock Exchange Listing Rules. Although this is merely a code of best practice, not a mandatory set of obligations, listed companies are, nevertheless, required to declare in their annual reports the extent to which they comply with the guidelines and to explain any non-compliance. Compliance therefore tends to be high: there is a perception that otherwise the company will need to justify something that is “wrong”. As well as the introduction of the Combined Code, there is also statutory provision for certain decisions to be approved by the shareholders in general meeting before the company can commit itself to the proposed course of action. The issues mandated for this form of special consent are those where it seems most likely that the directors (whatever the board structure) might act in a self-interested way to the detriment of the general good of the company and its shareholders. These include any substantial property transactions between the company and its directors, as well as certain issues related to remuneration of the directors.

Transition countries contemplating the potential advantages in regulating the structure and composition of boards of directors will appreciate that any regulation must be specifically designed to address the principal pressure points in their own system. These pressure points are largely determined by the dominant legal structure of the companies being regulated. In both the United States and the United Kingdom large companies are typically widely held; elsewhere in the developed world, such companies generally have a dominant shareholder, be it an individual or the state or a bank. This difference profoundly influences the issues to be addressed. Where companies are closely held, the emphasis typically shifts from shareholder-focused governance institutions to a broader set of devices for managing the issues of ownership and control. For example, in many countries where companies are closely held, Germany aside, legislators have found it unnecessary to specifically regulate the composition of boards of directors.

The dominant shareholder is seen as providing an effective monitoring function. Transition countries may feel this is a more appropriate model, although the pattern of shareholder ownership does appear to be diversifying even in countries where the closely held company has been the traditional model.

Specific regulation of management: directors’ duties

Since the objective is to raise the standard of board-level management, the regulatory framework should provide for the legal imposition of minimum standards of conduct to which directors must adhere. The higher these minimum standards, the better the general level of corporate governance. And the better the general level of corporate governance, the better things will be for all, it is assumed. Accordingly, directors in Western economies are now subjected to a raft of legal obligations designed to improve their contributions to the management of the corporate enterprise.

One of the principal challenges in this area is to balance the desire to impose high standards of conduct on directors against the risk of deterring potentially good directors from accepting the role, thereby stifling successful and beneficial entrepreneurial activity. Another is to articulate in a simple, comprehensible and comprehensive way precisely what is expected of directors. The duties described below apply to all directors of all companies, regardless of the size of the company, the type of business it conducts, and the age and experience of its managers. However, clearly this does not and cannot mean that precisely the same is expected of directors managing multi-national corporate giants and directors managing the corner grocery store. The importance of corporate context is also well recognised in the OECD Principles of Corporate Governance. There, unlike the United Kingdom the responsibilities of boards of directors are set out very succinctly. All of the matters which, in the United Kingdom are regarded as critical are articulated in one provision and one sub-provision. In considering the UK regime, it is useful to divide the relevant obligations.
imposed on directors into four broad but distinct classes.

i) Formal restrictions on directors’ activities

The first class comprises obligations requiring strict compliance with specific restrictions on directors’ conduct. For example, in the United Kingdom the Companies Act 1985 demands that directors perform certain activities and prohibits them from engaging in others. The company’s own corporate constitution (in the United Kingdom the memorandum and articles) may impose similar types of restriction which are particular to the company’s needs. Directors are required to adhere strictly to these statutory and constitutional requirements, and to any similar terms in their personal contracts of appointment. In most cases, breach of these requirements exposes the director to claims for compensation from the company for any loss the company may have suffered as a consequence. Where the breach is a breach of the statutory regime, criminal sanctions may be imposed. However, directors are rarely pursued for breaches, with one significant and important exception: where the breach relates to disclosure requirements imposed by statute. These disclosure requirements are regarded as so important that directors can be disqualified for persistent failures in this area.

ii) Directors’ duties of care and skill

Directors must exercise due care and skill in carrying out their management functions. This duty is simply one manifestation of the general duty of care imposed on all individuals in conducting their activities. If an individual is negligent and thereby causes harm to someone, then the law requires the individual to pay compensation. All of this is straightforward, and there would seem to be no reason to exempt directors from the general operation of the law. However, two specific matters have caused concern in the corporate context for much of the history of this duty.

First, it is quite difficult to say what sort of conduct is negligent when directors are carrying out their management functions, at least when the conduct is neither grossly negligent nor fraudulent. Companies are set up to take risks; directors are employed because they are good at this – they are entrepreneurs. The fact that a company makes a loss, or even fails totally, is not of itself indicative that its directors have been negligent in the management of the company’s affairs. This has led to calls in the United Kingdom for the introduction of a statutory ‘business judgement rule’, as operates in the United States and several other countries. Such a rule would confirm that directors who make loss-generating decisions reasonably, after collecting all the appropriate evidence, and after appropriate consultation and evaluation, will not be found guilty of negligence in the management of the company, and so will not be held liable to compensate the company for the losses suffered. To date the United Kingdom has resisted the pressure, rightly it seems. There appears to be no need for such a rule, since the normal rules of negligence clearly admit that damage and harm are not invariably caused by negligence, a director who offered proof of the matters outlined above would clearly not be found negligent, even in jurisdictions without a business judgement rule in place.

The other related issue is that the standard of care imposed is commonly perceived as too low to be effective in regulating directors. Shareholders suffer; and, if the company fails, creditors suffer too. Historically, directors were usually part-time, non-executive members of the board, not expected to devote much of their time to company business and not expected to bring any special skill to bear on their deliberations. The old cases reflected this: few directors were ever found liable in negligence for the corporate losses which resulted from what appeared to be clear mismanagement of the company’s business. Judges and commentators seemed unwilling or unable to recognise that this old legal principle demanding that directors exercise care and skill — and its modern counterpart in the

21In the late 1970s the European Commission embarked on an extensive programme of harmonisation, as permitted by the Treaty of Rome, Article 54(3)(g). The focus has been directed largely at public companies and the degree of success has been mixed. For example, no agreement has yet been reached on the Draft Fifth Directive on the structure of public companies. The German model, which formed the basis for the initial proposals on this Directive, failed to command support and has now been revised to provide a much-watered-down menu of options.

22These guidelines suggest, for example, that boards of public companies should contain a greater proportion of independent non-executive directors (in the United States such directors typically form over half of the board), and that these independent non-executive directors should be in the majority on the sub-committees responsible for determining matters related to director nomination, director remuneration and company audit.

23See Companies Act 1985, Part X.

24R. LaPorta, F. Lopez-de-Silanes and A. Shleifer, “Corporate Ownership Around the World”, Journal of Finance, Vol. 54, p. 471 (1999). Banks are seen as having a particularly important role in corporate governance in Western Europe, but not elsewhere in the developed world.

25The Netherlands, Belgium and Austria also provide for employee representation on supervisory boards. In the United Kingdom and the United States such representation as there is generally arises from employee share ownership schemes.

26In the United Kingdom most but not all of these specific obligations applying to directors are imposed by the general law, not by explicit provisions in the Companies Act 1985.

27OECD, Principles of Corporate Governance, Principle V A (“Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interests of the company and its shareholders”) and V D A (“The Board should ... [monitor and manage] potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions”).

28See the reporting requirements noted earlier: Companies Act 1985, Part XI, Ch. III and Part VII, secs. 234-234A.

29Companies Act 1985, Part X.

30See the Company Directors Disqualification Act 1986. Disqualification can, of course, be ordered for many other forms of failure by directors.

31The company’s creditors in fact received better protection, by statutory fiat, some years earlier than the shareholders: see Insolvency Act 1986, sec. 214.

32See the specific reference in the OECD Principles to this matter; OECD, Principles of Corporate Governance, supra note 6, Principle V E2 (“Board members should devote sufficient time to their responsibilities”).

33See e.g., Re City Equitable Fire Ins Co [1925] Ch. 407.
law of negligence – was capable of adapting to modern circumstances and assumptions to produce a result in conformity with contemporary commercial expectations.\(^\text{11}\) Within the United Kingdom the current law reform programme proposes to introduce a statutory statement of the duty confirming this view.\(^\text{12}\) Its effect will be to ensure that directors adhere to a minimum, objectively assessed, reasonable standard of care. If directors have even greater skills or knowledge than this minimum requirement, then they will be expected to use those greater skills for the benefit of the company and the standard of care in those circumstances will be assessed subjectively.\(^\text{13}\)

iii) Directors’ duty to act in good faith and for proper purposes

This next duty often seems less intelligible outside common law jurisdictions than within them, yet the more highly developed and widely accepted civil law conception of a duty to act in good faith covers the same territory in a different manner. In common law systems, this duty requires directors to act honestly in the interests of the company, and to use their powers solely for proper purposes. At first glance this duty would seem to ask little of directors that more positive duties could not demand equally well; moreover, it would seem inordinately difficult to prove a breach of the duty since it appears to demand an insight into the mind and motivations of the director.\(^\text{14}\) On these grounds the duty would seem to have little to recommend it. However, to understand the duty and its limited function it is necessary to go back to its roots.

The duty is equitable; it is not a common law duty. In the United Kingdom there is an historical jurisdictional divide between the Courts of the King’s Bench (the common law courts) and the Courts of Chancery (the Chancellor’s courts). This divide was initiated when the King gave his Chancellor jurisdiction to determine appeals from the common law courts brought by petitioners dissatisfied with the treatment they had received. Typically the petitioners would plead special circumstances which made it unjust, or unconscionable, for the other party to rely on his or her strict legal (common law) rights. If the Chancellor was moved to do so, he would give the petitioner a remedy which effectively prevented the defendant from insisting on his strict legal rights.

The basis for such intervention was “equity” or “conscience”. This broad-ranging discretion gradually hardened into its own rigid rules, although the policy issues underpinning these rules remain the same today.

The equitable duty to act for proper purposes has application where the directors have power to manage the company, but they use that power for unacceptable ends. Typical instances are where the directors have power to issue shares, but use that power to ensure their own continued role in the management of the company, or where directors use their position on the board to ensure that the company enters into an engagement for the benefit of a third party rather than for the benefit of the company. In such circumstances the directors clearly have power to issue shares or to commit the company to an engagement with a third party, but because of the specific circumstances surrounding the deal, this duty allows the company (usually via its shareholders) to insist that the directors cannot rely on their strict legal rights to drive the arrangement forward.\(^\text{15}\) The usual remedy is to order an injunction to prevent the directors doing this, or to make an order undoing things that have already been done (so long as this does not affect the rights of any innocent parties to the arrangement).\(^\text{16}\) The court does not, and cannot, tell the directors how their powers ought to have been exercised; the court does not impose its own management views on the company’s operations. As a result, this duty cannot be used to support an obligation imposed on directors to act in the interests of the shareholders, or any other stakeholder group.\(^\text{17}\)

It is difficult to advise transition countries on the benefits associated with incorporating this particular duty into their corporate governance rules and the best manner of any such incorporation. In the United Kingdom the current reform proposals advocate adoption of a statutory statement of the rule, one which insists that “a director must exercise his powers honestly and for proper purposes”.\(^\text{18}\) This stark statutory statement offers no specific guidance to the courts; courts will still need to make their own assessments of what should count as a breach. If this degree of judicial discretion is unacceptable in transition countries, then an alternative approach is to recognise that the duty finds its most important application in the context of corporate take-overs; in other circumstances, affected parties can often rely on alternative protective regimes.

Transition countries might therefore consider it preferable to insert specific provisions limiting the discretionary powers of directors to advance or inhibit potential take-over bids for the company.

iv) Directors’ duties of loyalty – fiduciary duties not to profit

This final duty imposed on directors is another equitable duty, but also a fiduciary duty. Equity typically saw fit to impose onerous obligations on anybody who had undertaken to exercise a discretion in managing the affairs of another. The gist of the obligation is to require loyalty. In the corporate context this fiduciary duty of loyalty is designed to deter directors from acting in ways which might prejudice the interests of their company. Directors are not allowed to favour their own interests over their duty to the company when the two are in conflict; nor are they allowed to use their positions to make a secret profit. If they do, then any profits they make must be handed over to the company. This disgorgement remedy is a powerful disincentive to breach.

These fiduciary rules are necessary because, in granting directors the power to protect and advance the interests of their company, direct-
ors are also necessarily given the opportunity to do the exact opposite. The company cannot be adequately protected from this risk by the laws of contract, tort or abuse of power rules. The fiduciary duty of loyalty is designed to fill this void. It is the breach most often alleged when a company decides to sue its directors, and it is easy to see why. An appearance of disloyalty, rather than active disloyalty, is sufficient to constitute a fiduciary breach; the director’s carefulness or good faith are irrelevant. Moreover, the company need not have suffered any loss, but it can nevertheless claim all the profits gleaned by the defaulting director from the breach.46

It is clear from this that the duty of loyalty is about prescriptive rules, not prescriptive ones. The duty demands self-denial: certain attractive opportunities are open to all bar the director, unless, of course, the company grants its fully informed consent. The danger in allowing otherwise is that the director will be swayed by personal interest rather than by duty.47 When the policy behind the rule is considered, certain situations are clearly “risky”: for example, a director’s use of corporate confidential information for personal gain; or transactions between the company and one of its directors. However, the difficulty is to find a balance between compelling directors to act exclusively for the benefit of the company by denying them the possibility of taking a personal benefit from any available opportunities and allowing the most productive and efficient—but fair—use of resources by all the players in the market. This tension is clear in judicial statements of the duty. How to define these boundaries has been a major concern of fiduciary law.48

The current UK reform proposals really provide little of assistance to transitional countries in dealing with these practical difficulties. Although there is a proposal for a statutory statement of the relevant duty, the statement affords no assistance in addressing the critical difficulties identified here.49 The judiciary will still be left with precisely the same problems in judging the boundaries between acceptable and unacceptable activity by directors. The same is true of the OECD Principles of Corporate Governance. These do not specifically identify this form of disloyal activity as unacceptable; instead, they simply require disclosure of the relevant facts to the shareholders.50 To Anglo-American eyes, this does not seem to go far enough unless there is a remedy open to shareholders who object to the conduct revealed to them in accordance with this disclosure principle. And if a remedy is to be made available, then the difficulties of defining the boundaries between acceptable and unacceptable conduct will need to be addressed. It seems impossible to do this by statutory statement of an absolute rule; the huge variety of possible fact patterns make it inevitable that the courts will have to exercise discretion. But a regime which allows breaches of the law to be assessed by a judiciary exercising discretion is clearly only acceptable if the judiciary commands the confidence of the country’s citizens.

These, in outline, are the four principal duties owed by directors to the companies they manage. When transition countries are considering the merits of adopting these four duties in their own legislative regimes, the UK experience suggests that the first two duties—the duty of strict compliance and the duty to act with care and skill—are relatively easily incorporated into statute. The second two duties—the duty to act honestly and for proper purposes and the duty to act loyally—are not. Yet these second two duties appear more important in promoting confidence in the corporate governance regime. These duties aim to limit the potential for directors to abuse the enormous discretionary power which they wield.

**Regulation of boards of directors: enforcement mechanisms**

As already noted, a regulatory regime will not be successful unless it has efficient and effective enforcement mechanisms. By and large the corporate governance duties imposed on

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48It is not clear whether defaulting directors can be personally liable for any losses the company may have suffered as a result of the arrangement: see S. Worthington, “Corporate Governance: Remedying and Ratifying Directors’ Duties” 116 LQR (2000).


51Regal (Hastings) Ltd v. Gulliver (1967) 2 A.C. 134n, at pp.144-5 per Lord Russell.

52Bray v. Ford (1896) A.C. 44, at pp.51-2 per Lord Herschell.


55OECD, Principles of Corporate Governance, supra, note 6, Principle II C.
It is universally recognised that even the best designed regulatory rules will be worthless in improving corporate governance if the rules are not effectively enforced. Effective enforcement demands a properly functioning, credible, national civil and criminal justice system. Law on the statute books which is not translated into law in practice counts as nothing. In truth, this must often be the difficult starting-point for emerging economies and the goal for transition economies. Reforms focusing on enforcement are recognised as often both more important and more difficult than reforms focusing on changes to the letter of the law.

Conclusions

Corporate governance covers an enormous field. It involves the full set of relationships between a company’s board, its management, its shareholders and its other stakeholders. Poor governance undermines confidence in the markets and so can hold the whole financial system hostage. If companies are to attract and retain long-term capital from a large pool of investors, they need credible and recognisable corporate governance arrangements. Companies and governments recognise this and are making increasingly determined efforts to improve governance. Of course, governance is influenced by matters ranging well beyond corporate law issues. Emerging and transition countries can often do much to strengthen their financial markets by looking to other mechanisms, such as regulation of competition, or regulation of labour markets. Nevertheless, regulation of corporate governance is an integral part of the whole process.

The search for the perfect mechanism for the regulation of board-level corporate management is like the search for the end of the rainbow: the end remains constantly and infuriatingly within sight, but out of reach. This is as true of established economies as of any others. Different countries have adopted different strategies, and yet the success of their respective outcomes is broadly similar. Certainly it is clear that any regulatory regime must be sensitive to national and local context, to the types of enterprises being regulated, and to the costs of compliance. Nevertheless, it is essential that certain minimum standards of conduct are imposed on corporate managers, and done so in a way which ensures that the rules are comprehensible, that breaches are easily detectable, and that sanctions are effectively and efficiently enforced. All these elements present difficulties, but the goal is to provide a regime which imposes sufficient, but not excessive, regulation. The regime must work and be seen to work if it is to inspire confidence in the country’s markets.

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[48] This is known as “the rule in Foss v Harbottle”, (1843) 2 Hare 461.


[50] This is not addressed here, but the greatest disincentive to action by shareholders is the burden of legal costs. Various mechanisms for reducing this disincentive have been mooted, but none adopted.

[51] Clearly the state, too, has an interest in some parts of this governance regime. It, too, needs to be in a position to monitor activity and pursue wrongdoers, imposing disqualified orders and criminal sanctions where appropriate.

[52] The German model is illustrative. It is recognised as having weak shareholder protection laws, but these are seen as balanced by strict competition policies, far-reaching labour-participation laws, two-tier board structures favouring extensive managerial networks, and tax laws favouring corporate cross-ownership.

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Bosnia and Herzegovina’s continuing struggle: legal and institutional challenges in the post-Dayton era

Crippled by war, torn along ethnic divides and burdened with a complex, hybrid legal and administrative framework, legal and economic transition in post-war Bosnia and Herzegovina (BiH) has been slow to take off. Recent developments, however, may allow for a cautiously optimistic note.

Constitutional legacy of Dayton

Initialed in Dayton, Ohio, USA on 21 November 1995 and signed in Paris, France, by the Republic of Croatia, the Federal Republic of Yugoslavia (FRY Serbia and Montenegro) and the Republic of Bosnia and Herzegovina, the General Framework Agreement for Peace in Bosnia and Herzegovina (the “Dayton Peace Accords”) marked the end to a violent chapter in the short history of BiH. Set out to create a multi-ethnic society, the Dayton Peace Accords consist of an elaborat e set of annexes which provide for extensive involvement of the international community. The result is a country with a hybrid legal framework of unparalleled complexity, falling somewhere in between a sovereign state chaperoned by the international community and a protectorate.

Annex 4 to the Dayton Peace Accords sets forth the constitution of BiH, which is something of an oddity. Unlike most constitutions that are the work of a constitutional assembly, BiH’s constitution is an annex to an international treaty signed by three different states. In addition, the constitution establishes two “Entities” which themselves ratify the instrument that creates them.

Reflecting deep-rooted mistrust between the three principal ethnic groups, BiH’s constitution established a decentralised governmental structure. The State has only limited powers (most of which pertain to foreign affairs). Any residual powers are automatically assigned to the two Entities: the Federation of Bosnia and Herzegovina (the Federation) and Republika Srpska (RS). In practice BiH’s constitution has created two states within a weak central state.
The State has strictly limited authority to regulate internal affairs. It has no army or police force. It cannot raise taxes, does not control its own borders and has a legislature which in practice cannot formulate laws without the Entities’ approval.

The Entities are the true repositories of power in BiH. RS has a centralised structure. The Federation, on the other hand, has a federal structure composed of several Cantons, each with its own constitution, government, parliamentary assembly and judiciary. This may seem rather strange considering that the Federation is itself part of a federal state. The explanation lies in the Washington Agreement of March 1994 which marked an end to the hostilities between the Croat Defence Forces and the Army of the Republic of Bosnia and Herzegovina and which created the Federation. At the time, the international community was hopeful that, soon afterwards, a peace settlement with the Bosnian Serbs would be reached. The Federation was to provide the federal framework which was to contain Bosniac, Bosnian Croat and Bosnian Serb-controlled Cantons. However, fate decided otherwise. In November 1995, when a global peace settlement was reached, the approach adopted by the Washington Agreement was abandoned in favour of BiH’s current hybrid structure.

Annex 10 to the Dayton Peace Accords establishes the Office of the High Representative (OHR) to oversee, on behalf of the international community, the implementation of the civilian aspects of the Dayton Peace Accords in BiH. Frustrated with the lack of progress in BiH, the Peace Implementation Council (PIC), a group of 55 governments and international organisations that sponsor and direct the peace implementation process, has subsequently expanded OHR’s mandate. Among the most important milestones in the peace implementation process was the PIC Conference in Bonn in December 1997. At that conference, the PIC empowered OHR to remove from office public officials who violate legal commitments and the Dayton Peace Accords and to impose laws as it sees fit. OHR has since then wielded its powers to push through a number of laws whose core objective is to reinforce BiH’s weak central state. These state building measures have been largely welcomed by the Bosniacs but are strongly resented by the Bosnian Croats and the Bosnian Serbs who view them as violating the Dayton Peace Accords.

The complexity of BiH’s constitutional framework is matched and possibly surpassed by the complexity of its legal framework. BiH inherited its core legislation from the pre-war statutes of the former Socialist Federal Republic of Yugoslavia (SFRY), hardly an inspiring source of legislation to develop a modern market economy. The Dayton Peace Accords create an overall framework to which state, Entity and cantonal level laws must conform. Post-war legislation both at the state and the Entity-level is largely created in response to the demands imposed by the Dayton Peace Accords and OHR. The result is an intricate patchwork of sometimes contradictory and often inconsistent laws. The law relating to collateral provides an example of the complexity inherent to BiH’s legislation. Pursuant to BiH’s constitution, collateral legislation falls within the ambit of the Entities. Each Entity is therefore free to regulate the taking of collateral as it sees fit, provided such legislation does not breach BiH’s constitution or the Dayton Peace Accords. Both Entities draw extensively on SFRY laws, in particular those on Obligations, on Ownership Relations and on Enforcement Procedure. These laws are largely outdated and require a major overhaul. Cognisant of the importance of good collateral legislation to attract investors, both Entities are taking active steps to upgrade their legislation. The Federation has enacted a new Law on Mortgage and both the Federation and RS have prepared, with USAID’s assistance, a draft Law on Registered Pledges on Moveables and Shares. These recent initiatives should encourage the granting of credit and development of commercial activities. Yet, pending several amendments to the SFRY based Law on Ownership Relations and the modernisation of the court and land registries, the new laws remain largely unimplemented.

Human rights and civil liberties

In the Annual Survey of Political Rights and Civil Liberties 1999-2000,3 more than 20 of the 53 suspects publicly indicted by the International Criminal Tribunal for the former Yugoslavia are still at liberty (among them Radovan Karadzic and Ratko Mladic). More than 17,000 persons remain unaccounted for and some 1.2 million persons are displaced. The number of actual returnees to pre-war places of origin is on the increase. However, compared with the number of displaced people, the number of returnees remains insignificant. Returnees and their property continue to be targets of violent attacks. Police protection is inadequate and perpetrators of crimes are rarely arrested, let alone prosecuted. Most displaced persons, rather than returning to
their pre-war places of origin, prefer to reclaim their property in order to sell it at a fraction of the price to the current occupant. According to the 1999 Semi-Annual Report\(^1\) of the Human Rights Coordination Centre and the 1999 Country Reports on Human Rights Practices\(^2\) compiled by the US State Department, discrimination on the basis of ethnicity, political opinion and gender remains endemic in BiH. Ethnic minorities frequently suffer abuses when exercising their basic rights such as repossessing their property, registering their residence, applying for an identity card, securing pensions, connecting to utilities networks, securing employment, accessing schools, etc.

BiH's poor human rights record is partly due to its recent history. In addition, a lack of state-level enforcement mechanism essentially means that OHR must rely on the Entities to enforce human rights and civil liberties in their territory. While OHR and non-governmental organisations can condemn human right violations, they are relatively powerless to prevent them or prosecute the perpetrators.

### Challenges for the rule of law

According to the 1999 Semi-Annual Report of the Human Rights Coordination Centre, there are serious issues relating both to the independence and impartiality of the Bosnian judicial system as well as to the quality of justice dispensed by the courts. In both Entities judges are largely appointed (and dismissed) on the basis of party affiliation and political credentials rather than experience and skills. Politics also determines their livelihood. The court budgets in RS are determined by the Minister of Justice. In the Federation, the Minister of Justice determines the budgets of the Federation Courts and the cantonal ministers of justice determine the budgets of the Cantonal and Municipal Courts in their respective Cantons. As a result, judges in both Entities risk their jobs and income if they render politically unpopular decisions.

There have, however, been significant legal developments designed to enhance the independence and impartiality of the judiciary. In June 2000 judges and prosecutors in both Entities adopted identical codes of ethics. Under the auspices of OHR, an independent judicial commission will be created to supervise the two judicial commissions set up in each Entity. These Entity judicial commissions (whose members will have to be acceptable to the OHR-created independent commission) will carry out a one-off vetting procedure of the current judges. It is hoped that the commissions will weed out many of the corrupt and ineffective judges, although some critics have already voiced doubt about the willingness of the judicial commissions to criticise their peers. Finally, the Federation is currently discussing the adoption of a draft Law on the Court Budget and Office of the Court Budget Administration which will ensure that an independent budget is prepared, supervised and administered by members of the judiciary.

The rule of law is also hampered by the lack of inter-entity judicial cooperation. The Dayton Peace Accords have largely deprived BiH of a cohesive administration of justice. Instead, each Entity has its own legal system, judiciary and law enforcement agencies. The problem is further compounded by the Entities’ varying attraction to the so-called “fatherlands”. RS largely models its laws and administration on FRY, whereas the Bosnian Croat-controlled Cantons in the Federation emulate the Republic of Croatia. Laws, jurisprudence and doctrine are to a large extent influenced by their fatherland equivalent. On 2 February 1998 the BiH Presidency established the Inter-Entity Legal Commission in order to reinforce legal cooperation between the Entities (whose mandate has since expired). On 20 May 1998 the Ministers of Justice of both Entities further executed a Memorandum of Understanding on Inter-Entity Legal Assistance concerning issues such as serving subpoenas, tracing of witnesses and facilitating ad hoc cooperation. Despite these initiatives, there is still no mutual recognition of judgements, and cross-entity enforcement of judgements is decided on an ad hoc basis by individual courts.

These are but a few of the impediments that obstruct the rule of law. The International Crisis Group produced two highly revealing papers in 1999 that relate in detail the legal and bureaucratic limbo that citizens and companies alike have to face in BiH.\(^3\) These reports call for an overhaul of the public administration and the judiciary and denounce, among others, the lack of experienced and qualified officials, the shortage of funding, political nepotism and the wall of silence faced by Bosnians when attempting to exercise their rights.

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2. Annex 6 to the Dayton Peace Accords established the Office of the Human Rights Ombudsman and the Human Rights Chamber which together form the Human Rights Commission. This Commission is incorporated in Article 2.1 of the BiH constitution. The constitution of the Federation furthermore provides for the creation of a Human Rights Court and the RS constitution boasts an impressive list of human rights and personal freedoms. Finally, OHR has established a Human Rights Coordination Centre which functions as a forum for international organisations active in the field of human rights in BiH and coordinates their activities.
4. Human Rights Coordination Centre, Semi-Annual Report April-September 1999. (The report can be found at http://www.ohr.int/hrreport/ar9902.htm.)
Implications for BiH’s investment climate

In 1999 the International Crisis Group published a 25-page report entitled Why Will No One Invest in Bosnia and Herzegovina? An Overview of Impediments to Investment and Self Sustaining Economic Growth in the Post Dayton Era. In addition to widespread corruption, the complex patchwork of laws and an inefficient and partial judiciary, the report cites obscure and insidious business regulations as a major obstacle to all forms of investment in BiH. Many business regulations, a legacy from the communist SFRY, are intrinsically pro-government and hinder private sector initiative. As a result, businesses face an array of administrative forms. The report also records that the state often expects private companies to solve social problems, such as unemployment, or financial problems, such as the low level of revenue collection. The general illegality in which businesses operate creates ample opportunity for nepotism and bribery. Those businesses which are willing to pay bribes may expect clemency from government officials; those who don’t face fines or imprisonment. Either way, BiH’s intrusive and conflicting business regulations generate unforeseen costs and impediments which threaten the economic viability of businesses.

The findings of the International Crisis Group are corroborated by the EBRD’s Legal Indicator Survey, which measures the perception of local lawyers of the extensiveness and effectiveness of the commercial and financial legislation in the transition countries. According to the 2000 Survey, BiH’s commercial laws (pledge, bankruptcy and company) are generally as extensive as its Balkan neighbours, though BiH does score slightly lower than all but Albania (see chart below). However, in terms of effectiveness, BiH scores significantly lower than the other Balkan countries and, as a result, has the single biggest gap between extensiveness and effectiveness. This implementation gap indicates that while practitioners consider BiH’s commercial legislation to be on a par with regional legal developments, its implementation is far less effective. The implementation gap is undoubtedly due to the intrusive and conflicting nature of BiH’s legislation and its inefficient and arbitrary administration and judiciary described above. Narrowing the gap between what the law provides on paper and what it means in practice should be an urgent priority for the state and Entity governments. This is essential if respect for the rule of law is to have any chance of taking hold, which is a pre-requisite for an attractive investment climate.

Cautious grounds for optimism

The future of BiH as a self-sustaining country is inextricably linked to the elimination of political obstruction and the intensive development of a coherent legal and social framework supportive of economic development. So far, nationalist parties have blocked the development and functioning of modern social, political, legal and economic structures which BiH needs to attract the high investment flows it urgently needs. Recent events, however, cautiously augur a brighter future for BiH. Slobodan Milosevic’s recent downfall as president of FRY and the death of Franjo Tudjman, president of the Republic of Croatia, in December 1999, mark the end of an era and hail a turning-point in Balkan history. Having rid themselves of their nationalist figureheads, the two countries gained in international stature and acceptability. As they turn towards the international community, and the European Union in particular, for their salvation they will come under growing pressure to forgo their nationalist pretensions and embrace the principles of democracy and pluralism. Publicly abandoned by their respective “fatherlands”, the nationalist discourses of Bosnian Serb and Bosnian Croat hard-liners should slowly lose their credibility. Simultaneously, the internal markets of the Entities are too small for businesses to achieve economies of scale necessary to increase profitability. As a result, businesses are likely increasingly to attempt to operate on a country-wide level.

In autumn 2000 the Micro-Enterprise Bank based in Sarajevo was the first bank to open a branch in Banja Luka. Other banks have
already indicated that they will follow suit. Another example is the recent debacle over mobile telephone licences. After much indecision the telecom authorities in the RS and the Federation (both Bosniac and Croat) finally acknowledged that setting up Entity-wide (as opposed to country-wide) licences would be economic folly. The combined effect of political developments in the Republic of Croatia and FRY and economic realities will hopefully encourage a closer cooperation between the Entities.

Milosevic’s demise has another important consequence for BiH. As international sanctions against FRY are lifted, donor attention is gradually shifting from BiH to FRY. Already governmental and non-governmental organisations have started reducing their operations in BiH and are progressively reallocating their resources to FRY. Paradoxically, this may be a good thing for BiH. Comforted by the financial largesse of the international community, BiH lacked incentive to tackle painful but necessary economic reforms such as privatisation. Dwindling donor funds may provide an awakening and should provide an incentive to use remaining funds efficiently and establish a self-sustaining economy before the complete withdrawal of international assistance.

These events, combined with the introspection that the International Criminal Tribunal for the former Yugoslavia will encourage among Bosnians as the war time activities of more Bosnians comes under scrutiny, may warrant a more positive outlook for BiH. For the foreseeable future, BiH can be assured of the continued backing of the international community. The international community can assist BiH in putting in place social, political and economic structures which will allow it to evolve as a modern European state. However, in order to ensure a truly viable, prosperous and peaceful future, the people of BiH must come to terms with their past before they can resolutely embrace their future.


\[\text{The account to tribunal of former RS President Biljancic Plavsic, who surrendered to the tribunal in early January, is still awaited.}

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Overview of Uzbekistan’s Civil Code

This article provides a general overview of Uzbekistan’s 1997 Civil Code, focusing on contract and property protections, and identifies the key changes from Uzbekistan’s communist past.

In the late 1990s Uzbekistan adopted laws on property, denationalisation and privatisation, enterprise and cooperation that created the legal framework for the initial stage of transition to a market economy.

The current Constitution of the Republic of Uzbekistan was adopted in December 1992. Chapter XII establishes the economic foundations of Uzbek society, while Article 53 provides the statutory basis for a system of market-based relations in Uzbekistan. The Civil Code has expanded these constitutional provisions. The new Civil Code is the first statutory instrument to enshrine the principle of freedom of contract (Art. 354) and the principle of inviolability of property ownership (Art. 1660). While the principle of freedom of contract grants the freedom to enter into various transactions, the principle of inviolability of property ownership guarantees the legal rights of property owners and safeguards their interests in their relations with third parties.

Uzbekistan’s civil legislation defines the legal positions of participants in civil transactions, the circumstances giving rise to ownership rights and the manner in which they and other proprietary and intellectual property rights may be exercised. It also regulates contractual and other liabilities and other relations involving property and associated non-property rights.

Ownership rights and other property rights

One of the key issues addressed by the Civil Code is the issue of ownership rights. Those able to exercise private ownership rights are private individuals, companies and partnerships, cooperatives, public associations, funds and other legal entities not owned by the state. Any property may be privately owned, except for specific types of property whose private ownership is forbidden by law. Such property is strictly defined, and includes assets that may be owned solely by the state (mineral wealth, water, air space, flora, fauna and other natural resources).

Land may be privately owned in some circumstances. However, agricultural land, common land and the land reserves cannot be privately owned. Agricultural land may be owned solely by the state, and is leased to producers of agricultural products. Since the bulk of Uzbekistan’s agricultural land requires irrigation, private ownership of agricultural land would result in a significant decline in the use of machinery and in loss of efficiency in agricultural production. This special treatment is above all due to the country’s natural and climatic conditions, its historical development and demography as well as to the mentality of the peoples of Uzbekistan.

Under Uzbek legislation, legal entities and private individuals can acquire ownership rights to land in the prescribed manner, as part of the privatisation of commercial and consumer service organisations, which are privatised together with the land on which they are located.

Ownership rights to the sites of diplomatic missions, as well as international organisations that are accorded the same status as diplomatic missions, which are accredited in the Republic of Uzbekistan, arise when buildings or parts of buildings in which they are housed, including the residence of the head of the mission, are sold to them in the prescribed manner, together with the land on which they are located and land on which it is proposed to build diplomatic mission buildings.
Unlike private property, state property is divided into republic property and the property of the country’s administrative subdivisions (municipal property).

In addition to ownership rights, the Civil Code also deals with other property rights, including (Art. 165):
- operating control and management rights,
- lifetime ownership of land with hereditary succession,
- right of permanent use of land, and
- easements.

An innovation introduced by the Civil Code is the inclusion of the right of limited use of land owned by another party (easement). The owner of real property (land or another kind of real property) has the right to ask for the grant of the right of limited use (easement) of a neighbouring plot of land, or if necessary of another plot of land from its owner. An easement may be granted in order to provide pedestrian or vehicular right of way through another person’s property, access for the construction and operation of electricity supply lines, telecommunications lines or pipelines, the provision of water supply or other supplies required by the owner which cannot be provided unless an easement is created. The creation of an easement does not deprive the owner of his rights to own, use and dispose of the land. Easements are created by an arrangement between the person requesting the easement and the owner of the land, and must be registered in the manner prescribed for the registration of real property rights. If agreement on the creation of an easement or on its conditions cannot be reached, the dispute is resolved by a court of law upon a motion filed by any person requesting the easement. Easements may also be created for the benefit and at the request of a person whose interest is based on a lifetime ownership of a plot of land with hereditary succession, or the right of permanent use of a land plot.

**Subjects of civil rights**

The Civil Code devotes a special subsection to the subjects of civil rights. This subsection deals with the special features of the participation of individuals and legal entities, as well as the state, in civil rights processes. The Civil Code stipulates that individuals achieve full legal capacity upon reaching the age of 18. In some circumstances (lawful marriage, starting a business, entering employment on the basis of a labour contract) minors can also achieve full legal capacity.

A legal entity is defined as an organisation which owns, manages or operates specific individual assets, has the right to acquire and exercise property and personal non-property rights on its own behalf, assume liabilities and act as a plaintiff and defendant in a court of law. In contrast with the laws of many countries, the Civil Code of Uzbekistan stipulates that irrespective of whether a legal entity is a commercial or a non-commercial organisation, it has a specific legal capacity, i.e., its legal authorities are specified in its charter, regulations or by law.

Uzbekistan’s Civil Code provides for the establishment of business partnerships and associations, which are recognised as commercial organisations with capital divided into interests or shares. Assets formed of contributions made by the founders or payments for their interests or shares, as well as assets generated or acquired by a business partnership or a company in the course of its operations, are fully owned by such partnership or company.

Among legal entities, limited liability companies, joint-stock companies, production cooperatives, farms and small agricultural companies are used most frequently in practice. There are various types of business, defined by law, in which legal entities may engage only if they have obtained a special permit (licence).

All legal entities must be officially registered. Their official registration particulars are entered in a single official register of legal entities, which is open to the public. Legal entities failing to follow the statutory incorporation procedures, or failing to ensure that their incorporation documents comply with the law, are refused official registration. The Code provides no other grounds for a refusal to register a legal entity.¹

Pursuant to Article 53 of the Civil Code, a court of law may declare the registration of a legal entity established in breach of the law to be invalid if the breach cannot be remedied. The burden of proof of the failure of the legal entity’s statutes or other incorporation documents to comply with the law rests with the registering authority.

**Objects of civil rights**

Both tangible and intangible assets may be objects of civil rights. Tangible assets include various kinds of property: things, movable and immovable property, animals, money, foreign currency and securities. Intangible assets include intellectual property, official and commercial secrets, personal non-property rights (life and health, personal honour and dignity, inviolability of a person, business reputation, inviolability of private life, private and family secrets, the rights to names and images, copyright, etc.).

**Transactions and general provisions on contracts**

The Civil Code devotes a special subsection to transactions. Transactions may be completed...
orally or in writing. Silence is recognised as an expression of will to complete a transaction in the circumstances provided by law or by an agreement between the parties. Transactions may be completed in a simple written form, or may be notarised. Certain transactions involving real property must be officially registered. Failure to notarise a transaction or to have it officially registered renders it invalid, and the transaction is regarded as null and void. Other transactions regarded as null and void are those which do not comply with statutory requirements, have been entered into by persons adjudged legally incapacitated or by those under 14 years of age and transactions concluded purely for the sake of appearance and not intended to result in any legal consequences. The Civil Code also identifies various kinds of voidable transactions (e.g., transactions entered into by persons unable to comprehend the meaning of their actions or control them, etc.). A court of law may determine that such transactions are invalid upon a motion filed by interested parties. Where this is the case, such transactions will not result in any legal consequences, except for the consequences arising out of their invalidity.

In Uzbekistan, the general statute of limitation is three years. However, courts will admit motions for the protection of a violated right even after the expiration of the statute of limitation, and will apply the statute of limitation only upon a motion from one of the parties to the dispute filed before a ruling has been made. The expiration of the statute of limitation, motioned by a party to a dispute, can serve as a ground for the dismissal of the lawsuit. At the same time, the Civil Code lists cases to which the statute of limitation does not apply. For instance, Art. 163 provides that the statute of limitation should not apply to actions for the return of property of historical, cultural, scientific or artistic value and other valuables exported from Uzbekistan before the declaration of its independence.

The Civil Code provides a broad range of methods to secure enforcement of obligations: various types of fines and penalties, pledge, deposit, retention, surety and guarantee. Of all these methods, retention is of special interest, featuring only in the Civil Codes of Uzbekistan and Russia. Under the provisions on retention contained in Uzbekistan’s Civil Code, a creditor holding a thing intended for transfer to a debtor or a person designated by the debtor has the right to retain it if the debtor defaults or fails to refund costs and losses associated with this thing until such a time when the relevant payment has been made.

Uzbekistan’s Civil Code specifies the circumstances giving rise to liability for default. A debtor is liable for the non-performance or insufficient performance of his or her obligations if he or she is at fault. A debtor is adjudicated not to be at fault if he or she can demonstrate that all possible steps have been taken to ensure proper performance of their obligations. The absence of fault must be proved by the person who has breached his or her obligations. All prior agreements removing or restricting liability for deliberate non-performance are considered invalid from the time of their execution.

The Civil Code devotes special attention to contracts. In a market system, a contract is the principal legal instrument regulating relations between various subjects. For this reason, both the general and special parts of the Code deal with the terms and conditions of contracts, the procedures for executing, amending and terminating contracts and different types of contracts. Specific types of contracts, such as contracts on leasing, renting, franchising, factoring and trusts, are noteworthy as they have been borrowed from the experience of developed countries and included in Uzbekistan’s Civil Code for the first time.

**Intellectual property**

Section IV of the Civil Code deals with intellectual property. Intellectual property includes:

- the products of intellectual work: copyright, items, i.e., works of science, literature and art, performances, recordings and broadcasts, computer software and databases,
- industrial property: images, utility models and industrial designs,
- developments in agricultural selection,
- information not in the public domain,
- marks used to distinguish commercial entities, goods, labour and services, trade names, trademarks (service marks) and the names of places of origin.

The Civil Code defines the substance of exclusive rights to such intellectual property, the legal status of its authors, creators, title holders and users, and the forms and methods of safeguarding their rights.

**Conclusion**

Shaping and perfecting civil laws is an ongoing and dynamic process. In addition to the Civil Code, Uzbekistan’s civil legislation includes dozens of statutes (dealing with entrepreneurship, secured transactions, business associations and partnerships, property ownership, enterprises, etc.) and hundreds of regulatory acts. Uzbekistan’s parliament and interested communities in Uzbek society are currently discussing draft laws dealing with specific forms of property, the securities market, intellectual property and other laws essential to the establishment of a market economy in Uzbekistan.
Focus on Concessions

One of the challenges of infrastructure development has always been to identify sources of finance. The Egyptians subsidised the building of the Pyramids with heavy taxes and a large contingent of slaves. The Romans heavily taxed the peoples they controlled to build road and water systems. However, with the development of democratic institutions and increased demand for services, governments have looked to means of financing infrastructure developments more consistent with modern legal and political norms.

Concessions and similar contractual or licensing arrangements which provide for private sector investment in infrastructure development pose obvious advantages to forced labour and heavy taxes. For concession finance to flourish it is imperative that investors and governments bear in mind two critical elements: clarity and commitment. The legal regime in which investment needs to be made must be clear, so that the risks associated with investment may be properly assessed and fairly allocated among governmental authorities and investors. Parties must also be aware that the development of a successful concession project with private sector financing is a process which requires strong governmental political support, and commitment by all involved to hurdle the obstacles to reaching an agreement among investors, governments and lenders.

The following articles focusing on concessions provide information to policy makers and investors on the clarity and efficacy of the legal regimes for promoting private investment in central and eastern Europe. This section focuses on assisting policy makers in pursuing the development of an effective concessions regime by describing international efforts in this area, and describing a successful example of concession-based financing.

There is an emphasis in the following articles on the legal regimes applicable to concessions in south-eastern Europe. Recent political developments in this region generally, and Yugoslavia especially, make south-eastern Europe particularly topical. Enhanced political stability has made private sector investment in concessions more commercially viable. Moreover, there has been a concerted effort by these countries to develop concession projects. This effort has led to the adoption of a number of specific laws providing for the grant of concessions. Furthermore, this region has focused on infrastructure development in sectors which are conducive to limited recourse concession financings. In particular, a number of municipalities in the region have developed or are developing waste-water concession projects in a desire to facilitate accession to the European Union. For example, last year the EBRD provided financing for the construction of a waste-water construction facility in Maribor, Slovenia, and the upgrading of a water and waste-water facility in Sofia, Bulgaria. Partly as a result of the success of these financings, similar projects are being considered in Albania, Croatia and Romania.

The first article in this focus section is targeted at policy makers and investors assessing the adequacy of the concession law regime in the countries of central and eastern Europe and the CIS. The article is divided into two parts: the first highlights legal issues of concern to lenders in considering financing concession projects and suggests how a legal regime may be developed to enhance the bankability of concession projects; the second part describes the results of the EBRD's annual Legal Indicator Survey on concessions in the Bank's countries of operations. The second article illustrates the French experience of developing public service concessions. The author provides an historical perspective that may interest transition countries as they upgrade their concession laws.

The next three short pieces describe international initiatives designed to promote concessions and concession-based financing. The first describes the work of UNCITRAL in developing its Legislative Guide on Privately Financed Projects. The Guide has developed over several drafts since 1996, and with its adoption in July 2000, has become the starting point for government authorities in preparing new laws or reviewing the adequacy of existing laws relating to concessions. Next, the United Nations Economic Commission for Europe (UNECE) describes the work of its Build Operate Transfer (BOT) Group in developing guidelines on best practices, and the establishment of two new initiatives – a Regional Flagship Initiative and a Public Private Partnership Alliance – with the objectives of assisting governments in developing priority projects, harmonising their regulatory framework, and providing objective information to assist in project assessment. The final piece describes the work of an expert group formed under the auspices of the Organisation for Economic Cooperation and Development to prepare Basic Elements of a Law on Concession Agreements.

The next three articles describe the legal framework in three countries in south-eastern Europe. The first article provides a description of the legal regime applicable to concessions in the Federal Republic of Yugoslavia. This article is particularly timely for the EBRD as FR Yugoslavia became a member of the EBRD in January. The next article explains the development of the Bulgarian Law on Concessions and describes how the law interacts with other Bulgarian legislation. This section concludes with an article on the implementation of the Romanian Concession Law which was adopted in 1998. The focus section concludes with a case study of the first private sector limited recourse financing of a waste-water concession in central and eastern Europe. The article provides an overview of some of the legal challenges posed in structuring the EBRD financing of the Maribor waste-water project.
A favourable concessions regime: a lender’s perspective and perceptions from transition countries

The first part of this article discusses the legal issues of primary concern to lenders generally, and in particular to the European Bank for Reconstruction and Development (EBRD), in assessing the risks associated with lending to a concessionaire in the context of an infrastructure development project. The second part describes the results of the EBRD’s Legal Indicator Survey assessing the legal regime for concessions in the transition countries. Many of the questions in the survey focus on issues of concern to both developers and lenders in assessing the legal regime applicable to concessions in a particular jurisdiction.

Issues of concern to lenders in concession financing

Lenders are most comfortable when lending money against known or identifiable commercial risks. Lenders can establish formulas for assessing the country risk associated with loans to a project in a specific country. Similarly, lenders can assess and price the market risk of a project (i.e., whether there will be sufficient demand for the project’s product to make the project profitable). However, lenders, and in particular international lenders, are less comfortable in assuming many legal and political risks associated with a project. Accordingly, in determining whether to invest in a company which is awarded a concession and intends to develop an infrastructure project, lenders will assess the extent to which they are being asked to assume non-commercial risks. In making this assessment, they will look at the allocation of risks as provided in the concession agreement and the general legal regime governing concessions in the country. To the extent that the general legal regime minimises...
legal uncertainty in connection with the award and implementation of concessions, allows the concession granting authority, concessionaires and lenders to contractually allocate risks among themselves and takes into account the interests of lenders to ensure effective security over a project, such regimes can enhance the bankability, and thus the viability, of concession projects. More specifically, there are seven areas where policy makers can act to enhance the bankability of concession projects through the development of a concessions regime.

1. Award concessions fairly

In considering whether to finance a concession, lenders are particularly concerned with the process by which a concession was awarded. If a concession is awarded to a private investor in a manner which suggests that the concessionaire obtained such rights through influence, corruption or on the basis of having access to non-public information, lenders face a number of risks. First, the credit risk for the lenders is increased because it may be easier for the award of the concession to be challenged, either legally or politically. A new government may decide that an awarded concession is unfair and actively seek ways of either terminating the concession or inhibiting the ability of the concessionaire to exercise rights. Second, most lenders are wary of risks to their reputation associated with financing a project where there are, or may be, rumours of corruption or unfairness in the award of the concession. Third, international financial institutions like the EBRD have a policy objective to encourage public tendering for concessions as part of their objectives to facilitate the transition of the economies of their countries of operations to market economies. By encouraging public tendering for concessions, the EBRD strives to enhance investor confidence in the process for awarding tenders, and to allay investor concerns of corruption or unfairness in connection with the investment in a particular country.

2. Clarify power of granting authorities

Lenders are obviously concerned that any concession agreement to be financed has been properly entered into by the relevant governmental parties. In addition, it is important that the government’s authority to enter into a concession agreement will not be subject to challenge. This issue is not always clear. For example, in a Sofia water and waste-water concession project in which the EBRD provided financing in December 2000 there was some uncertainty under applicable Bulgarian law regarding the respective scopes of authority of the mayor of Sofia and the municipal council. It was therefore necessary to exercise great care in negotiating the concession agreement and the financing agreements to ensure that the appropriate level of approval was obtained. Accordingly, it is essential that either the general concessions law or the sector-specific concessions laws, if any, identify the authority/authorities that are empowered to enter into concession agreements, and specify the scope of their authority to modify the terms of a tendered concession agreement.

3. Clarify tax and licensing regimes

An important component of lender due diligence in a concession project is to ensure that the concessionaire has (or will obtain) all licences necessary for the construction and operation of a project. In addition to licensing issues, the financial viability of a project often hinges on whether tax or customs duties exemptions granted contractually in a concession will be respected by the relevant authorities. Unfortunately, in many jurisdictions inconsistencies among various laws and the terms of a concession agreement raise uncertainty regarding the tax and licensing regime applicable to a project. In assessing the efficacy and clarity of the legal regime applicable to a concession, lenders would look at the existence of a general regime that regulates the tax and licensing issues relating to the grant of concessions in a number of different sectors. It is often preferable to have such

4. Provide lenders effective security

A legal regime which seeks to establish a framework for concession financing should allow and encourage structures which provide for protection of the rights of lenders under their relevant security documents, and in the event of the termination of a concession. Of fundamental interest to any lender considering project finance of a concessionaire is whether the lender will have effective security over the assets of the concessionaire. Lenders require security from which they can realise value in the event of a borrower’s non-compliance with a loan agreement. Such security includes real property, buildings, equipment, insurance proceeds, bank accounts and receivables. Lenders also require security which is readily realisable. For example, some jurisdictions have effective legal regimes, where enforcement of rights is relatively straightforward and in which lenders feel comfortable protecting their loans by taking security. On the other hand, in other jurisdictions, including some in central and eastern Europe, the enforcement of lenders’ security rights is more problematic. One approach that

The term concessions, as adopted in the Legal Indicator Survey, is “an agreement or license pursuant to which a governmental authority grants rights and agrees obligations to be undertaken in relation to the construction, rehabilitation or provision of infrastructure or the exploration for and/or exploitation of natural resources (including any related treatment or transport facilities) to a private sector entity to utilise government assets in order to proved facilities or services to members of the public or otherwise”.

Focus on concessions
lenders might use to reduce enforcement risk in such cases is to require that sponsors hold their interests in a concessionaire through a special purpose company located in a foreclosure-friendly jurisdiction, and provide that lenders would take liens on the shares of such special purpose company.

One of the challenges of concession-based financing, however, is that a concessionaire’s primary asset is usually a contract right, the concession agreement, which may be subject to termination in the event of a concessionaire’s non-compliance with its obligations. Under most concession agreements, the concessionaire is not the owner of the property associated with a concession and, accordingly, the lenders may not obtain a mortgage over the real property on which the project will be built. Under most concessions, even if a concessionaire is the owner of facilities constructed or equipment associated with a project (which is not always the case) upon termination of the concession such facilities typically pass to the grantor of the concession. Notwithstanding the limited nature of the assets owned by a concessionaire, it is important for lenders to take security over whatever those assets are, such as contract rights (including the concession contract), insurance proceeds, bank accounts and equipment. Lenders require such liens primarily to maintain a level of control over the concessionaire, ensure their priority over other creditors in bankruptcy and, in many jurisdictions, enhance their level of control over bankruptcy proceedings.

5. Permit government undertakings to lenders

Lenders invariably require some form of direct agreement or consent to assignment with the government authority granting the concession the granting authority. The legal regime should allow for the granting authority to make such undertakings. Lenders will look for direct agreements with the granting authority on a number of issues:

- formal recognition by the granting authority that lenders are financing this project, have an interest in the concession agreement, and are relying on representations from the granting authority regarding the validity of the concession agreement;
- acknowledgement by the granting authority that the lenders have a lien on the concession agreement and the other rights associated with the project;
- commitment to notify lenders in the event a concessionaire is breaching its obligations under a concession agreement;
- granting authority agreement not to terminate the concession agreement without permitting the lenders an opportunity to cure breaches which give rise to such termination rights;
- permission for lenders to introduce a substitute concessionaire in the event that the existing concessionaire is not performing its obligations under relevant financing agreements;
- agreement that any termination payments due to the concessionaire shall be payable to lenders; and
- clear waiver of sovereign immunity by the granting authority in the event disputes arise under a concession agreement or the relevant direct agreement.

Lenders also seek to minimise the risk of termination by requiring the granting authority to pay the fair market value of the facilities to be transferred to the granting authority in the event of termination. In mining or oil and gas activities under a production licence, lenders try to minimise the risk of termination by agreeing that if the licensing authority terminates the licence it will require bidders for the re-tender of the licence to undertake to repay the lender’s debt. Similarly, in a number of telecommunications transactions where the concession is in effect a licence, licensing authorities have agreed as an accommodation to lenders to restrict the circumstances in which termination of such a licence might be possible.

6. Permit concessions to be governed by investor-friendly choice of law rules and dispute resolution mechanisms

Choice of law

Lenders are more comfortable with the legal risks associated with financing concession contracts when such contracts are governed by a set of local rules that are well known, generally acceptable internationally, and rooted in a system with effective enforcement. In many jurisdictions, however, where a concession agreement is entered into between a local authority and a company formed in the country in which the project is located, the concession agreement must be governed by local law. Obviously, the more developed local law is in enforcing concession agreements, the more flexible lenders are on this issue. However, lenders are often unwilling to proceed with financings where the concession agreement is governed by a local law which is uncertain as to the interpretation and enforceability of the terms of the concession agreement.

Dispute resolution

Lenders are more comfortable in relying on enforcing any rights they may have under a concession agreement exclusively in the courts of the granting authority. In most cases, they require that such disputes be resolved in accordance with an international arbitration regime outside of the relevant country, in order to avoid any perceived (or real) bias in the local courts which may not have a track record in adjudicating against the government.

In addition to these concerns, it is also worth noting the special requirements of international financial institutions like the EBRD. The EBRD’s normal practice would be to require arbitration in accordance with UNCITRAL rules with a dispute resolution mechanism that is impartial, regulated according to established rules, confidential and provides a binding decision which forecloses the possibility of endless appeals.
While the EBRD will consider other arbitration regimes, certain regimes can be problematic. For example, in some jurisdictions, like Croatia, international arbitration between two local entities is not permitted, other than arbitration conducted under the rules of the International Centre for Settlement of Investment Disputes (ICSID). However, ICSID arbitration presents a number of problems for international financial institutions like the EBRD and the IFC. Under Article 25 of the ICSID Convention, the jurisdiction of the Centre extends only to legal disputes arising directly out of an investment between a contracting state and a national of another contracting state. If the EBRD as a lender were to exercise its rights against the grantor of a concession under a concession agreement subject to ICSID arbitration (which might be the case in the context of exercising its foreclosure rights), it is unclear whether ICSID would be able to exercise jurisdiction over such dispute since the EBRD is not a national of a contracting state. Similarly, if the EBRD were to assume control over the shares of a concessionaire, it is not clear whether ICSID would view a project company in effect controlled by an international financial institution as a national of a contracting state for the purposes of exercising jurisdiction.

7. Provide for financial stabilisation

Lenders and concessionaires are particularly concerned about the effects of changes in the tax or licensing regime on the financial viability of the project. In a number of projects lenders and concessionaires are also concerned about the effects of currency devaluation and force majeure events on the ability of the concessionaire to meet its debt service obligations.

It is important that a concession-friendly legal regime permit the grantor of the concession to include provisions in the concession contract which would provide for additional compensation in case such events occur. These provisions are generally known as financial stabilisation provisions and are fundamental mechanisms for allocating risks. One such risk for which a concessionaire would expect to be compensated would be changes in the tax or licensing regime which have financial implications for a project, as these risks are often in the control of governmental authorities who may have granted the concession in the first place. While a government would not agree to restrict its ability to enact such tax laws, it would generally be expected to place the concessionaire in the same position as it would have been had the legal regime not changed. With respect to other risks, the decision as to which party will bear the cost of such events (and in particular the scope of force majeure events) would be the subject of negotiation and discussion in any project. The decision over how these risks are allocated will often determine whether a concession project is financeable.

**EBRD Legal Indicator Survey: perceptions of concessions law and climate**

In 2000 the EBRD’s annual Legal Indicator Survey (LIS) included a new section on concessions. This addition was a recognition that an increasing number of infrastructure and utilities projects in emerging markets are achieved using concessions and a key determinant of the success of these investments is the legal regime. The LIS concessions questions are based, in part, upon the work of UNCITRAL, which has developed a legislative guide to the financing of public-private infrastructure projects. As with other LIS segments, the concessions questions attempt to capture the perceptions held by local lawyers as to whether a country’s concessions laws are comprehensive (referred to as extensiveness) and whether they work in practice (referred to as effectiveness). The Survey questions focused not only on elements of a legal regime that are perceived as necessary to encourage private sector investment but also on those which will enhance the bankability of infrastructure development.

Many of the local lawyers surveyed represent lenders as well as concessionaires. Their perceptions provide an interesting insight into whether a country appears legally prepared for concessions activity. To the extent that local lawyers perceive that a certain concessions climate is legally uncertain or unfavourable, this may translate into a lesser degree of confidence among investors or lenders.
Perceptions of the adequacy of the legal framework for concessions in transition countries

Trends across the region

In general terms, the state of reform of concessions laws can be seen to fall into five broad categories (see accompanying map).

**Comprehensive**

The legal framework for concessions is perceived as comprehensive and highly effective. The selection process is seen as fair, well defined and transparent in practice. Effective mechanisms exist for dealing with challenges to the selection of concessionaires and to legal disputes generally. The rights of concessionaires under the law applicable to concessions are clear. The contracting authority is largely free to enter into concession agreements that include governing law and dispute resolution provisions as the parties agree. The legal regime provides lenders with effective means for taking security over or otherwise protecting their interest in concessions. Procedures may exist for certification of a bona fide concession agreement by a government authority protecting such agreement from subsequent legal challenge.

**Adequate**

The legal framework for concessions is perceived as adequate and reasonably effective. The selection process is seen as well defined although not always consistently or transparently applied. Mechanisms exist for dealing with challenges to the selection of concessionaires and to legal disputes generally. However, these are not always effective. The rights of concessionaires under the law applicable to concessions are reasonably clear. The contracting authority is largely free to enter into concession agreements as the parties agree, although there may be some restrictions regarding governing law and dispute resolution provisions. The legal regime provides lenders with effective means for taking security over or otherwise protecting their interest in concessions, although there may be significant restrictions on the effectiveness of this security.

**Barely Adequate**

The legal framework for concessions is perceived as barely adequate with minimal effectiveness. The selection process is defined, but not always in clear or consistent terms. Mechanisms exist for dealing with challenges to the selection of concessionaires and to legal disputes generally. However, the authority of the court is unclear particularly in relation to the invalidation of improperly awarded concession agreements. Rules governing the terms of the contract between the contracting authority and the concessionaire exist, but are frequently unclear and sometimes unenforceable. There are significant restrictions regarding governing law and dispute resolution provisions. The legal regime may provide lenders with effective means for taking security over or otherwise protecting their interest in concessions, although there are significant restrictions on the effectiveness of this security.

**Inadequate**

The legal framework for concessions is perceived as inadequate and ineffective. There may be no unified framework for concessions in the country and the law affecting concessions may be very unclear. The selection process is generally viewed as not transparent or unfair in respect of at least some key elements of that process. Mechanisms may exist for dealing with challenges to the selection of concessionaires and to legal disputes generally.
However, there is a perception that the courts would not be impartial and transparent in their decision making process. Rules governing the terms of the contract between the contracting authority and the concessionaire may not exist or, if they exist, may be highly uncertain or grant limited freedom to the parties to agree the terms of their contract. The legal regime may not provide lenders with effective means for taking security over or otherwise protecting their interest in concessions.

**Detrimental**

The legal framework for concessions is perceived as wholly ineffective and may discourage economic activity based on concessions. There is either no unified framework for concessions or, if there is, it is not utilised in practice. The granting of concessions as a means of promoting infrastructure development and attracting investor participation is not an established concept in practice. The legal regime does not provide lenders with effective means for taking security over or otherwise protecting their interest in concessions.

Concessions climates perceived as adequate at best

Concessions legislation in many transition countries was not enacted during the first part of the 1990s. For many governments, the decision to grant concessions is a recent one, necessitated as a means of financing needed infrastructure and of exploiting natural resources. Legislative activity in this area is a relatively recent phenomenon.

The concessions results indicate that many concession systems function, but the legal framework regulating them is rather weak. The overall scores in the concessions category are far lower than in other LIS categories (e.g., in secured transactions, company and insolvency law). The lower concession scores may reflect the newness of such laws. At most, half of the countries surveyed have enacted consolidated framework legislation. Many countries have laws solely on procurement or perhaps have licensing laws for specific sectors like energy or telecommunications. Consequently, respondents were often unclear as to how concessions agreements were negotiated or performed in practice.

For the majority of countries, concessions scores also showed a perceived gap between extensiveness and effectiveness (with a few notable exceptions discussed below). At present, none of the countries surveyed are perceived as having a “comprehensive” concessions framework. The majority of countries fell into the “inadequate” or “barely adequate” category for their concession laws, with a handful obtaining a rating in the “adequate” category. Effectiveness scores were also quite low. Nearly all of the surveyed countries received scores of lower than 50 per cent for legal effectiveness and more than one-third received an effectiveness score of lower than 30 per cent. The low effectiveness scores suggest a widely held perception that many jurisdictions are not selecting concessionaires in a consistent, open and transparent manner. Only three survey countries fell into the “detrimental” category. This indicates that in the majority of jurisdictions’ lawyers perceived there to be some framework governing concessions or infrastructure projects.

Some countries with similar concessions laws and legal systems were rated differently. For example, the Czech and Slovak Republics have virtually identical concessions systems. None the less, the Czech respondents rated its concessions as “inadequate” rather than “detrimental”. To some extent, greater economic activity in the Czech Republic may have created a more conducive environment for concessions, or at least the perception of one.

The lack of a coherent legislative framework very often led to confusion as to the scope and nature of concessions practice. Russia, for example, fell into the “inadequate” category, in part because of low effectiveness scores as well as seemingly uncertain or inconsistent responses about the extensiveness of its legal framework. However, in some cases even the existence of a relatively coherent legislative framework was outweighed by the ineffective-ness of the applicable legal regime. For example, Tajikistan has a law on foreign investment that recognises the right of foreign investors to use land, other natural resources and property rights, but does not have any specific measures for concessions. Tajikistan also has a general concessions law that provides parameters for concessions to be entered into by government authorities. Accordingly, respondents rated Tajikistan as generally “adequate” in respect of the extensiveness of the legal regime. However, respondents perceived the effectiveness of the concessions regime to be so ineffective so as to place it in the “detrimental” category.

The existence of a framework concessions law appeared to impact the legal community’s awareness and understanding of concessions as a subject matter. The majority of countries that are grouped in the “adequate” and “barely adequate” categories have a unified framework law. The existence of a framework law appeared to be a key determinant of whether a legal system was perceived as reaching a baseline of adequacy. Respondents may have been more aware of a concessions framework when it was self-contained within a single act as contrasted with jurisdictions where multiple laws, regulations and administrative decrees cover the same ground.

With the exception of Estonia, countries grouped in the “barely adequate” category are jurisdictions that have a framework law. Ukraine, for example, enacted a new concessions law which became effective in July 1999. The Ukrainian law is comprehensive in its scope and provides detailed guidance on the terms to be included in the contract. The law provides a clear process for tenders. It also allows parties to seek international arbitration for disputes when one of the parties is a non-resident of Ukraine. Survey respondents

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8 S. Brown and V. Laconic, “Ukraine: Law on Concessions”, Eastern European Forum Newsletter, pp. 45-49 (June 2000). (“The foreign investor will not be subject to vague and unfair rules of tenders past because the Law provides clear, concise and detailed terms and conditions for competing in the concession tender.”)
appear to have taken the substance of the new law into account when responding to the Survey. Ukraine’s extensiveness score was very strong; its effectiveness score, however, was significantly lower. This may be because there were few, if any, concessions granted in Ukraine during the first year of the new law’s operation. The significant implementation gap caused Ukraine to fall into the “barely adequate” category.

Bulgaria also fell into the “barely adequate” category. This may initially seem unexpected, given the enactment of a concession law in October 1995, together with a Law on Municipal Obligations in May 1996. The Bulgarian laws did translate into a fairly strong extensiveness score, though some respondents perceive that the law does have some ambiguities or problems. Some commentators have noted, for example, that the assignment by a concessionaire of its rights in a concession agreement (or alternatively arrangements that would provide lenders with the ability to substitute concessionaires in the event of foreclosure) are not permissible under Bulgarian law. In addition, it is unclear under Bulgarian law whether concession rights are in rem or contractual. If such rights are contractual, disputes can be resolved by arbitration. If they are in rem, only Bulgarian courts can resolve disputes over such rights. Concession agreements are also non-assignable in Bulgaria. As noted above, these restrictions in the Bulgarian legal regime make it difficult for lenders to extend credit to a concession project.

Most countries in the “adequate” category have a unified concessions framework and more importantly, had strong effectiveness scores. The existence of a legal framework was bolstered by a concessions system that appears largely to be effective in practice. The adequate countries include FYR Macedonia, Georgia, Hungary, Poland, Romania and Slovenia. Poland does not have a framework concessions act, but does have an act on procurement as well as a Geological and Mining Act and an Energy Law, which provide for private sector investment.

Nor does Slovenia have a framework concessions law. Some data exists, however, to suggest that Slovene concession practice is functioning quite efficiently and frequently in the absence of a single framework law. It appears that other legislation, combined with administrative decrees and customary practice, has created in Slovenia what is perceived as a well-functioning and predictable concessions regime. The process of granting a concession in Slovenia is based on provisions of the Slovenian Public Services Trading Act of 1993 (PSTA). The PSTA allows concessions to be granted only through competitive bidding, and provides that the deed of concession shall be a government regulation or a decree of local authorities. It provides for a tender process and an appeal procedure. The certainty of Slovenia’s concessions climate has translated into external lending from institutions such as the EBRD. Perhaps one of the reasons Slovenia has done so well in the rating is that a large number of smaller concessions have been granted in Slovenia. Small municipalities have granted a number of concessions for wastewater and gas supply projects. The large number of concessions is driven by the lack of available municipal finance and the drive for water projects to facilitate EU accession.

Nor does Slovenia have a framework concessions law. Some data exists, however, to suggest that Slovene concession practice is functioning quite efficiently and frequently in the absence of a single framework law. It appears that other legislation, combined with administrative decrees and customary practice, has created in Slovenia what is perceived as a well-functioning and predictable concessions regime. The process of granting a concession in Slovenia is based on provisions of the Slovenian Public Services Trading Act of 1993 (PSTA). The PSTA allows concessions to be granted only through competitive bidding, and provides that the deed of concession shall be a government regulation or a decree of local authorities. It provides for a tender process and an appeal procedure. The certainty of Slovenia’s concessions climate has translated into external lending from institutions such as the EBRD. Perhaps one of the reasons Slovenia has done so well in the rating is that a large number of smaller concessions have been granted in Slovenia. Small municipalities have granted a number of concessions for wastewater and gas supply projects. The large number of concessions is driven by the lack of available municipal finance and the drive for water projects to facilitate EU accession.

Transparency and fairness of concessionaire selection process

Note: Survey respondents were asked whether in their view the concession selection process in their particular country was fair and transparent.

Some concession climates function without framework laws

In a few cases a country received a higher effectiveness than extensiveness score. Respondents may have believed that, despite the lack of a comprehensive or unified concessions framework, it was none the less possible for government entities (at some level) to effectively grant concessions. Countries such as Armenia, Azerbaijan, FYR Macedonia and Kazakhstan all received higher effectiveness than extensiveness scores. Of these countries only FYR Macedonia has a specific law concerning concessions. In practice, a system may work despite the paucity of the legal framework.
Perceived lack of fairness and transparency in the selection process

The LIS asked local lawyers whether, in practice, the concession selection process in their jurisdiction was fair and transparent. The chart at left shows the responses received from lawyers in various regions. There appears to be a perception that concessions are not consistently awarded in an open and predictable manner. The majority of respondents in all four geographic regions believed that the selection process was, at best, fair and transparent some of the time (i.e., less than or equal to 50 per cent of the time).

Respondents in Central Asia showed the highest degree of scepticism, approximately 33 per cent indicating that the selection process is never fair and transparent. No respondents in Central Asia believed that the process was fair frequently or almost always. CIS lawyers also appear to lack confidence in the selection process. Only 13 per cent of CIS respondents believed the process worked frequently; none selected “almost always”. Both central European and Baltic respondents and south-eastern European respondents gave more positive responses. Roughly 45 per cent of lawyers surveyed in each of these regions found that the selection process was fair and transparent more than 50 per cent of the time (i.e., responding “frequently” or “almost always”).

Uncertainty over taking security

As noted above, it is critical for lenders to be able to take some form of security over concession assets, including the concession contract itself. The ability to obtain a security interest promotes certainty for the lender with respect to repayment of the loan.

The LIS asked respondents whether a contractor could grant a security interest in the concession itself. Only 23 per cent of respondents overall indicated that this was clearly possible in their jurisdiction. Thirty-five per cent responded that it was unclear whether such assignments were permissible and 42 per cent responded that it was not possible for such a security interest to be granted.

Seventy-seven percent of lawyers surveyed felt that it is either non-permissible or unclear as to whether third parties can take security interests in concessions, a key requirement for lenders interested in financing concession-based investments. As a result, the survey has identified an area where legal reform could improve the overall concession regime.

We note, however, that the specificity of this question may not have captured other methods employed by lenders for protecting their security interests in a concession. By way of illustration, while it is preferable for lenders to have a so-called “lien” on a concession contract, the primary interest of lenders is in creating a mechanism for transferring the concession to a reputable and financially capable third party in the event that the existing concessionaire fails to fulfil its requirements under the relevant financing agreements. Such a transfer can necessitate a lender obtaining further consent from relevant governmental authorities for a transfer, provided that such consent would be granted if certain criteria were satisfied. These “security” arrangements are typically more comprehensively addressed in direct agreements between grantors of concessions and lenders. It is not entirely clear whether respondents took a broad view of whether granting a security interest was possible or a narrow one, although as a practical matter a legal regime which recognised the enforceability of direct agreements between governmental authorities and lenders with respect to transferring rights under a concession would achieve a great deal in creating an environment conducive to financing concessions.

Uncertainty with respect to freedom to contract

There were several issues regarding concessions on which respondents did not have a clear understanding. For example, a high number of respondents were uncertain as to whether contracting parties could choose an applicable law other than the law of the contracting authority. Freedom of contract, or the latitude afforded to the contracting authority, was the area where respondents appeared the least knowledgeable. This may reflect either an under-utilisation of concessions law in some jurisdictions or, alternatively, a lack of clarity with respect to what can or should be included in a concession agreement.

Additionally, respondents were often unclear whether an international arbitration clause could be included in a concession agreement. Because respondents were unsure about the substance of the law, often they
were unable to answer how various concepts worked in practice.

**Conclusion**

In considering whether to finance projects based on concession agreements, lenders look to minimise the impact of non-commercial risks associated with such financings. To the extent a legal regime provides a cohesive and clear structure for the grant of concessions, lenders will be encouraged to provide financing. Similarly, to the extent a legal regime recognises lenders’ interests in establishing effective security over a project, and in ensuring effective enforcement remedies, lenders will be better able to evaluate such projects on their commercial merits.

As the EBRD’s 2000 Legal Indicator Survey shows, the transition countries have not yet reached the level of providing such a comprehensive legal regime for concessions. A number of countries have in recent years focused attention on improving their concessions laws. However, according to the Survey the major areas where there is a perceived need for further reform include:

- greater clarity in the legislative framework (this could, of course, be achieved via new laws or amendment/supplementation of existing laws);
- increased transparency in the tender/selection process and more publication of information pertaining to the invitation for bids and the selection of the concessionaire; and
- more examples of what should be included in a concession agreement, either through the promulgation of sample contracts or through revisions to the law.

It will be interesting to see in the future whether perceptions of LIS respondents in the surveyed countries improve with the increased use of existing laws and the introduction of new or amended concessions legislation. Additionally, there is room for study of the relationship between a favourable concessions climate and the degree of investor and lender financing of concessions. To the extent that a jurisdiction’s concessions laws remain unclear or seem to be applied inconsistently, there will be a continued reluctance for lenders to finance projects.
International efforts to promote and harmonise concession law

UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects

José Angelo Estrella Faria, Legal Officer, UNCITRAL*

At its thirty-third session (New York, 12 June-7 July 2000) the United Nations Commission on International Trade Law (UNCITRAL)¹ adopted the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects.² This was the culmination of work that began in 1996, when UNCITRAL first considered the possibility of working in the field of privately financed infrastructure projects.

UNCITRAL has reviewed various draft chapters of the Guide since its thirtieth session in 1997. The draft chapters were prepared by the Secretariat with the assistance of outside experts from both the public and the private sectors. The Secretariat also held consultations with other international organisations, such as the United Nations Economic Commission for Europe (UNECE), the United Nations Industrial Development Organisation (UNIDO), the World Bank, the European Bank for Reconstruction and Development (EBRD), as well as with non-governmental organisations such as the International Bar Association, the Berne Union, the Panamerican Surety Association, and the Fédération Internationale des Ingénieurs Conseils (FIDIC).

The Legislative Guide

Purpose

The Guide is intended to become a reference that national authorities and legislative bodies may use when preparing new laws or reviewing the adequacy of existing laws and regulations. For that purpose the Guide helps identify areas of law that are typically most relevant to private investment in public infrastructure projects. It also discusses legislative options that would be conducive to attracting private capital, both national and foreign. The Guide is not intended to provide advice on drafting agreements for the execution of privately financed infrastructure projects. Nevertheless, it discusses some contractual issues to the extent that they relate to matters that legislation might usefully address.

Scope

The Guide is concerned with infrastructure projects that require the selected investors to undertake physical construction, repair or expansion, in exchange for the right to charge a price (either to the public or to a governmental agency) for the use of the infrastructure facility or for the services it generates. It does not deal with “privatisation” transactions unrelated to the development and operation of public infrastructure,² nor does it address projects for the exploitation of natural resources, such as mining, oil or gas exploitation projects.

Background to UNCITRAL’s work

In recent years, private investment in infrastructure has rapidly increased. In some developed and developing countries it represents a new business market which requires the development of a new legal framework. The Secretariat’s studies of domestic laws and regulations pertaining to privately financed infrastructure projects show a wide array of approaches to the legal issues raised by these projects and varying levels of experience in handling them. It is essential to bear in mind this diversity in order to understand the

¹ UNCITRAL is a subsidiary body of the United Nations General Assembly. It was established in 1966 with the general mandate of furthering the progressive unification and harmonisation of the law of international trade. UNCITRAL is composed of 36 member states elected by the General Assembly. Membership is periodically renewed, and is structured so as to be representative of the world’s various geographic regions and its principal economic and legal systems.
³ The reader will find an excellent overview of the various privatisation techniques that have been used in various countries and a discussion of the legal issues involved in Pierre Guislain, The Privatization Challenge (Washington, D.C., The World Bank, 1997).
approach taken by UNCITRAL when formulating its recommendations.

The United Kingdom, for example, has established a comprehensive legislative framework for private investment in infrastructure in the last two decades. Such framework includes legislation adopted to liberalise the public utilities sectors and to attract private investment to other types of infrastructure or services through the Private Finance Initiative (PFI). The PFI goes beyond the traditional notion of privatisation to provide a new approach for the procurement and delivery of services by government. It is estimated that a high proportion of public expenditure investment in the United Kingdom over the next years will be financed privately and the experience gained with the PFI has attracted global attention.

Significant legislative developments have taken place in eastern Europe, where new general or sector-specific laws governing private participation in infrastructure projects have been adopted as part of the measures taken to allow the transition to a market-based economy. In the Asia-Pacific region, the Philippines was one of the first countries to adopt a comprehensive legal framework for the development of infrastructure through private investment. Many countries of the region have since adopted a policy of promoting private investment in infrastructure. This has in some cases resulted in the adoption of general enabling legislation (Thailand, Vietnam), or sector-specific legislation (India) although in some countries, legal developments have been, at least initially, limited to the issuance of policy statements (Sri Lanka) or general guidelines (China).

The large amount of new legislation adopted in the past two decades should not lead to the erroneous conclusion that privately financed infrastructure projects represent an entirely new phenomenon. Not only was there considerable investment in public infrastructure during the nineteenth century and up to the first half of the twentieth century, but in some countries there is a well-established legal tradition in respect of infrastructure projects financed and carried out by the private sector. The public utilities sector of the United States, for example, has traditionally been open to private investment. A considerable amount of case law in that country and special regulations are applicable to the terms of public utility franchises and the operations of public utilities. Nevertheless, recent legislation has restructured certain infrastructure sectors and enabled governmental agencies to attract private investment for sectors not yet privatised.

Within the civil law tradition, France has for centuries engaged private entities for the provision of certain public services, and the French Conseil d'Etat has developed a rather elaborate body of rules and principles of administrative law governing agreements for “delegation of public services”. Although most of the existing general legislation on privately financed infrastructure projects in civil law countries is relatively recent, as in the case of Turkey and most Latin American countries, the notion of private provision of public services is well embedded in most legal systems belonging to the civil law tradition.

International experience shows a varying level of success in the implementation of privately financed infrastructure projects. Some of the difficulties experienced by some countries have been attributed to deficiencies in the existing legislative framework. This circumstance had led UNCITRAL to offer its legislative advice, in particular to legislators and policy makers in developing countries and transition economies. By presenting and explaining best practices, the Guide aims to help those legislators and policy makers evaluate the adequacy of laws and regulations relevant to those projects. However, UNCITRAL was mindful of the different legal traditions and legislative practices in various countries; therefore, the Guide is not intended to unify the law of privately financed infrastructure projects, nor is it meant to lead the domestic legislator to crystallise the law in rigid legislation. Throughout the Guide the legislator is invited to bear in mind the need to ensure that the parties have the necessary flexibility to negotiate contractual arrangements that suit the needs of individual projects.

Overview of Legislative Guide topics

In this short introduction to UNCITRAL’s work in this area it is not possible to include a full presentation of the treatment given to privately financed infrastructure projects in various legal systems and the solutions proposed in the Guide. The following paragraphs give only a brief overview of some of the main topics dealt with in the Guide.

Balancing the interests of public and private sector

From the beginning of its work UNCITRAL has aimed at achieving an appropriate balance between the need to attract private investment for infrastructure projects and to protect the interests of the host government and the public through the Legislative Guide. Of course, achieving such a balance is, to a large extent, a matter for negotiations between the parties concerned. However, there may be limitations to party autonomy in the form of implied or mandatory contractual terms. There may also be certain implied powers of public authorities that result in a substantial inequality between the contracting authority and the concessionaire.

This inherent imbalance, either as a matter of law or as a result of government contracting practice, may be found in various legal systems, but it is more apparent in legal systems of the civil law tradition. Special prerogatives for governmental agencies are justified in those legal systems by reasons of public interest, which the Guide does not question. The Guide recognises, however, that special governmental prerogatives, may, if improperly used, diminish the vested rights of government contractors. The Guide invites countries interested in attracting private investment in infrastructure to review their laws on government contracts, so as to provide the degree of protection needed for fostering private investment and remove those provisions which give rise to concerns about the long-term contractual stability required for infrastructure projects.
Devising appropriate bidding procedures

In line with the advice of international organisations such as UNIDO and the World Bank, the Guide expresses a preference for the use of competitive selection procedures which several delegations participating at the UNCITRAL deliberations felt necessary in order to counter improper practices and corruption, as well as to obtain the best value for the host government and the users of privately financed infrastructure facilities. However, the Guide proposes selection procedures specially devised for infrastructure projects, which differ in many respects from the tendering process typically used in government procurement.

Facilitating financial closing

The Guide highlights the importance of security arrangements for raising finance for infrastructure projects. It invites host countries to review their laws on security interests; it stresses the importance of ensuring that domestic laws provide adequate legal protection to secured creditors and do not hinder the ability of the parties to establish appropriate security arrangements. The Guide also invites governments to take account of international developments in the area of security interests, including the Model Law on Secured Transactions, which was prepared by the EBRD to assist legislative reform efforts in central and eastern European countries.

Dealing with changed circumstances

The Guide stresses the importance of contractual mechanisms for dealing with changes in circumstances, with a view to preserving the long-term sustainability of infrastructure projects. In that connection, it calls the attention of legislators to two particular categories of change: legislative or regulatory changes and unexpected changes in economic conditions.

For the purpose of considering the appropriate solution for dealing with legislative changes, the Guide distinguishes between legislative changes having a particular incidence on privately financed infrastructure projects (or on one specific project), on the one hand, and general legislative changes affecting other economic activities also, and not only infrastructure operation, on the other hand. The Guide discusses the most appropriate risk allocation schemes for each of these categories.

As regards changes in the economic conditions, the Guide notes that sometimes their impact may be covered automatically in the project agreement, either through financial arrangements such as a tariff structure that includes an indexation clause, or by the assumption by either party, expressly or by exclusion, of certain risks. However, some changes might not lend themselves easily to inclusion in an automatic adjustment mechanism or that the parties may prefer to exclude from such a mechanism. Different remedies may be available to the parties, depending on the law governing the project agreement. The Guide stresses the importance of ensuring that the contracting authority has sufficient powers to agree on contractual mechanisms to deal with changes in the economic or financial conditions that render the performance of the concessionaire’s obligations substantially more onerous than originally foreseen at the time they were entered into.

Conclusion

The preceding paragraphs have provided only a few examples of issues discussed in the Guide. In addition the Guide considers matters such as:

- general legislative and institutional framework for the implementation of privately financed infrastructure projects (constitutional and legislative framework, scope of authority to award concessions, administrative coordination, institutional arrangements for the regulation of infrastructure services);
- project risks, risk allocation and government support;
- legislative and contractual agreements for the construction and operation of infrastructure, including core terms of the project agreement (such as organisation of the concessionaire, the project site and easements, financial arrangements, security interests, assignment of the concession, transfer of controlling interest in the project company, construction works, general conditions for infrastructure operation, guarantees of performance, insurance arrangements, force majeure, events of default, step-in rights of the contracting authority and the lenders);
- duration and extension of the project agreement, termination of the project agreement and consequences thereof; and
- settlement of disputes.

It is expected that the Guide will be a useful tool to assist domestic legislators, in particular in developing countries and in economies in transition, in the establishment of a favourable legislative framework for the implementation of privately financed infrastructure projects.

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Public-private partnerships for infrastructure development: The next steps

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Public-private partnerships (PPPs) continue to attract the interest of governments across Europe and around the world, as they look for a more affordable and effective means of developing infrastructure projects. In response to this demand, the United Nations Economic Commission for Europe (UN/ECE) established an expert group to promote best practices in PPPs for the countries of central and eastern Europe and the Commonwealth of Independent States (CIS).

After recently completing its guidelines, the group is undertaking a new initiative aimed at accelerating the delivery of PPP projects by emphasising training, regional cooperation, enhanced coordination among regional and international bodies, and the active participation of the private sector.

Over the course of the last decade many transition countries have encountered a number of challenges as they seek to develop a modern infrastructure that not only attracts investment, but supports continued economic expansion. Facing the reality of limited resources, the governments of central and eastern Europe and the CIS began to look towards forging public-private partnerships (PPPs) as a means to meet the growing demands of their citizens and economy. At the request of its member governments, the UN/ECE responded to this growing interest by establishing an advisory group of experts in 1995, which later became known as the UN/ECE BOT (Build Operate Transfer) Group. Recently, the BOT Group has launched a new initiative in conjunction with the release of its Guidelines on Best Practices for PPPs. The BOT Expert Group was formed in January 1996. Led by its Chairwoman Ms Corinne Namblard-Bouvetot, the UN/ECE BOT drew upon experts from enterprises, governments, international organisations, regional development banks, and most notably from the European Bank for Reconstruction and Development (EBRD) and UNIDO. In pursuing its goal to promote new project financing techniques, the BOT Group’s work has fallen into three related areas:

1. Preparation of Guidelines on Best Practices
2. Development of a Negotiation Platform
3. Consultative meetings and visits with governments.

Guidelines on Best Practices

The Guidelines on Best Practices in PPPs provide a comprehensive overview of PPPs including: a historical perspective, political and institutional aspects, financing and risk allocation, how to create a national PPP Unit, and the necessary social considerations. Since the guide is designed to be a continual work in progress, space is made available for updates and various case studies. Linked to its legal, technical and policy advice the Group further prepared principles and objectives governing the social, environmental, good governance and human rights objectives of PPPs. Although a variety of projects can be accomplished through PPPs it should be understood that some endeavours are better left completely within the hands of either the public or the private sector. Accordingly, PPPs can work only when the public and private sectors come together to espouse a set of common objectives, which should be clearly presented to the public at large.

Negotiation Platform

In addition to the Guidelines, members of the Group prepared a Negotiation Platform on PPPs. Intended to facilitate and ensure the implementation of PPPs by providing a basis for training public officials charged with infrastructure development in the negotiation of PPPs, the Platform provides a balanced approach to reconciling and harmonising the interests of the public and private sectors. While the Platform does not focus on any individual infrastructure sector, it does highlight the major issues relevant to PPPs in general. Beginning with a discussion of the basic structures of PPPs, the Platform goes further by: examining the principles of risk allocation; providing an analysis of the major interests of the host government, private sponsors, and lenders with respect to a PPP; covering the pre-development phase procedures and documents; discussing the issues related to project construction and completion; and providing an analysis of the most significant issues related to the operation of a PPP infrastructure project.

Consultative meetings

In developing its Guidelines the BOT Group gauged support for, and examined the experiences of, governments in the application of PPPs by holding an extensive round of consultative meetings with several governments from central and eastern Europe. These con-
sultations were designed to evaluate the legal and regulatory framework and the feasibility of applying PPPs to certain infrastructure projects. Extending its reach beyond Europe, the BOT Group, in cooperation with UN/ESCAP, also conducted a consultation and training programme with representatives of the government of Bangladesh.

Filling the public sector skill gap

During the course of the BOT Group’s work the importance of establishing a specialised agency or task force to promote and enhance the effectiveness of PPPs within governments became evident. The complexity and sophistication of PPP arrangements places a significant burden upon the government. Such projects require the development of new skills in public officials such as skills in writing output specifications, negotiating long-term contracts, and a solid understanding of the financing products used to fund PPPs. Recognising this burden, a number of Western governments with significant PPP programmes have sought to address their own skill shortage by creating specialised units, staffed in the main by private sector experts. These experts are recruited to support the public sector in developing high-value PPP projects. Recognising that government officials in the transition economies are no better grounded in the requisite skills than their counterparts in Western economies, the Group perceives that this skill shortage could be a primary bottleneck to implementing projects in the region. As a result the BOT Group is prepared to assist transition countries in addressing this skill shortage.9

Next steps

While the work of the UN/ECE BOT Group and other international organisations has assisted in the development of PPPs in the transition countries, much still needs to be done. The pace of project development is far slower than in other regions of the world. A detailed account of why this is so is beyond the scope of this article; however, the critical areas in need of improvement are:

- legal and regulatory structures;
- properly trained civil servants in dealing with PPPs; and
- enhancing interest among the private sector in the region, especially by the commercial banks, in PPP schemes.

Regional Flagship Initiative

In the aftermath of the recent war in Kosovo, and other conflicts in south-eastern Europe, reconstruction has become a major concern to the international community in securing peace and stability. Even though the international community under the Stability Pact10 has already made progress in earmarking funds for quick start projects, the amount is clearly insufficient for such a massive undertaking. As a result, the active participation of the private sector will be necessary to fill the gap. In response to this shortcoming, a Regional Flagship Initiative (RFI) under the auspices of the (OECD/UK government) Investment Compact11 of the Stability Pact was launched on 5 December 2000. The RFI will help to develop PPPs, create support for regional cooperation, raise awareness of new project finance techniques, enhance opportunities for the local business community, improve legal and regulatory frameworks, and generate greater coordination among multilateral and bilateral as well as international and regional financial institutions.

The RFI will address these challenges in a step-by-step process in order to bring about the greatest results possible. Stage one will involve the creation of strategic task forces for regional partnerships in project development in order to develop priority projects. In bringing these priority projects forward, members of the task forces will use their experiences with successful projects to develop similar projects in south-eastern Europe. In addition, government representatives will present projects that could be developed on a private financing basis for initial assessment. Members of task forces will also help in determining the degree of government involvement and support necessary to make proposed projects viable while looking for ways in which regional

1 Public-private partnership is not a precisely defined term. It embraces a range of structures and concepts, which involve the sharing of risks and responsibilities between the public and private sectors. The approaches and techniques range from the simple commercialisation of assets that remain under public ownership right through to virtual privatisation. The way in which risks, responsibilities and powers are allocated between the public and private sectors will vary enormously from structure to structure across this spectrum.
2 The UN/ECE was created in 1947 and currently has 55 member states in Europe, North America and Israel. The ECE’s areas of work include environment, transport, statistics, trade facilitation, industry, agriculture and forestry, as well as housing and planning. The commission also undertakes various activities to assist countries of central and eastern Europe and the CIS in their transition to market economies.
3 The initiative was launched at an International Forum in Geneva, entitled “Public-Private Partnerships for Infrastructure Development: The Next Steps”, on 4 and 5 December 2000.
4 The Guidelines, which are still draft form, were produced as background information for the WP5 Forum on Public-Private Partnerships for Infrastructure Development: The Next Steps (4 and 5 December 2000) and were edited by Xavier Bezançon and Rees Griffiths.
5 The United Nations Global Compact was introduced by the UN Secretary-General, Kofi A. Annan, on 31 January 1999 at the World Economic Forum in Davos, Switzerland by challenging business leaders to “embrace and enact” a set of nine principles covering human rights, labour and environment. See http://www.unglobalcompact.org
6 A special thanks to Richard Ornitz and Stanely Parks of the law firm Coudert Brothers in preparing the Negotiation Platform.
7 The BOT Group is at present exploring opportunities for involvement in the Russian Federation.
8 The United Nations Economic and Social Commission for Asia and the Pacific (UN/ECE) has a mandate to address the economic and social issues of the region it represents which includes 48 member states and 10 associate members. Along with the UN/ECE and three other regional bodies, it reports to the Economic and Social Council and operates under the authority of the Secretary-General.
9 The BOT Group has been requested by the government of the Czech Republic to provide advice on establishing a special task force within its government to develop PPPs.
10 The Stability Pact is a political declaration of commitment and a framework agreement on international cooperation to develop a shared strategy among more than 40 countries, organisations and regional groupings for stability and growth in south-eastern Europe. See http://www.stabilitypact.org
11 The Investment Compact of the Stability Pact sets out a number of commitments for policy reform which countries in south-eastern Europe need to implement in order to create a robust and sustainable market economy and to encourage increased local and foreign direct investment.
cooperation could be helpful in the development of these projects. Finally, the task forces will evaluate the enabling legal and institutional environment that is required for developing these projects.

The second phase of the RFI will focus on regional legal and regulatory harmonisation to simplify the environment for investors. A regional symposium on the legal issues related to PPPs will be held in the first half of 2001 to promote the improvement of the legal and regulatory framework in the region. This symposium, organised in cooperation with UNCITRAL, and to be held in Slovenia, will determine legislative and institutional gaps that need to be filled in order to attract private investment for infrastructure. The final phase of the RFI will focus on institutional capacity-building. It is important that governments at both the national and local levels learn how to protect their interests and those of their citizens when negotiating with skilled counterparts from the private sector. To address this challenge, several extensive regional training seminars will be held for negotiators, using real PPP cases. Provisionally, the governments of Albania, Bosnia and Herzegovina and Bulgaria have expressed an interest in hosting these seminars.

In addition to the actions described above the RFI will encourage and support the creation of PPP structures within governments. Such a body, either regional or national, should also become a centre of excellence for the public sector and a “one stop shop” for the private sector. Encouraging such a culture over time ensures clarity and efficiency, particularly where BOT and concession projects are considered. This development eventually translates into lower risk profiles and finer margins on the financing. Such a coordinating body can focus on policy and lessons learned from previous projects and may be best placed within the Ministry of Finance or the Office of the Prime Minister. In order to help governments achieve this result, the UN/ECE BOT Group will advise governments on establishing a PPP Task Force Unit capable of developing projects at a pre-feasibility stage. Further, a training programme on how to develop these units, the structure and modalities of developing projects, as well as a programme on project appraisal will be held.

**Public-Private Partnership Alliance**

In addition to the RFI, a Public-Private Partnership Alliance was recently created. Open to governments, companies and international organisations, it aims at providing a framework for cooperation between the public and private sectors and creating a network of government agencies and private-sector partners throughout Europe to provide information and advice on best practices. The PPP Alliance is designed to stimulate interest in and awareness of PPP methodologies, support the development of PPP projects that take account of social development and environmental sustainability within a market oriented framework, offer a neutral mediation service for recovering projects that encounter difficulties, provide policy-makers with details of successful PPPs and provide examples of legislation that can enhance the probability of developing a successful PPP. The scope of the Alliance expands beyond that of Europe and the CIS, to other regions of the globe looking for support and cooperation in the promotion of PPPs. Within this framework, the success and failures of projects are tracked so that new innovative processes can be developed taking into account the unique circumstances of each region and avoiding a “cookie cutter” approach to ensure the maximum impact of a PPP.

**Conclusion**

“The demand for infrastructure development in central and eastern Europe and the CIS is acute. For governments and private sector alike, this represents both a challenge and an opportunity. The challenge is unquestionably complex, but the potential rewards are immense: not only do PPPs provide a means of meeting an immediate need for services and facilities, but their implementation will serve to promote economic and commercial growth and development. Even if progress in this field to date has been limited, there is now widespread recognition that PPPs represent one of the keys to development in the transition economies.”

Ultimately, the success of PPP projects will depend on ensuring a proper synthesis of public and private sector strengths, skills and resources that satisfies the priorities of both within each project. The PPP Alliance hopes to harness the vision and determination of both the public and private sectors to bring about PPPs capable of making a valuable and lasting impact sustainable for the economic and social revitalisation of the region.
In early 2000, under the auspices of the Organisation for Economic Cooperation and Development (OECD) managed Centre for Private Sector Development in Istanbul, an expert group was formed with the objective of preparing Basic Elements of a Law on Concession Agreements.¹ Set forth below is a discussion of some of the considerations of the expert group in connection with the development of the Basic Elements.

The group initially focused on clarifying areas of law that may be uncertain and which may cause difficulties in the implementation of build-operate-transfer (BOT) concession-style transactions. A policy paper in the form of a draft principles for the Basic Elements was developed in early February 2000. This working document has evolved over several drafts in response to comments, and in particular following an OECD organised seminar in May/June 2000 in Istanbul attended by representatives of a number of OECD members. The group members have now generally agreed on these basic provisions, and explanatory notes on the Basic Elements are under preparation. Ultimately, the draft Basic Elements and explanatory notes will be circulated to a wider “Expert Group” which will include representatives from the relevant countries.

**Scope of the Basic Elements**

An important issue for the working group was to determine the intended scope of the Basic Elements. Some members in the group argued that the Basic Elements should focus solely on infrastructure developments and not project financings in the energy/mining sector on the grounds that grants of concessions in these sectors were typically governed by a separate legal regime. Others were of the view that the core principles of the Basic Elements were equally applicable to projects in the energy/mining sector, and that, as long as the law permitted countries to exclude certain sectors from the application of the law, the objectives of the Basic Elements would be more fully realised by making the scope for the law as broad as possible. A consensus emerged that the Basic Elements would be given as broad a scope as possible, leaving individual countries to exercise their discretion on whether to exclude certain sectors from the application of the law.

**Contracting authority**

One of the fundamental objectives of the Basic Elements is to minimise uncertainty regarding the power of contracting authorities to enter into concessions. Accordingly, the Basic Elements include clear provisions specifying the powers of contracting authorities. In addition, the Basic Elements clarify that contracting authorities are empowered to enter into ancillary or related agreements associated with a concession, including any agreement for the purpose of facilitating related financing (such as a direct agreement with lenders).

Among the more controversial provisions were those defining the scope for concessions to be awarded without competitive procedures. Some in the group argued that the Basic Elements should include provisions which clearly provide that concessions should be awarded only in accordance with specified and detailed public procurement procedures. Others believed the Basic Elements should offer more flexibility to permit the direct award of concessions in a number of circumstances. Much of the discussion focused on the scope for possible exceptions to public tendering of concessions. A structure has evolved which, under certain limited circumstances, would provide for the possibility for the award of concessions through mechanisms which would not involve the more conventional public tender procedures.

**Invalidating concession agreements for fraud**

The expert group discussed a number of alternatives which would balance the objectives of concessionaires’ and lenders’ need for certainty regarding the validity of concessions with public policy concerns against permitting concessions awarded corruptly to continue indefinitely. Among the options proposed for addressing the issue is the creation of a certification procedure for concessions, limiting possible challenges to such certification procedure, and providing that in the event the certification procedure is successfully challenged, a concession may be terminated by the granting authority only if loan financing has

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¹ The group is comprised of representatives from seven countries (Bulgaria, Bosnia and Herzegovina, Georgia, Kazakhstan, Romania, Turkey and Ukraine) and by the authors of this article with the help of UNCITRAL.
been fully repaid. It is intended that this approach would encourage private sector financing of concessions.

**Provisions in concession agreement**

Given the broad scope of the Basic Elements there was some disagreement as to whether they should specify mandatory provisions of the concession agreement, or merely clarify that the granting authority would have the ability to contractually agree whatever terms were commercially appropriate for the proposed concession agreement. A consensus was reached, however, that most jurisdictions would benefit from a list of core items which should be included in any concession agreement, but clarify that the relevant granting authority would have the authority to determine when such provisions were not appropriate in a particular concession.

Among the core elements of a concession agreement the Basic Elements include: the nature and scope of the work to be performed; the duration of the concession; a degree of exclusivity; the right of the concessionaire to charge third parties for services; methods for adjustment of payments due to the contractor by the contracting authority or third parties; obligations of the concessionaire in respect of the environment; and remedies available to the contracting authority in the event of default of the other party.

**Security**

While the Basic Elements will need to fit within an overall legal regime which addresses the ability of lenders to take security over a concessionaire’s assets, the Basic Elements offer some clarity on the ability of concessionaires to grant a security interest in the concessionaire’s rights under a concession agreement.

**Settlement of disputes**

The Basic Elements include provisions which specify that concession agreements may include provisions providing for international arbitration procedures.

**Financial stabilisation**

While arguably addressed by provisions which provide that the content of the concession agreement is subject to negotiation, the expert group felt it important to clarify that the contracting authority is authorised to include provisions which would have the effect of providing appropriate assurances to a concessionaire that it will be protected from the financial circumstances of legislation which becomes effective after the date of the concession agreement, subject to certain limitations.

**Conclusion**

The Basic Elements are not intended as detailed legislation for direct incorporation into local legal systems. Their main objective will be to provide a reference for governmental authorities and Parliaments in preparing new laws or reviewing the adequacy of existing laws and regulations. The development of the Basic Elements will also provide a useful focus point for investors evaluating the efficacy of a concession law regime. It is intended that the Basic Elements with suggested explanatory notes will be circulated to a wider expert group in the middle of 2001.
Drawing on the concessions experience of developed jurisdictions: the example of France

Policy makers in transition countries, in developing their concessions frameworks, may wish to look to the experience of jurisdictions with developed concession laws and practice. This article looks at the example of France, a civil law jurisdiction with a long history of regulating public service concessions.

French public law was one of the first legal systems to recognise the potential uses of providing a framework for the grant and financing of “public services” through concessions. Accordingly, concession finance and the development of concession projects in France has a history of success in providing public services efficiently.

Under French law, a public service concession is commonly defined as a long-term contract under which a public entity (the conceding authority) entitles another person, either private or public (the concessionaire), freely chosen, to manage and operate, at its own risk, a public service activity, including the carrying out of investments. This person is paid essentially by the users of the service through direct fees. Despite the lack of a legal confirmation of such definition by any constitutional or legal sources,1 the above definition is generally accepted by most French authors.2

This article discusses the evolution of French concessions law in three general areas: contractual relationship between public and private entities, the scope and nature of the conceded activity and the financial conditions of the concession.

Contractual relationship between public and private entities

There are three main elements of the contractual relationship established under a concession agreement, the scope of which can have significant implications on the development of concessions. These elements include the identity of the conceding authority, the identity of the concessionaire and the legal regime applicable to concessions. The evolution of conces-

1 The Law dated 29 January 1993 relating to prevention of corruption and relating to transparency of economic activities and public proceedings, better known as “Law Sapin”, which is one of the first attempts to regulate public service concessions, does not provide a general definition of such notion.

Focus on concessions

Public service concessions are granted by public entities. The presence of a public entity as a conceding authority distinguishes such contracts from commercial concessions regulated by commercial law (for instance, the grant of rights in a motor vehicle through a lease or conditional sale by a private person to another private person). Historically, public entities involved in public service concessions were the French state and local public entities (collectivités locales such as towns, districts, regions). Historically, the state granted concessions only in specific sectors, such as railroads, electricity production or domestic waste disposal. This development in French law resulted in a number of concessions awarded has increased dramatically during the last 50 years.

The nature of the conceding authority

Public service concessions are granted by public entities. The presence of a public entity as a conceding authority distinguishes such contracts from commercial concessions regulated by commercial law (for instance, the grant of rights in a motor vehicle through a lease or conditional sale by a private person to another private person). Historically, public entities involved in public service concessions were the French state and local public entities (collectivités locales such as towns, districts, regions).

Over time French public (administrative) law began to recognise the ability of other public entities, such as autonomous public entities (établissements publics) or state companies (sociétés d’État), to enter into concession agreements. Various laws organised a transfer of power from local public entities for the benefit of autonomous public entities and created new public entities dedicated to the operation of several public services on behalf of the participating local entities (établissements publics de coopération intercommunale). Such autonomous entities also began to enter into concession agreements delegating the power vested in them in certain public services: such as water distribution, electricity production or domestic waste disposal. This transfer or devolution of power to public entities and public companies has encouraged such companies to seek alternative private sources for financing the provision of infrastructure and other public services. As a consequence both the number of conceding authorities granting concessions and the number of concessions awarded has increased dramatically during the last 50 years.

The nature of the concessionaire

It has long been natural for public entities to choose a private company with which to conclude their concession agreements; it was considered that private sector entities, chosen through competitive tender procedures, would function more efficiently than publicly owned companies. However, French law evolved gradually to permit the award of concessions to companies which were in effect state majority owned and controlled, but which had a corporate structure which allowed management to function relatively independently, having efficiency as their primary objective. This evolution addressed concerns about placing sectors of particular national interest under the control of private entities. However, it was critical to this evolution that the management of these state majority owned entities should function in practice like a private sector company, with a degree of autonomy which would not be typical of entities which are publicly owned.

This development in French law resulted in the award of concessions to some of the largest and most successful French companies. For example, concessions were granted to public companies such as Air France for air transportation, Société Nationale des Chemins de Fer (SNCF) for railway transportation, Electricité de France (EDF) for electricity and Gaz de France (GDF) for gas. As the state is the only or the main shareholder in these companies, its financial interest in the concession is strengthened by its shareholding. However, such ownership structures raise some questions as to whether a conflict of interest arises when, in the administration of the concession agreement, the state acts as both co-contractor and shareholder.

Concessions have also been concluded with joint-venture companies, including public and private shareholders, but with a voting majority for public entities (sociétés d’économie mixte). Such companies are specifically created and dedicated to manage a public service and seek to optimise cooperation between public and private sectors. Concession agreements concerning motorways could have been entered into with this type of company only until 1970, as laid down by a law of 1955. More recently, a number of motorways and motor tunnels have been managed by joint-venture companies. Such companies have also been granted concessions relating to the management of national food interest markets (marchés d’intérêt national) created by law to organise food distribution on French territory.

The legal regime of public service concessions

Concession agreements have been characterised by the French judicial system as public contracts and constitute the most representative category of such contracts. Indeed, concession contracts are concluded by at least one public entity and are entered into especially for the operation of a public service, both elements being necessary to qualify them as administrative contracts. Concession agreements are therefore governed by French public law, and related disputes are under the jurisdiction of the French administrative courts. This introduces peculiarities due to wide powers granted to public entities in contractual relationships, such as the right to unilaterally terminate a concession agreement for reasons of public interest or the right to modify the regulatory provisions of the contract during its existence. In this respect, it should be emphasised that a concession agreement is made of several contractual documents. Apart from the concession contract executed by the conceding authority and the concessionaire, which is freely negotiated within the boundaries set by French public law, a concession agreement includes a document called “cahier des charges particulier” which defines the specific terms and conditions of the concession; that is to say, the rights and obligations of the parties. Such a document is based on a standard form document established by the state, “le cahier des
Charges-type", and is published in the Official Gazette (for instance, for water distribution, under a decree dated 13 August 1947, or for electricity distribution, under a decree dated 22 November 1960).1

Under French law, the conceding authority, in particular the French state, may, at any time during the term of a concession, modify those provisions of the agreement which are regulatory (clauses réglementaires) and which are not exclusively within the purview of contractual negotiation.2 For instance, the conceding authority may decide to modify one of the regulatory conditions for the operation of a public service in order to improve its quality. In this case, the concessionaire is not allowed to refuse the modifications decided by the conceding authority. The concessionaire is entitled to request financial support only if the modification changes the general balance of the concession contract.3

This distinction among provisions of these documents is also important for the users of the public service, because it entitles them to request the concessionaire to comply with the regulatory provisions of a concession. Users are also entitled to challenge before administrative courts the consistency of the concession agreement with the legal requirements of regulatory provisions of the public service, whereas, not being party to the concession contract they are not entitled to challenge the other provisions of the contract.4

The scope and nature of the conceded activity

The scope of the conceded activity has also been significantly expanded during the twentieth century and that modification reflects the evolution in France of the concept of public service itself.

Milestones in the development of concession agreement

The evolution of French concession agreement may be divided into three historical stages. During the first period, from the end of the nineteenth century until the First World War, the scope of concession agreements developed increasingly rapidly in response to economic development in France as a result of the industrial revolution. Most of the public works in connection with large substructure projects, such as the railway network, electricity and gas production and distribution or water distribution, were managed through concession agreements. Such development was based on liberal theories justifying the choice of private companies to bear the cost of the necessary investments. A combination of long-term agreements and monetary stability during this first period ensured the success of concession agreements.

In the period from the first World War until the end of the second World War with the economic situation subject to dramatic change, some concessionaires went through financial difficulties, thus threatening the quality of service. In this context, French administrative courts recognised the right of the concessionaire to receive financial support from the conceding authority when the economics of the concession contract became unbalanced by external events; this right is better known as the thèorie de l’imprévision.5 When external events prevent the concessionaire from continuing the operation of a contract, the concessionaire is also entitled to seek early termination of the concession.6 The development of these principles under French public law has become an important element of the concession regime. In order to ensure financial equilibrium under a concession, the French state also decided during this second period to nationalise some concessionaires. The most famous examples of this were the nationalisation of the five existing private railway transportation companies in 1937, which became SNCF, and the nationalisation of the private electric and gas producers in 1946, which became respectively EDF and GDF.

After the Second World War, reconstruction required new developments to encourage concessions in connection with the reorganisation of public services. During this period new fields of development of concession agreements appeared within other legislative regimes: such as the development of local transportation services,7 the regulation of bridges and ferries8 and the administration of public hospitals.9

This brief description of the expansion in the sectors in which concession agreements may be granted demonstrates the importance of concessions in the development of the French economy since 1945.

Main fields of concession agreements

Initially limited to industrial and commercial services (services publics industriels et commerciaux; SPIC), the scope of public services eligible for concession agreements has been expanded to include administrative services (services publics administratifs; SPA). The development or decrease of the scope of concession agreements reveals the evolution of the concept of public service in France. The evolution of that concept is mainly due to the development of the idea of “general interest” which is essential in the definition of French public law.10

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2 See also decree dated 28 November 1953 for public station operation, decree dated 6 October 1981 for water cleaning service.
One of the main fields of concession agreements is in the energy sector:
- electricity distribution: the state is in charge of general supply concession;
- electricity distribution: local public entities are in charge of local public distribution;
- gas distribution with local public entities;
- gas transportation with the state.

The specificity of such concessions is that at an early stage the concessionaire became a unique type of company due to nationalisation (apart from a few remaining private companies), following which concession agreements became uniform for every local public entity without scope for negotiation.11

**Financial aspects of concession agreements**

Under the commonly accepted definition of a concession agreement, the concessionaire is responsible, at its own risk, for the management and operation of a public service, including the carrying out of investments, and the concessionaire is paid by the users of the service through direct fees. At the end of the concession, all investments made by the concessionaire automatically become the property of the conceding authority without any obligation by the conceding authority to indemnify the concessionaire.

**Responsibility of the concessionaire for financial risks**

The concessionaire is responsible for the supply of the service towards both the conceding authority and the users of the service. The conceding authority and the users are entitled to check the adequacy of the service supplied pursuant to the contractual provisions, in particular in terms of quality of service, the area covered and the level of the annual fees.

It has nevertheless been considered that for some specific projects, such as motorways, the concessionaire is only an agent of the conceding authority, which determines the conditions of the service and the financial solutions to achieve it.12 On this hypothesis, the concessionaire has no say in the organisation of the service.

The concessionaire is paid directly and mainly by the users of the service. Concessions are not, in principle, financed by taxes or subsidies. This method of payment, based on user fees, is one of the most important elements of concession agreements and is considered by French case law as a condition of the existence of a concession agreement.14

**Cooperation between private and public financing**

Recent developments in concession agreements authorise the possibility for the conceding authority to finance a portion of the necessary investments to help the concessionaire to ensure the quality of the service. Thus financing is more and more often established on a cooperative basis between private and public funds.

It has now been accepted that the conceding authority may grant various advantages to the concessionaire for the financing of public services, and in particular:
- interest support to ensure a minimum level of interest for subscribers of bond-subscription;
- investment subsidies for financing works and the building of the concession;
- net loss compensating subsidies to cover net losses incurred by the service; and
- indemnities to cover unenforceable costs resulting in a loss of economic equilibrium of the concession.

Apart from such support provided by the conceding authority, the concessionaire has also developed alternative financing mechanisms to ensure the financial viability of a concession project. For instance, it is now commonly agreed that the concessionaire may lease equipment used in a concession for advertising and receive funds in return for it.

**Conclusions**

Historically, concessions have provided an important means for private parties to provide traditional public services in France. This historical review of the French notion of a concession agreement reveals a modification of its nature concerning the parties to the concession agreement, the scope of concession contracts and the financial means used to achieve quality of service. These changes have contributed towards the evolution of concession agreements as a vehicle for providing public services in France. The French concessions model may provide a useful framework for other countries developing their own concession legal regime. In addition, the evolution in French concessions law may presage a similar evolution in the laws of countries seeking to develop concession-based financing.
Legal framework for infrastructure projects in FR Yugoslavia

The development of infrastructure is one of the main challenges currently facing the Federal Republic of Yugoslavia. Concessions are considered an effective vehicle to enable such development to be achieved. This article gives an overview of the legal framework governing concessions. It points out the lack of certainty and consistency of the existing legal regime, and the need for thorough review and harmonisation, taking account of the economic and political issues at stake.
The strong one-party system of the late 1980s in Yugoslavia revealed the direct impact of the state in the economy and particularly in an area such as infrastructure: telecommunications, roads, railways and waterways. With the collapse of Communism in eastern European countries in the late 1980s, Yugoslavia entered the process of transition towards democracy and an open market economy. However, wars in Croatia and Bosnia, sanctions imposed on the Federal Republic of Yugoslavia (Serbia and Montenegro) by the UN Security Council in 1993 and 1998, the Kosovo conflict and NATO intervention in 1999 effectively stopped this process before it could get started, particularly in Serbia. In the last couple of years Montenegrin policy has evolved more independently. The federal elections in FR Yugoslavia in September 2000 and elections in Serbia in December 2000 resulted in a new beginning for long-awaited democratic change. However, FR Yugoslavia generally, and Serbia specifically, enters the new century with a shattered economy.

One of the most vivid examples of neglect, poor maintenance and decline in the past ten years is the transport and power infrastructure. There are a number of reasons for this decay. Irrespective of wars in Croatia and Bosnia, UN sanctions or the NATO campaign in 1999, inappropriate management, a practical ban on importation of technology and little or no investment in infrastructure were characteristics of the past decade. An official policy restricting prices for these services as a social valve contributed significantly to the process. The lack of appropriate legal environment, and in particular an inconsistent system of law at federal and Republic levels, also contributed. For these reasons almost all infrastructure services have gradually collapsed.

**A typical infrastructure company: EPS**

A typical example of infrastructure decay is the production and distribution of electricity. Electric Power of Serbia (EPS) is the only company in Serbia producing electricity. It is the largest utility with 8.5 GW net of primarily thermal capacity.

EPS is a state-owned company, which most importantly means that company management has been appointed by the government and electricity prices were set by the government. However, the price of electricity has declined over a number of years as various governments have attempted to use cheap electricity as a means of assisting the impoverished population, and as a result, the total amount of accumulated funds available for investment has been shrinking. In addition, this lack of finance has led to problems in the proper maintenance of the existing generating capacity.

Such regulatory problems present a number of obstacles to eventual privatisation, which will require well-designed stages. Privatisation of existing enterprises will be a long process for a number of reasons. In the legal field for example, legislation is not harmonised with the new technical and economic environment, regulations are unclear and there are no regulatory bodies. In addition, price levels are low and the political risk is markedly high. A further major issue in the country is payment of arrears, since a large portion of industrial users and households fail to pay their electricity bills.

A similar situation can be found in other infrastructure areas, such as public transport, water supply and other communal services.

**Concessions as direct investment**

Direct private investment in infrastructure is possible by privatisation or concessions. Considering that privatisation has occurred only intermittently in Serbia and Montenegro over the past ten years, and given the legal and regulatory reform necessary to establish effective preconditions for privatisation, it is most likely that concessions in the area of communal services and infrastructure will be the first instrument to be used to boost private sector investment in infrastructure development. It would also appear more politically expedient for the government to solve legal problems relating to concessions rather than privatisation. However, privatisation will have to play its role, as a separate method or combined with concessions.

Currently, in both Yugoslav republics, Serbia and Montenegro, concessions are regulated at two levels: federal and republic.

The Federal Foreign Investment Law1 (the “Federal Law”) provides that foreign persons (entities or individuals) may be granted concession rights on the condition of bilateral reciprocity. Such concessions may be granted for use of (a) a natural resource, (b) goods for public use, or (c) to provide a service in the public interest.

The Federal Law defines the legal framework for concessions, providing for the general procedure through which concessions are granted, and approval of applications and registration of concessions. The maximum concession period provided by this law is 30 years and public tender is mandatory. Concessions are granted on the basis of a concession agreement made with the federal state. The main elements of such concession agreements are defined in this law, which, among other elements, defines “build, operate and transfer” (BOT) as a type of concession. The republics can define concessions and concession agreements in greater detail but they must be consistent with the Federal Law.

The only limitation on foreign entities being granted concessions, as defined by the Federal Law, is the prohibition of foreign investment in mass media and telecommunications, “if such investment may distract the unity of the system”. This prohibition, of a historical nature, obviously creates uncertainty for parties considering investing in telecommunications or mass media.

Under the Federal Law concessions may be assigned (as security for lenders or otherwise),
partly or in full, subject to approval from the concession granting authority. There are no restrictions on termination of concessions under this Law. The parties to the concession agreement may agree on any international dispute resolution mechanism as long as the concession is granted to a foreign individual or entity and the subject matter of the dispute is not immovable property.

On the Republic level, the Serbian Parliament enacted the Concession Law of the Republic of Serbia in 1997. Although both laws (the Federal and the Republic) were made by virtually the same regime, significant differences in important matters, such as the conditions for granting concessions, procedures and respective granting authorities, exist between the two laws.

Under the Serbian Concession Law the development, maintenance, reconstruction, modernisation or exploitation of telecommunications by foreigners falls within the scope of concessions as opposed to the general Federal Law prohibition of foreign investment in mass media and telecommunications.

The Serbian Concession Law imposes a complicated and bureaucratic procedure for granting a concession. In accordance with this law, the Republic created the new Agency for Investments of Special Interest to the Republic. This advisory Agency serves as mediator between the government and third parties.

The procedure is defined as follows:

1) Every applicant interested in obtaining a concession may request the government, in particular the Cabinet of Ministers, to commence the concession-granting procedure.

2) The applicant cannot, however, propose directly to the Cabinet of Ministers; the proposal must be made through the Agency. The applicant may be an entity, individual, even a ministry or local authority.

3) If the applicant is someone other than a ministry, the Agency must obtain the opinion of the respective ministry (for example, the Ministry of Energy or of Transport) before submitting the proposal to the government.

4) Once it has received a valid proposal from the Agency, the Cabinet of Ministers “takes a position” on starting the concession-granting process. The Cabinet of Ministers itself informs the applicant of its position.

5) In accordance with “the position of the Cabinet of Ministers’ intention to grant a concession”, the Agency, together with the relevant ministry, prepares a draft concession decision. Such decision results from economic, financial, social and other relevant considerations, including an analysis of possible environmental issues. The Serbian Cabinet of Ministers must then approve a Concession Decision. This signals the commencement of the concession-granting process. Public tender is required for granting concessions. All issues relating to the public tender are under the responsibility of the Agency.

6) The decision to grant a concession is made by the Cabinet of Ministers.

7) Within 60 days of making the decision the Cabinet of Ministers and the winner of the public tender must conclude a concession agreement. Such agreement must be in accordance with the Cabinet of Ministers’ Concession Decision, the Republic’s Concession Law and the Federal Foreign Investment Law.

8) If the object of the concession is communal activities or providing community services, the concession agreement is concluded between the concessionaire and the respective local authority, with the permission of the Cabinet of Ministers.

9) When the concessionaire is a foreign entity or individual, such agreement is registered at the Federal Ministry for Foreign Investment.

Assignment of concession is permissible under the Serbian Concession Law unless otherwise agreed by the parties to the concession agreement. Similarly to the Federal Law, all partial or full assignments are subject to approval from the granting authority, the Serbian Cabinet of Ministers.

The concession may be terminated under the Serbian Concession Law for the following specified reasons: (a) endangerment of life and nature, (b) war and state of war, (c) impossibility of activities due to destruction or substantial damage of concession object, and (d) other circumstances provided by the concession agreement.

Serbian Law also provides that disputes between the parties may be resolved by international or foreign forums unless both parties are domestic or the subject matter of the dispute is immovable property (i.e., not related obligations, such as payment, performance, etc.).

Montenegro also has a Concessions Law, enacted in 1991, before the Federal Law. Although brief (12 articles long), the Montenegrin Concessions Law also regulates the general procedure for granting concessions, the approval process and the registration of concessions. The main difference from the Federal Law is that Montenegro’s law does not provide for granting concessions to domestic entities, but only to foreign individuals and corporate entities. It also appoints the Montenegrin Cabinet of Ministers as the granting authority.

In 1996 the Federal Constitutional Court decided that a number of provisions of the Montenegrin Law on Concessions (five articles) were in conflict with the Federal Law and were therefore not valid. However, for political reasons the Montenegrin Law on Concessions still applies as it was originally enacted.
The Montenegrin Law on Concessions does not contain any specific provisions related to partial or full assignment of concessions, termination of concessions or dispute resolution mechanisms. Practice does not provide clear guidance, so it remains to be seen whether Montenegro will follow solutions provided by the Federal Law and the Serbian Concession Law regarding these issues.

There is a significant disparity between the legal regulation of concessions at federal and republic levels. This results in lack of clarity and transparency in concession-granting procedures. One of the major tasks facing the new federal government, as well as the Montenegrin and new Serbian governments, will be to close such legal loopholes and traps, in order to create less bureaucratic and more investment-friendly procedures.

“Indirect” investment

As noted above, the concession laws are among the few laws that allow direct foreign investment in infrastructure. Direct investment in itself does not exist in an explicit legal form. A form of “indirect” investment infrastructure is regulated at republic levels only. In Serbia it was regulated by the Law on Communal Services (1997-98) and the Law of Public Enterprises and Executing Service of Public Interest of the Republic of Serbia (2000). The latter law generally covers various industries in the public services, including:

- production and distribution of electricity;
- production and processing of coal;
- research, production, processing, transport and distribution of oil and natural gas;
- petrol stations;
- railway, postal and air transport;
- telecommunications;
- media; and
- communal activities (i.e., water supply, sewage systems, recycling, etc.).

In accordance with this Law public services are carried out by public enterprises. However, the Serbian government is entitled to conclude an agreement for provision of public services directly with any local company. There is no restriction regarding ownership or shareholding of the local company.

In practice, as a result of this law any foreigner (entity or individual) could, through a local company, apply for and receive public service provider status through direct negotiations with the government. Foreigners must comply with the Foreign Investment Law’s requirement of reciprocity (i.e., the country where the foreign entity is incorporated or otherwise organised must allow similar dealings to Yugoslav companies) and registration at the Federal Foreign Trade Ministry. Similar provisions exist under Montenegrin laws and regulations.

This “indirect” investment possibility allows both the Serbian and Montenegrin governments to avoid public tender and the complicated concession procedure. However, the position of the investor is significantly weaker because it obtains only national status. The permitted legal remedy under this status is within the national legal framework only. As a result the investor cannot resort to foreign arbitration, foreign ruling law, foreign jurisdiction, etc.

Conclusion

Given the shattered Yugoslav economy and banking system, raising finance for infrastructure projects within that country is extremely difficult. Due to the lack of experience, legislation in the area of project finance is far behind the standards required.

Although it is currently a few steps behind, FR Yugoslavia is expected to undergo a period of democratisation and transition to become a modern European state. Recent political changes could establish a stable and secure political environment to allow for economic progress; however, Yugoslav infrastructure requires substantial restructuring and investment in order to be modernised and made operational. Privatisation of state-owned companies that provide infrastructure services is vital for both the Serbian and Montenegrin economies. It is expected that the new federal and republic authorities will provide for conditions that will make possible transparent and legally secured foreign investment. It is necessary that several steps be taken:

1) Establish political stability, without which great interest from foreign companies to invest into the Yugoslav economy cannot be expected.

2) Make legislation compatible with EU standards. The governments should draft new regulations to establish legal frameworks that will secure the position of investors and investments in general.

3) Separate infrastructure from the states. The regulation and operation of infrastructure should be commercialised in order to allow for provision of efficient services. The tariffs for such services should be regulated not by the state but by the market.

4) Establish a supportive legal and economic framework for private and foreign investment in infrastructure in order to secure such investment.

5) Establish secure investment climate, with no interference from political authorities.

6) Ensure compliance of infrastructure services with high environmental and safety provisions and standards.

7) Privatise the entire economy in a swift, thorough and transparent manner.
Bulgarian law on concessions

Bulgaria’s law on concessions has provided a basic framework to facilitate the granting of concessions and the execution of concession agreements. The recent development of more detailed and specific legislation, in particular in areas such as telecommunications and energy, has meant that the significance of the law on concessions itself has diminished. This article explains the development of the law and examines its interaction with other relevant legislation. It also considers a number of obstacles presented to potential investors under the current regime.

The concept of a “concession” was first introduced in Bulgaria in the new Constitution of 1991. The Constitution itself did little more than list the types of property and the activities in respect of which a concession could be granted, but it enabled Bulgaria’s National Assembly to enact legislation on the basis of which the state would grant concessions in respect of certain property and activities. The first relevant legislation to appear included the Concession Law and the Municipal Ownership Act. As a result, the “concession” concept was developed on the basis that, although the state or individual municipalities, as public authorities, should continue to enjoy exclusive rights and powers in relation to certain property and activities, the private sector should not be excluded from investing in such property or activities. The law therefore provided a framework whereby public control of public property and resources could be maintained while private participation could be encouraged. A “concession” is the constitutionally defined legal means whereby the state or municipality, while retaining its responsibility for the public interest, is able to grant rights to a private party to utilise such restricted resources and to engage in such restricted activities.

Concessions may be granted by both the state and individual municipalities in their capacity as public authorities, and different procedures are provided by the Law on Concessions and the Municipal Ownership Act, respectively, depending on the identity of the grantor. In addition, as indicated above, regardless of the identity of the grantor, a concession has two aspects. The first is as a right to use public property or resources; the second is a permit for carrying out public services which are otherwise exclusively reserved for the state/municipalities.

The situation has also become more complex because the Concession Law and the Municipal Ownership Act were enacted at a time when the Bulgarian legal system was underdeveloped, particularly in the areas of energy, telecommunications, water and natural resources. The recent enactment of legislation in these areas means that the importance of the law on concessions under the Concession Law and the Municipal Ownership Act has gradually diminished. In relation to certain types of resource...
Focus on concessions

Scope of concessions

The scope of permissible concessions under Bulgarian law and the legal regime governing such concessions are largely determined by the nature of the state interest in the rights or assets which are to be the subject of a concession, and how such rights or assets fall within specific categories provided for in Bulgarian law, as more fully described below.

Character of state interest in concession assets

The interest of the state in assets which may be subject to a concession has four different possibilities under Bulgarian law.

Concessions for the use of publicly owned property and resources

The Constitution lists property and resources which may be owned only by the state and the utilisation of which by private entities may therefore be permitted only by way of concession. This property includes underground resources, beaches, national thoroughfares, waters, forests and parks of national importance, and natural and archaeological reserves. Such property is not limited to existing state-owned property; it also includes property which is developed at the concession holder’s expense. This list is not exhaustive, as Article

17, Paragraphs (2) and (4) of the Constitution enables the National Assembly to enact legislation concerning the ownership rights of the state and municipalities. Accordingly, the National Assembly has the authority to declare additional properties as public property of the state or municipalities. Such property may not be transferred by its “public” owner to third parties, nor utilised in the way allowed for private assets. It may therefore be utilised by private entities only under a grant of concession.

As noted above, the legal regime applicable to concessions granted in respect of state or “public” property is defined both by the Concession Law and by sector-specific legislation (municipal concessions are discussed separately below). Sector-specific legislation includes the Law on Underground Resources and the Water Act. However, even within such specific legislation, the proposed nature of a concession right can have implications on whether the grant of a concession would be governed solely by sector-specific legislation or a combination of such legislation and the Concession Law. The Water Act, for example, distinguishes between the utilisation of water in the economic sense (for the purpose of generating profit) and the mere usage of the water, including as a means for the conduct of profit-generating activities.

In addition, the Constitution and the Concession Law provide that, where the state exercises sovereign rights over certain property the use of that property is also subject to the grant of concession by the state. Although this category of property is listed in both the Constitution and in the Concession Law, the Concession Law does not include those items which are covered by different legislation. For example, the utilisation of the radio-frequency spectrum is subject to the grant of a licence by the state under the Telecommunications Law and not to a concession, and is therefore not specifically addressed in the Concession Law.

Concessions for the use of property and resources which may be state-owned or privatised

Another category of property specified under the Concession Law includes property which may be either public state-owned property or, alternatively, may be privatised and owned by private entities, including the state acting in a private capacity. This category includes:

- harbours and civilian airports for public use; the law expressly extends the possibility for grant of concession rights in respect of both of existing facilities and facilities to be developed at the concession holder’s expense;
- water-supply facilities and systems; as noted above; however, in the case of water, a concession right over water-supply facilities and systems may not be sufficient and a “water utilisation permit” under the Water Act may also be required in order to secure rights in respect of the supply of raw water.

Again, the character of state ownership of such assets can have implications in respect of the scope of concession rights which may be granted. Obviously, the ability of a concession holder to obtain private ownership of assets can have significant implications on his or her ability to control the development of a concession and obtain financing for it.

Concessions for the use of property and resources which may be owned by a municipal entity

If assets are owned by a municipal entity, the Municipal Ownership Act sets out the concession regime in respect of property owned
by municipalities. Again, this regime may have to be interpreted in conjunction with the procedure set out in other applicable legislation, such as the Water Act and the Law on Underground Resources.

**Concessions for the use of property and resources which may be owned by 100 per cent state or municipal owned entities**

The Concession Law and the Municipal Ownership Act were enacted at a time when a large proportion of state and municipally owned mining, water and energy industries had been restructured as commercial companies wholly owned by the state or by municipalities. It was not considered appropriate that such entities should be required to compete for concessions and for the right to carry on these industries. For this reason, an exception was created whereby 100 per cent state-owned commercial companies are authorised to utilise property and engage in activities for which a concession would otherwise be required under the Concession Law, without the need for a concession. A similar rule exists under the Municipal Ownership Act in respect of companies wholly owned by municipalities in respect of property and activities requiring a municipal concession. Until such time as these companies are privatised, no concession is therefore required by those industries.

**Nature of activity in respect of a concession**

Apart from the impact of the character of the state or a municipality’s interest in a concession on the rights of a concession holder, the specific asset or activity with respect to which a concession is to be granted will largely determine the legislative regime applicable to such concession. As noted above, a number of such regimes exist in respect of water concessions, natural resource concessions, telecommunications concessions and other sectors. In addition, in respect of certain restricted activities, both the form in which such concessions are granted and the legal regime applicable thereto differ from those in other sectors.

Restricted activity concessions concern the grant of permission to carry out activities in respect of which the state has exclusive rights. A “permit” concession may be granted either together with or independently of a “utilisation” concession, depending on the nature of the grantor and the rights sought by the potential concession holder. For example, where a concession holder is granted a permit to provide water services on the basis of property which is not public property but is owned by the state or a municipality in its private capacity, a “utilisation” concession is not required. “Permit” and “utilisation” types of concession are also capable of being granted together, however, as would be the case if a concession were granted to utilise a publicly owned water and sewerage network together with a concession to provide water supply and sewerage services in respect of that network.

The state’s exclusive rights in respect of certain activities arise from the concept of state monopoly. According to Article 18, Paragraph (4) of the Constitution, the National Assembly may establish a state monopoly over railway transport, national postal and telecommunications networks, nuclear energy, and manufacture of radioactive products, weapons, explosives and powerful toxic substances.

Concessions may be granted by the state only in respect of those activities over which it has a monopoly. The Telecommunications Law has not established a state monopoly in respect of telecommunications networks (except in the case of certain fixed telephone services where the Bulgarian Telecommunications Company was granted an exclusive licence) and concessions therefore do not apply to telecommunications services. Similarly, the Law on Postal Services did not establish a state monopoly in respect of postal services. The Law on Railroad Transport also abolished the state monopoly over railroad services and opened the door for private undertakings to carry these out under a licence. The potential scope of concessions authorised by the Constitution has therefore not been realised and certain activities have been made subject to a licensing regime instead.

The Concession Law provides that a concession is required for the manufacture of weapons and explosives but the Law Concerning the Control over Explosives, Fire Arms and Ammunitions on the other hand, provides that such activities are instead subject to a permit. The position of Bulgarian law as to the manufacturing of “powerful” toxic substances is also unclear. Various laws address and regulate manufacturing and other activities related to drugs and poisonous or other biologically active substances, but none of them clarifies whether the substances addressed by such laws fall within the constitutional category of “powerful toxic substances”. None of these laws establishes a concession regime, but instead they set out permit or licensing requirements. Therefore, to the extent that the manufacturing of “powerful toxic substances” is addressed by specific laws, it is solely permits or licences which are required. Thus, the requirement of the Concession Law for the grant of a concession in respect of manufacturing of “powerful toxic substances” has not been translated into law and no state monopoly has been established for these activities. Until the legislation is clarified, the application of the Concession Law in respect of such activities remains unclear.

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7 Art. 2, Paragraph (1), Sub-paragraphs (1) and (2) of the Law on Concessions and Art. 67, Paragraph (1) of the Municipal Ownership Act.
10A concession would be required if a private company intends to provide water supply services to a city by way of utilising state-owned water, but the supply of raw water necessary for the provision of water services must be authorised by way of a water utilisation permit. This means that the Water Act is likely to dominate any structure where a concession is to be granted under the Concession Law.
12Art. 4, Paragraph (1), Sub-paragraph (6) of the Concession Law.
15Official Gazette, Issue no. 64, 4 August 2000.
Procedures for granting concessions

The general rule: tender or auction

With limited exceptions, concessions are awarded by way of competitive tenders or auctions. When a concession is proposed the Council of Ministers is responsible for determining whether the concession should proceed and whether the concession should be awarded following a tender or an auction for the selection of the concession holder. However, where particular legislation allows a concession to be granted without a tender or auction (see below) the Council of Ministers itself will directly award the concession. The decision of the Council of Ministers is made only following consideration of a report on the legal, economic, financial, social and environmental implications of the tender. The decision of the Council of Ministers as to whether a proposed concession scheme will proceed is final and may not be the subject of appeal.

The Prime Minister is responsible for appointing the tender or auction commission, as the case may be, and determines which Minister shall be responsible for running the procedure. Applicants for admission to the procedure are required to submit comprehensive plans, on the basis of which they may be precluded from participating in the procedure. Following the tender or auction, this commission submits its report on the results to the Council of Ministers together with its recommendation for the award of the concession. The Council of Ministers then determines to whom the concession shall be granted and authorises the relevant Minister to execute a concession agreement with that person. Article 19 of the Concession Law provides that the concession agreement must be concluded within one month of the date of announcement of the successful bidder, a period which may be insufficient in many cases, particularly as, in practice, the successful applicant may need time to carry out further independent testing before being in a position to negotiate the terms of the agreement.

Concessions in respect of municipal property, as well as in respect of activities over which a municipality has exclusive rights, are granted by the relevant municipal council. In this case, the procedure is initiated by the mayor of that municipality and the municipal council determines whether the concession procedure proposed by the mayor should proceed. The municipal council determines whether the concession is to be awarded following a tender or auction procedure for selection of the concession holder. Following the completion of the tender or auction, the mayor executes the concession agreement with the concession holder. In practice, the subject of a concession may be owned by several neighbouring municipalities, requiring the proposed concession holder to enter into negotiations with each, thereby inevitably prolonging and complicating the procedure. This administrative difficulty has been addressed by the recently enacted Water Law in the case of water supply concessions. Concessions for water supply systems which are co-owned by several municipalities may now be awarded by the Council of Ministers, provided that the prior consent of the representatives of the individual municipalities is obtained.

A concession may be awarded for up to 35 years, although an extension of the term to a total maximum duration of 50 years is possible, if determined by the Council of Ministers or the Municipal Council, as the case may be. Upon the expiry of a concession, Article 3(3) of the Concession Law, unusually, appears to give priority to the incumbent concession holder for the grant of a new option. There would appear to be no reason to include such a right of priority in the law and, as no concession granted under the Concession Law has yet expired, the procedure has so far not been tested.

Direct award of a concession

Both the Concession Law and the Municipal Ownership Act authorise the grant of the concession without a tender or auction in particular cases provided for by law. In the absence of such authorisation, the concession may be granted only pursuant to a tender or auction.

An exception to the tender/auction requirement, common to both state and municipal concession, arises in the case of privatisation. As mentioned above, the law authorises companies wholly owned by the state or a municipality to utilise property and to carry out activities which would normally require a concession without the need for a concession. However, at such point as these companies are privatised, the privatised companies, whether privately owned in full or in part,
must be able to continue their normal operations. In these circumstances, the Privatisation Law authorises the Council of Ministers to award the required concession to the privatised company, without a tender or auction. The procedure requires the relevant concession agreement to be entered into before the privatisation agreement is signed. This procedure was utilised in the privatisation of the potash producing company Sodi Deyvna, which was sold in 1997 to Solvay S.A.. In this transaction the purchaser was able to acquire the company in a manner that ensured that the company had in place the necessary concession to carry on business under private ownership. The concession agreement is made conditional upon the transfer of ownership pursuant to the privatisation agreement. A similar rule exists under the Municipal Ownership Act, whereby the municipal council is authorised to award a concession to a municipally owned company in the process of privatisation without a tender or auction.

Another significant exception to the tender/auction rule is provided by the Concession Law in cases where a wholly state-owned company owns a significant shareholding in the potential concession holder. A concession may therefore be awarded without a tender or auction to a company in which (i) a state-owned company owns at least 25 per cent of the equity of such company and (ii) the value of such equity exceeds BGN 300,000.

Bulgarian law provides certain other circumstances in which a concession may be awarded without a tender or auction. Principally, the law specifically allows this in relation to privatisation procedures. The justification of this approach is twofold. First, the law seeks to exclude the potential for cases where a successful purchaser of a former state-owned company may end up not obtaining the concession required to enable the company to continue its activities. Second, the grant of a concession without a tender or auction in the course of privatisation is in any case preceded by the privatisation procedure itself. As this is a competitive process the competitive component is considered to have been addressed already. The non-competitive award of a concession has not to date caused problems or invited allegations of abuse or corruption, although the overall privatisation process itself (with or without the grant of a concession) has provoked such allegations.

Transferability

A concession is non-transferable, unless transferability has been allowed by exceptional provision of a specific statute which applies to the particular concession. There exist two such cases. The first is the provision of Clause 2, Paragraph (3) of the Concession Law, which provides that “the rights and obligations of concession holders pursuant to contracts entered into during 1991 following an international auction, concerning exploration and extraction of oil and gas from the continental shelf of the Republic of Bulgaria, may be transferred only once to third parties which have a merchant capacity, following a permit by the Council of Ministers”. The second case is provided by Article 25, Paragraph (2) of the Law on Underground Resources, whereby the rights and obligations pursuant to an extraction concession may be transferred to certain qualifying third parties following a permit by the Council of Ministers. There is no apparent reason why this solution as provided in the Law on Underground Resources should not be developed to apply to all types of concession. This would, it is suggested, increase the commercial viability of concessions generally.

It is of principal importance to lenders that the concession holder has the ability to assign the concession rights and other related agreements to the lenders as security. At present, Bulgarian law prohibits assignment other than in the limited circumstances noted above. The assignment should also provide “step-in” rights for the lenders, enabling the lenders or a special purpose company controlled by them to be substituted as concession holder but, again, this is not permitted by Bulgarian law at present. This situation could be addressed if the non-transferability provisions of the Concession Law were made subordinate to any agreement of the Bulgarian government to permit assignments to lenders. In structuring security arrangements involving concessions lenders have therefore sought to secure not the concession itself but the shares of a special purpose company incorporated to hold the concession. Care has to be taken to ensure that the concession agreement does not include as a termination event the change of control of the concession holder. In addition to a pledge of the shares of the concession holder, lenders have also secured the right to vote the shares of the company following an event of default and to appoint a specialist management company to the board.

Dispute resolution

Of significant concern to international investors is the question of dispute resolution in relation to concession agreements. Although the state may freely agree to submit to arbitration, Bulgarian law prohibits the submission to domestic arbitration of any disputes to which the state is a party. Since this would be the case with all state-granted concessions, international arbitration is the obvious alternative to the domestic Bulgarian courts. This presents another major obstacle, however, as under the Concession Law a concession may be awarded only to an entity registered to do business in Bulgaria and Bulgarian law prohibits international arbitration where both parties to the dispute are Bulgarian entities. If the concession holder is a Bulgarian registered company, international arbitration involving the state would therefore be prohibited. It may, however, be possible for a foreign company to register a branch in Bulgaria and have the concession awarded to that branch. In this case the foreign nationality of the concession holder (a branch is not a separate legal entity under Bulgarian law) should mean that inter-
national arbitration is possible. There is growing support for these limitations on the availability of international arbitration to be lifted. Foreign private companies are uneasy that any disputes to which they are party in relation to a concession will by law be a matter only for the domestic courts, which may not always have the expertise to deal with the complexities of certain commercial disputes and may not be perceived to be entirely impartial.

Another issue of concern is the prohibition under Bulgarian law for disputes concerning rights \textit{in rem} in real estate to be submitted to arbitration. While this concern should not be relevant to a concession which is solely for the carrying out of certain activities, any concession related to the utilisation of property classified as real estate is affected. Bulgarian law is not clear as to the precise nature of the “utilisation” concession right and the courts have not yet had an opportunity to take a position on this issue. Lawyers are divided as to what is the legal nature of a “utilisation” concession right. One view is that this is of a purely contractual nature and, therefore, should be treated as akin to a rental right. Disputes concerning such a right should therefore be capable of submission to arbitration.

Another view, however, maintains that the “utilisation” concession right is a special kind of “usufruct”, i.e., a typical right \textit{in rem}. In that case, the “utilisation” concession right being a right \textit{in rem}, disputes related thereto would not be capable of being submitted to arbitration. Until Bulgarian law takes a clear position on this issue there will be some uncertainty as to the validity of an arbitration clause concerning disputes over a “utilisation” concession right.

Finally, another issue should be addressed in the case of concessions granted by a municipality. Under Bulgarian law municipalities (unlike the state) are not prevented from becoming parties to domestic arbitration. If the concession holder is a Bulgarian-registered entity any arbitration involving the municipality would have to be domestic Bulgarian arbitration. Bulgarian arbitration law requires the arbitrators appointed to serve on the panel to be Bulgarian nationals and the language of the arbitration to be Bulgarian. Again, however, the technique of having the concession awarded to a Bulgarian branch of a foreign entity, thereby introducing a foreign party to the arbitration, would be equally valid in these circumstances to enable international arbitration to take place.

\section*{Conclusion}

The Bulgarian concession law should be viewed as a statement of principle, rather than as an established and detailed system of rules and solutions. Each concession project is therefore capable of becoming a test case and may require creative solutions to unanticipated problems. Private sector investors who wish to utilise state resources or engage in the provision of public services must expect to comply not only with the Concession Law but with other laws and regulations. Coordinating the grant of the necessary concessions, permits and licences for the provision of public services represents a significant challenge to investors, both domestic and foreign.

On the other hand, the general spirit of Bulgarian law and the widely supported economic policy towards enabling, strengthening and broadening private initiative should not be ignored. Bulgaria has consistently ranked in the top quartile in the EBRD’s Legal Indicators survey of effectiveness and extensiveness of commercial laws. Such spirit and principles should ensure that Bulgarian authorities will act prudently, reasonably and diligently to solve the problems that will arise in the area of concessions. It can also be stated with confidence that with each project the legal framework for concessions and the implementation of concession legislation and other related legislation becomes more settled and accommodating in respect of future concessions.
Implementation of the Romanian concessions law – an update

On 29 January 1999 a new law on concessions came into force in Romania1. The Concession Law brought clarity to the legal regime applicable to concessions and appeared as an important step towards the development of concession projects in Romania. This article provides an update on its practical implementation after two years of application.

In Autumn 1999, Law in transition published an article describing the new Romanian Concession Law, which we concluded on a rather positive note. In our opinion, the Concession Law was to bring significant improvements to the reliability and consistency of the legal framework applicable to concessions and foster the development of concession and build-operate-transfer (BOT) projects in Romania. At the same time, we indicated that substantial improvements remained to be introduced to the Romanian legal framework to allow for the smooth implementation of concession projects. In particular, we pointed out that improvements to tariff regulations were required.

In fact, since February 1999, to our knowledge only two concession contracts have been signed under the new regime, both concerning the operation of municipal water and sewage services (one in Bucharest and another in Ploiesti). The signing of a third one (in Timisoara), also in the water sector, is pending at the time this article goes to print.

The uncertainties and risks arising from the imperfections of the Romanian legal framework are of a nature that international utility companies interested in developing concessions in eastern Europe would find acceptable. Accordingly, the reasons for Romania’s limited track record of successfully

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3 A number of concessions regulated by specific sectoral concession regulations, such as Law No. 134/1995 “on Petroleum”, Ordinance No. 30/95 “on the Concession Regime for Construction and Exploitation of Land Communication Lines, Highways and Railways” (approved by Law No. 136/96), Law No. 61/1998 “on Mining” and Emergency Government Ordinance No. 198/1998 “on the Privatisation of Commercial Companies Administering Agricultural Land or Land Continuously Covered with Water” have been or are in the course of being awarded. These do not, however, fall within the scope of this article.
completed concession projects should be sought in the country’s economic and political circumstances rather than in the inadequacies of the Romanian legal framework. The fundamental difficulties that operators are currently facing when attempting to develop concession projects in Romania relate to the lack of institutional and political support for concession projects.

Notwithstanding these difficulties, certain significant new developments relating to the implementation of the Concession Law merit reporting. The concession of the water and sewage services of Bucharest has been awarded and has recently come into force. Prompted by the requirements of the Bucharest project, the Romanian Government has finally adopted a new tariff regulation that allows for the operation of contractual tariff formulas in concession contracts and establishes the competence of the Competition Office as the “economic regulator” of concessions in Romania. Lastly, the adoption by the European Commission of its Interpretative Communication on Concessions under Community Law of 12 April 2000 will, upon Romania’s accession to the European Union, impact on certain provisions of the Concession Law and current concession contracts.

The Bucharest water and sewage services concession

The Bucharest water and sewage services concession, awarded in March 2000, is in many respects a landmark project for Romania. The fact that it was successfully completed demonstrates that a concession project can be developed and awarded under the Concession Law and in accordance with international practice.

Project structure

The City of Bucharest, advised by the International Finance Corporation (IFC), initiated the international tender for the award of the concession of the municipal water and sewage services of Bucharest in February 1999. In structuring the project the City chose to ‘spin off’ the main private property assets of the Regia Generala de Apa Bucuresti (RGAB), the self-managed public enterprise that was responsible for the “administration” (i.e., the use and operation) of the Bucharest water and sewage system belonging to the public domain of the City of Bucharest. These assets (primarily equipment dedicated to the operation of the system) were then contributed by the City, in return for shares, to a new concession company established by the winning bidder for the purposes of receiving the right to use and operate the system and provide the concession services.

The concession, formally awarded on 22 March 2000, is now operated by a commercial company controlled by an international operator, in which the City of Bucharest and employees hold a minority shareholding. The RGAB remains responsible only for the use and operation of certain non-core public property assets of the City, in particular a number of lakes situated in Bucharest and used for leisure activities.

Concession tender

The tender was organised pursuant to the tender procedures provided in the Concession Law. It involved three rounds of comments by the shortlisted tenderers on the concession documentation provided by the City of Bucharest. Participants in the tender were not required to submit any technical offer. The selection of the concessionaire was based exclusively on a comparison of the bidders’ tariff proposals, with the bidder submitting the lowest tariff bid, calculated as the average water and sewage tariff over the period of the concession, being the winner.

Participants in the tender were required to base their tariff proposals on the terms of the final draft of the concession contract and the other project documentation as finalised by the City and its advisers. The tender rules expressly excluded any negotiation of any part of the project documentation after the award of the concession. Thus, the documentation was signed within days following the official announcement of the award.

Concession contract

The Bucharest concession project and its contractual structure are likely to influence the manner in which concessions (in particular water and sewage services concessions) in Romania will be structured and documented in the future. This, in fact, is already the case with a municipal concession project on which the author is currently advising.

It would be beyond the scope of this article, however, to provide a detailed review and analysis of all of the terms of the Bucharest concession contract. The following, therefore, focuses only on certain of its main characteristics.

The approach taken by the City of Bucharest and IFC in structuring the tender and the concession contract was strictly “output based”. The City and IFC structured the concession contract around a stringent obligation placed on the concessionaire to achieve and maintain compliance with specific levels of services (LOS), without regard to the manner in which they are achieved and maintained by the concessionaire. Under the concession contract, the concessionaire is bound by the terms of the tariff proposal submitted during the tender and remains completely free to determine the nature, timing and level of investments in the water and sewage system necessary to achieve and maintain the levels of services. At the same time, the concession contract provides for substantial penalties in the case of non-achievement of, and/or subsequent discontinued compliance with, the levels of services.

The other terms of the contract are relatively standard for a project of the nature and size of the Bucharest concession. The duration of the concession is 25 years, extendable by agreement of the parties in accordance with the provisions of the Concession Law. Interestingly, the City agreed to set the concession fee at the strictly nominal amount of €5,000,
thereby agreeing not to draw revenue from the concession through the concession fee (which, in any event, the concessionaire would have passed through to consumers).

The contract also contains extensive provisions regulating the adjustment of the terms of the contract, primarily its tariff provisions, upon occurrence of certain circumstances affecting the financial balance of the concession, which circumstances cannot be factored in the tariff formula. In this respect, the City took the view that the list of grounds for adjustment referred to in paragraphs (a) and (b) of Article 32 of the Concession Law (change in law and force majeure) can be contractually expanded to include other grounds, in particular, “a fundamental change in the underlying economics of the concession” resulting in a decrease of the billable water consumption. In addition, the contract provides for a regular rebasing of the tariff by agreement of the parties, the purpose of which is to ensure that the return of the concession is within, and does not exceed, a predetermined target return band.

A key condition precedent to the coming into force of the concession contract consisted in the adoption of a law or other appropriate regulations allowing for the application of the sophisticated tariff provisions in the contract. Thus, the successful conclusion of the tender for the Bucharest concession played an important role in the development of the Romanian legal framework applicable to concessions. It prompted the government to adopt a much-awaited amendment to the rigid tariff control regulation until then applicable to the public services regulated by Emergency Government Ordinance No. 7/1998.  

**A new regulation of public services tariffs**

Before the adoption by the Romanian Government on 28 September 2000 of Emergency Ordinance No. 150/2000 for amending Article 3 of Emergency Ordinance No. 7/1998, the regulation of the prices and tariffs of basic public services was wholly inadequate.

As a general rule, Emergency Ordinance No. 7/1998 provided that the tariffs of these public services, whether organised at the national or the local level, could be adjusted only with the approval of the Competition Office. In addition, this adjustment could be made only upon the variation of certain indices (local inflation index or the ROL/USD exchange rate, depending on the service concerned) in excess of 5 per cent. As a result, concession contracts relating to the services covered by Emergency Ordinance No. 7/1998 could not provide for an automatic escalation and/or adjustment of tariffs in accordance with a formula taking into account the internal and external factors affecting the price of the services, such as the operator’s operating costs, financing costs or changes in the production and/or consumption of the relevant services.

A draft law “on Local Public Services” prepared by the Ministry of Public Works and Territorial Planning contemplated the liberalisation and decentralisation of the setting of tariffs for local public services. In particular, the draft law proposed to leave the establishment of such tariffs within the responsibility of the relevant local authorities and to allow such tariffs to be determined on the basis of factors that actually affect the price of the relevant service. Although these principles appeared to establish a sound basis for a reform of the regulation of utilities tariffs, they have not been implemented. The draft law, which was submitted to Parliament in September 1998 and was later replaced and completed by a new draft law “on Public Services” (Autumn 1999), has not yet been adopted.

In this context, and given that the adoption of suitable tariff regulations – a prerequisite for the successful completion of the Bucharest water concession – had become urgent, the Romanian Government finally adopted Emergency Ordinance No. 150/2000 for the amendment of Emergency Ordinance No. 7/1998, Article 1 of Emergency Ordinance No.  


In substance, the new regulation of utility tariffs allows the government to approve by a simple decision any type of tariff formula agreed in a concession contract, subject,
however, to such tariff formula being acceptable to the Competition Office. Emergency Ordinance No. 150/2000 does not determine any precise rules governing the costs of the concessionaire that shall be taken into account when determining the tariff or, alternatively, any principles concerning the limitation or capping of the tariff or the profitability of the concession. In fact, the Emergency Ordinance does not take a view on the model of tariff regulation that should apply to public services tariffs in Romania (e.g., “cost plus”, “tariff cap” or “rate of return” models). As a result, neither the Competition Office nor the government is bound by any regulatory principles in their assessment of the appropriate business of a tariff formula submitted to their approval, which remains, therefore, largely discretionary.

The new regulation brings, however, a useful clarification to the uncertainty created by the terms of Article 2.3 of the Concession Law, which states that public property, activities or services cannot be granted in concession if there does not exist a regulatory authority “whose opinion is binding concerning the prices and tariffs applied by the concessionaires”. Emergency Ordinance No. 150/2000 now designates the Competition Office as the regulatory authority referred to in Article 2.3. The Emergency Ordinance, however, contains only a very summary characterisation of the role of the Competition Office as the regulator of concession tariffs. In fact, its “rights and obligations” as the “economic regulator” of concessions must be determined, on a case-by-case basis, in the government decision approving the tariff formula and other tariff adjustment mechanisms of the relevant concession contract.9

Although formulated in summary terms, Emergency Ordinance No. 150/2000 brings a major improvement to the legal framework of concessions in Romania by allowing concession tariffs to be structured in an economic manner. In this respect, the generality of its terms, which in the Romanian context appears appropriate, provides a great flexibility in the determination of the most appropriate tariff formula for a given concession. At the same time, the discretion granted to the Competition Office and the government will require conceding authorities and operators to involve the Competition Office at an early stage of the structuring of the project and the determination or renegotiation of the principles governing the tariffs of the concession, in order to secure the Office’s approval and its favourable recommendation to the government. It remains to be seen whether this discretionary competence left to the Competition Office and the government will result, in practice, in excessive central government control over local concessions or, to the contrary, will be used by the Competition Office to progressively develop an expertise in concession tariff matters which will benefit to local authorities.

The European Community Treaty is not yet applicable in Romania. At present, a provision in a concession contract pursuant to which the parties to the concession may extend the term of the concession by mutual agreement for a period of up to half of the original duration of the concession would be perfectly valid.10 However, when the Treaty becomes applicable in Romania, upon Romania’s accession to the European Union, the Concession Law will have to be reviewed so as to ensure its compliance with the principles identified by the Commission in its Interpretative Communication.

In this context, it is most likely that the provisions relating to contract extension in concession contracts concluded before the Treaty came into force in Romania will also be deemed inapplicable, irrespective of the fact that these provisions were valid at the time they were agreed. This means that a concessionaire whose contract provides for the possibility to agree with the conceding authority an extension of the term by a certain period of time at the end of the original concession period will soon not be able to rely on that provision in its legal and financial assessment of the concession. It will, for example, no longer be possible for the concessionaire to

The impact of the Commission’s Interpretative Communication on Concessions under Community Law

Until recently, European Community law regulated only the public procurement of works and services.11 In such a context, it was unclear whether the publicity and competition rules set out in the Treaty and the relevant directives were applicable to public services concessions. In order to clarify the question, the European Commission issued an Interpretative Communication in April 2000 setting out the main principles applicable to the award of public concessions.12

According to the Communication, it is not because there are no specific European Community regulations governing concessions that the general principles derived from the Community Treaty, such as the principles of transparency, non-discrimination, equality and proportionality, do not apply to concessions.

It shall therefore be inferred from the terms of the Communication that, as a result of the applicability of the principles of transparency, non-discrimination and equality, a concession may be awarded only following publicity and a competitive procedure. This does not mean that a concession must systematically be tendered. However, the grantor of the concession must select the operator with which it will negotiate the final terms of the concession after having given the possibility to several candidates to submit proposals; and the selection made by the grantor must be based on objective criteria.

Concerning the renewal or extension of a concession, the Commission’s Communication states that any renewal of a concession that comes to its term shall be considered as equivalent to the granting of a new concession. This means that the grantor cannot renew and/or extend a concession without complying with the rules applicable to the award of the concession.
undertake significant investments shortly before the term of the concession for the primary purpose of being in a better position to secure a contract extension.

This might not be an issue in the context of concessions granted for longer durations (20-25 years) as seems to be currently the trend for concessions in Romania. This is much more an issue, however, for concessions granted for shorter periods, where the operator will, in fact, have to rely on a future extension to be able to make a decent return, as would appear to be the case in certain ongoing concession projects in other central European accession countries.

**Conclusion**

Notwithstanding its imperfections, the Romanian Concession Law provides a solid basis for the development of concession projects. In fact, the Romanian legal and regulatory framework of concessions is, in many respects, more practical than that of other central European countries, such as Poland or the Czech Republic.

In these countries, the lack of an appropriate legal framework for concessions is probably one of the key reasons for the limited number of completed public services concessions projects at present. By comparison, in Romania the obstacles to the development of concession projects are not primarily of a legal nature, but result essentially from the lasting economic and institutional difficulties that the country has endured since 1990.

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1 The tariff formula and adjustment mechanisms applicable to the Bucharest concession were approved on 26 October 2000, by a Government Decision No. 1019 “on the Approval of the Methodology for the Establishment and Adjustment of the Tariffs for the Water and Sewage Public Services in the City of Bucharest”. The Government Decision also establishes the “rights and obligations” of the Competition Office as the regulator of the concession through the ratification of the terms of the concession contract prepared by the City and the IFC, and which contains extensive developments on the role of the “economic regulator of the concession”.

10 See, in particular: Works Directive 93/37/EEC, Special Sectors Directive 93/38/EEC, Services Directive 92/50/EEC. Based on the Commission’s communication, it is now possible to clearly distinguish between concessions and public procurements. In substance, a concession under EC law is a contract in which (i) the private operator bears the risk of the operation of service that is the subject matter of the concession; and (ii) the private operator derives a significant part of its revenue from charges paid by the users of the service.


12 Such possibility is expressly contemplated in Article 30(1) of the Concession Law.

13 In particular, the absence of a distinction between public infrastructure assets and private property assets, and of general laws governing public services concessions.

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Slovenia case study: the Maribor waste-water project

This article gives an overview of some of the main legal challenges posed by the structuring of the project financing for the Maribor waste-water concession project in Slovenia. Arguably the first water-sector infrastructure project in the region, the Maribor project provides an interesting example of how important issues, such as negotiating the concession and direct agreements as well as structuring the security package, can be dealt with successfully in an environment relatively new to complex project finance transactions.

Recent years have witnessed a sharp rise in the frequency and sophistication of attempts to apply public-private partnership and project finance structures to infrastructure projects in the countries of central and eastern Europe. Governments in the region have turned to this approach to infrastructure development for fundamentally the same reasons as have governments in numerous other jurisdictions across the globe. Tight budgetary constraints, a growing faith in the virtues of privatisation, the extent and urgency of the need for new infrastructure, the search for better value for money in public services, and the rapid evolution of the techniques and skills deployed in structures of this kind have all played their part, as they have in so many other regions and countries around the world.

One of the recent successes in this sphere, and arguably the first water-sector infrastructure project financing to reach financial close in the region, is the Maribor waste-water concession project. The deal, financed by the European Bank for Reconstruction and Development (EBRD) and a syndicate of participant banks, and sponsored by a consortium of European water companies led by Suez Lyonnaise des Eaux SA (SLDE) and Degremont SA, involved a broad range of issues typical for the region and for a concession-based infrastructure project. As such, it may represent something of a benchmark for similar projects in the future. This article discusses some of the main challenges faced in connection with the structuring of the financing for the project.

Project structure

The project involves a concession for the construction and operation of a waste-water processing plant to serve Maribor, the second largest city in Slovenia. Maribor is located close to the Slovenian-Austrian border; in addition to SLDE and Degremont, the project sponsors include two Austrian water companies: Aquanet GmbH and Styreon GmbH.

The composition of the sponsor group was designed to maximise the skills and strengths represented by international corporations with wide experience in the water sector and in infrastructure projects in the region.

The concession was granted by the Municipality of Maribor to a locally incorporated special purpose entity, Aquasystems d.o.o., wholly owned by the project sponsors. The EBRD provided senior debt financing to Aquasystems using an A/B Loan structure, in a total principal amount of €28.1 million (of which the A Loan amount constituted €14.8 million, and the B Loan amount comprised €13.3 million).

Somewhat unusually for emerging markets projects, the project involves a public-sector sourced revenue stream. Aquasystems will not be obliged or entitled to collect service charges directly from the consumers in Maribor, but will instead be paid a tariff by the Municipality in compensation for perfor-
formance of its construction and operational services. The tariff will be paid out of a dedicated account to which municipal water taxes are to be transferred. In the event of a shortage of funds in this dedicated account, the Municipality will be obliged to pay the tariff out of its available financial resources.

Aquasystems has in turn entered into a fixed-price turnkey construction contract with SLDE and Degremont, and into technical assistance and know-how licence agreements with SLDE (thus ensuring that it would have sufficient technical resources available from the sponsors at all times to perform its concession agreement obligations). As part of the security package for the loan, Aquasystems has granted to the EBRD first-ranking security interests over its receivables (including the tariff payments to which it is entitled under the concession agreement), its project contracts, bank accounts and assets.

The sponsors in turn have provided the Bank with a full construction completion guarantee, and the EBRD has entered into a direct agreement with the Municipality, providing for step-in rights in favour of the Bank in case of a default under the loan or a purported termination of the concession. By way of security for its obligations under the concession agreement, Aquasystems is also obliged to provide the Municipality with a completion guarantee and, upon commencement of operation, a further operation period performance bond, as security for its operating obligations.

**Concession agreement**

**General**

The Maribor concession agreement is between the project company, Aquasystems, and the Municipality. The sponsors are not party to it but are identified as owners of Aquasystems (certain restrictions being placed on their ability to sell-down their interests).

The agreement grants an exclusive right to the concessionaire to provide water and wastewater services in the Maribor area during the term of the concession. This exclusivity is important not only for the concessionaire from a commercial point of view, but also as a statement of commitment of the Municipality to the concession structure and to the success of the project, thus providing a valuable degree of reassurance to the project lenders. As with any cash-flow-based financing structure, a high level of confidence about the revenues to be generated by the project in future is essential. Competition with the project company’s rights to provide services and generate these revenues could have seriously undermined that confidence.

**Term and phases**

The term of the concession is 22 years from the scheduled acceptance of the first phase of the facility (perhaps a comparatively long period for an infrastructure concession, but one justified by the nature and economics of the project). The agreement is split into separate construction and operational periods in a way which is designed to isolate the risks relating to each and thus facilitate the concessionaire’s ability to manage them. The construction period in turn consists of three phases, based on the technical capabilities of the purification units to be designed and constructed during each phase: a mechanical pre-treatment facility during phase one; a biological treatment facility for carbon removal during phase two; and a biological treatment facility for the removal of nitrogen and phosphorous compounds during phase three.

This phasing of the project represented a challenging complication of the transaction. Each phase is subject to specific conditions, only the initial phase being treated as a full commitment of the project company from the outset. Phases two and three are, in effect, contingent, their implementation being conditional on the outcome of further technical and commercial tests and studies, and the satisfaction of certain resourcing conditions. It was therefore important to ensure that the concession agreement provided sufficient flexibility to allow the parties to delay or cancel a phase if any of the relevant conditions could not be satisfied, but at the same time that it contained enough certainty to ensure the bankability of the project and full recovery of financing costs. The intention was to make the implementation of each phase dependent as far as possible on objective criteria and procedures, however, avoiding the risk of a wholesale renegotiation of its terms at each stage. During the construction period this is achieved in part by means of a mechanism for determining start and target acceptance criteria and dates for each phase, and for modifying the overall project schedule (and the construction delay penalties payable by the concessionaire). The tariff applicable to the operational period also had to be structured in a way which preserved this flexibility (see further below).

**Principal issues**

Any number of issues can arise as concession-based projects are structured and negotiated in the transition economies of the region. This is one of the reasons standardisation of concession agreements has proved so elusive at an international level. Set out below is a brief description of some of those issues and the way they were handled on the Maribor transaction.

**Permits and consents**

One of the challenges on any infrastructure project is to allocate the parties’ prospective responsibilities for obtaining permits and consents. This is rarely as straightforward as it seems. The consents needed can be numerous and occasionally unclear, and obtaining them can be a difficult and time-consuming process.
The concessionaire’s confidence in the integrity and transparency of the local permitting system will play a part in this allocation, as will its view of its own ability to obtain the necessary consents quickly and efficiently.

In the case of the Maribor project, most of the permitting responsibility is allocated to the concessionaire, with the Municipality being obliged to provide all reasonable assistance to Aquasystems in obtaining and maintaining the permits. This is suitable for Slovenia’s comparatively well-developed permitting system, but may not be appropriate for countries with less sophisticated and transparent permitting procedures. The exposure of the concessionaire to permitting risks is also mitigated by the fact that the receipt of the relevant required permits is made a condition precedent to the concessionaire’s obligations. If the permits were not obtained, the project would not be able to move forward and, thus, the Municipality has ample motivation to provide support to the permitting process.

**Site**

Concession-based projects often involve extensive discussion of how the site needed for the project is to be acquired and the risks associated with it borne by the parties. In difficult investment environments it rarely makes sense to attempt to transfer too much of this risk to the private sector. The Maribor concession agreement approaches the subject in a straightforward way. In common with many other concession agreements, the Municipality is responsible for obtaining and providing to the concessionaire the site and appropriate rights of use and access to it. These include rights of use for the duration of the concession, with a warranty of vacant possession granted by the Municipality. The agreement also gives the concessionaire such additional rights of access to the site as it may require for the purposes of performing its obligations, thus providing a degree of flexibility to cater for the uncertainties of construction.

**Public sector monitoring**

Another contentious area in negotiating concession agreements tends to be the extent of the public sector entity’s control over the concessionaire’s activities. Government bodies often view concessions as merely another form of public procurement, and can find it difficult to break with the more traditional procurement methods and habits of the past. Excessive control – or “micro-management” – can be counter-productive, however, inhibiting the effective deployment of private sector skills and innovation. On the other hand, governments cannot take the concessionaire’s performance of its obligations entirely on trust. There is always a balance to be struck, in other words. The Maribor concession agreement seeks to achieve a reasonable balance between the desire of the Municipality to have a sufficient degree of control over the project to protect its legitimate concerns as a public authority, and the importance of granting the concessionaire enough autonomy and freedom in its management decision-making to enable it to run its business effectively. The prescribed monitoring regime is based mainly on the concessionaire meeting construction deadlines and performance standards, and complying with pre-agreed operating plans and procedures. Within these constraints, the concessionaire retains a reasonable level of independent decision-making.

The concessionaire is subject to the general supervision of the Municipality (as required by local law). The Municipality is allowed to monitor the project and verify that it is being operated and maintained in accordance with the requirements of the concession. Appropriate record-keeping, information and reporting requirements (including the provision to the Municipality of monthly operating reports and annual technical and financial reports) have been put in place to allow the Municipality to discharge this function.

**Tariffs**

Structuring the tariff payable to the concessionaire was one of the project’s main challenges. This area will typically represent one of the focal points in the pattern of risk allocation on a concession-based project. This was so in the case of Maribor. The tariff had to be sufficiently certain from the date of signature to meet the project’s commercial and funding requirements, but also flexible enough to accommodate its contingent investment features (see further above). It was also structured to reflect a number of the central risks being borne by the concessionaire and the Municipality respectively. For example, construction cost is treated as a concessionaire risk, as are many of the basic cost elements of operation, although changes in certain taxes are a pass-through.

This is accomplished primarily by breaking the tariff down into a number of distinct components: a capital charge, an operation charge and a tax pass-through charge. The capital charge provides for the recovery of costs for the design, construction and start-up of the facility. It is based on fixed monetary amounts set forth year-by-year (as adjusted for changes in certain economic conditions, the Municipality’s construction change orders, and certain other public sector risks). The agreement contains a mechanism for recalculating these components as and when each new phase is implemented.

The operation charge consists of a fixed monthly component, in Slovenian tolers (SIT), and a variable component, being a fixed rate in SIT per cubic metre of influent. The volume component is designed to transfer a share in the risk of performance (e.g., quantities of water and waste-water treated under normal circumstances) to the concessionaire, but to
leave the risk of less predictable changes in volume with the municipality. Both of these elements are subject to escalation based on the Slovenian Retail Price Index.

The tax pass-through charge is designed to enable the concessionaire to recover the cost of a number of identified Slovenian taxes, including, inter alia, sales tax and VAT. Other taxes, including profit and income taxes, are specifically not reimbursable.

**Force majeure, hardship and financial balance**

The agreement’s force majeure provisions are typical of a concession contract of this kind. On some projects, the attempt is made to use a narrow definition of force majeure, based on a list of limited events. This is unlikely to be acceptable to sponsors or lenders in a relatively new investment environment, however, where few projects of the kind in question may have been financed. This was the position with Maribor. The innovative nature of the deal and long-term nature of the concession agreement meant that future unanticipated (and unidentified) events had to be allowed for. An open-ended definition was therefore adopted. Many of the public sector risks against which the concessionaire needs protection are also built into the definition. The agreement provides for the extension of deadlines for the performance of obligations where events of force majeure occur (as well as relief from liability). It also contains a right of termination for prolonged events of force majeure (i.e., lasting six months or more).

The concession agreement also provides for appropriate adjustments to its provisions to be made in certain circumstances to address the consequences of force majeure, changes of law or “hardship” (i.e., an event beyond the reasonable control of the parties which makes performance substantially more onerous). Where this occurs, adjustments are to be made on the basis that the concessionaire should be left in no better and no worse financial position as a result of the relevant event. This “financial balance” mechanism – an almost invariable feature of concession agreements for emerging markets projects – used a combination of a renegotiation mechanism and the agreement’s dispute resolution procedures where the parties cannot agree on the adjustments needed. In extreme cases a right of termination may arise.

**Termination payments**

One of the most difficult areas in the negotiation of any concession-based project is the subject of termination payments if the concession agreement is terminated before it has run its full term. What amounts should be paid to the concessionaire by the public sector in these circumstances, especially where the former is at fault? The main difficulty here is the possible mismatch between the sums likely to have been invested by the project company and its lenders when termination occurs, and the losses which the municipality stands to suffer as a result of a breach. There is often little correlation between the two. The issue tends to be highly emotive. The public sector may be deeply surprised by the suggestion that it should pay anything at all on a concessionaire default. Yet, on an early termination of the concession agreement, a valuable set of assets may change hands, long before lenders and investors have been paid out from the cash-flows generated by those assets.

These difficulties certainly played their part in the structuring of the Maribor project. As with so many emerging markets projects, one critical consideration in this context was the project’s bankability. Lenders will frequently be unable to lend unless their position is at least substantially covered on a premature termination. Thus it may be necessary to provide that termination payments will always be sufficient to pay out the senior lenders, irrespective of the cause of termination. This is the case with Maribor. This means that, even in the event of a termination for force majeure, hardship or concessionaire default, the Municipality will cover the outstanding principal and interest of the project loan or (after completion of phase two) the net book value of the plant.

In the event of termination for Municipality default, the Municipality will in addition be liable for the expenses and costs resulting from early termination of any concession-related contracts, and for the lost profits of the concessionaire over a number of years. The Municipality also has the right, under the agreement and Slovenian law, to terminate the concession for “convenience”.

Where it does so, however, as a disincentive to use this right except as a matter of strict need, its liability would be further increased to include the concessionaire’s lost profits until the end of the term of the agreement.

**Direct agreement**

Direct agreements can take time and patience to negotiate. Often, the public sector promoter will not have come across them before, and will need to be convinced of the need for them. The idea that it should, in effect, suspend or forgo its termination rights on a concessionaire default in order to leave the senior lenders with control of a troubled project can be far from self-explanatory. Yet, the reality is that, without the step-in rights which direct agreements are designed to give effect to, the typical limited-recourse infrastructure project will not be bankable. The termination of the concession agreement will otherwise render the lenders’ security package virtually valueless. These issues were much in evidence on the Maribor project. Detailed and lengthy discussions took place about the rationale for a direct agreement, the powers and responsibilities exercisable by the EBRD after it was invoked, the conditions relating to “step-in” and “step-out” procedures, and the criteria governing an acceptable substitute entity. In addition, the EBRD worked with the Municipality to address concerns that the direct agreement should not be perceived as an amendment to the concession agreement or as otherwise relieving the concessionaire of its obligations under it. In the end, an agreement was settled on terms acceptable to the Bank.
and the Municipality, and may well prove to be a valuable precedent elsewhere.

Security documents

Determining the structure of the security package to be taken by the project lenders often represents a challenging risk-management exercise for a limited-recourse financing in the emerging markets. Close coordination with local counsel is necessary to review and examine the types of security available under local law and the extent to which it can satisfy the expectations of international lenders. Again, this was very much the case with Maribor. In many respects, this is one of the most difficult areas of the “law in transition” process, since the development of security structures compatible with freemarket banking techniques in countries with different legal traditions of their own is never straightforward.

A number of alternative security mechanisms were considered in structuring the Maribor project and achieving the requisite level of comfort. Inevitably, a number of compromises had to be reached to accommodate aspects of local law. For example, under Slovenian law, security over after-acquired tangible property would not be effective without the execution of further documents after the acquisition of the new assets. Potentially, this could have called for a cumbersome procedure involving the execution of new documents each time further assets were incorporated in the project. As the project company initially had very few movable assets, it was therefore decided not to take a movables pledge, at least until such time as the company would acquire sufficiently valuable movables. A mechanism was put in place to allow the lenders to call for the execution of security later on in identified circumstances. Currency-control issues were encountered in attempting to set up offshore bank accounts of the project company (a mechanism often used in emerging markets projects for mitigating exchange rate, convertibility and transferability risks), and only onshore Slovenian bank accounts were used.

Appropriate local security over such accounts was taken by way of a Slovenian law cession of claims for security.

No security could be taken over immovable property of the project independently of the concession, as, under Slovenian law and the concession agreement, the concessionaire had a licence only to use the project site, which could not be mortgaged or otherwise encumbered by way of security. However, security taken over the rights of the concessionaire under the Concession Agreement (by way of a Slovenian cession of claims and rights, the local law equivalent of an assignment), together with the provisions of the direct agreement, were accepted as sufficient, as they provided a right to the lenders to take over control of, and operate, the project plant and facilities. Other security taken included security over the concessionaire’s receivables (including project revenue under the concession agreement), security over the project contracts (Slovenian or foreign, depending on the governing law of the underlying contract), pledges of shares of the concessionaire (governed by Slovenian law, as the underlying shares are shares in a Slovenian company), and security over any compensation the sponsors or the concessionaire might receive in case of expropriation or nationalisation of the project. The pledge of shares proved particularly challenging to structure since in Slovenia a bank cannot be given effective power to manage a company’s affairs (e.g., to appoint an administrative receiver) without a full transfer of equity interests, i.e., enforcement of the pledge.

Conclusion

The Maribor waste-water project was, we believe, the first limited-recourse concession-based municipal infrastructure project financing in eastern Europe to reach financial close. As a result of this first-mover status it is likely to be treated as a standard against which similar projects will be measured. It is hoped that the success of the Municipality promoting and financing the Maribor project will provide a sound basis for investor and lender confidence in the use of other concession-based project financings in central and eastern Europe.
**Legal transition developments**

### Armenia

**Legal Reform Projects**

**Telecommunications**

The European Bank for Reconstruction and Development (EBRD) has been providing technical assistance to the Armenian government in establishing the telecoms regulatory processes that will permit the effective monitoring and control of the incumbent operator to be achieved. The consultants have produced a study on the quality of telecommunication services that Armenian authorities could reasonably expect and the tariff methodology that would be best suited to Armenia’s situation. Following a thorough consideration of the consultants’ recommendations, the Armenian authorities have recently decided to create an independent regulator separate from the government but possibly merged with the energy regulator. The EBRD has assisted with the drafting of a new law establishing this regulator and the draft law has been submitted to the Armenian Minister of Justice for comment.

### Bulgaria

**Legal Developments**

**Bankruptcy Law**

In October 2000 the Bulgarian Parliament passed amendments to the bankruptcy law (published in the State Gazette issue 84 of 13/11/2000). The amendments are aimed at speeding up bankruptcy and bringing bankruptcy procedures in line with the three-stage process of judicial review contemplated by the Civil Procedure Code. In particular, the amendments introduce an improved system for preparing lists of claims, time restrictions for raising claims and an amended timeframe for raising repeal actions.

**Financial Markets**

In September 2000 a new Law on Bonds was adopted which removes the need for prior authorisation for issuing debt securities on foreign capital markets. On 1 January 2001 amendments to the Securities Law entered into force, allowing the Czech Securities and Exchange Commission to issue new licences to foreign companies interested in floating and selling stocks, bonds and mutual funds on the Czech market. It is hoped that the new law will help level the playing-field for Czech and foreign investment funds.

### Czech Republic

**Legal Developments**

**Bankruptcy Law**

On 1 May 2000, Law No. 105/2000 Coll., which amends the Czech Bankruptcy and Composition Act No. 328/1991 Coll., entered into force. The amendments introduce a number of positive changes but fail to address key weaknesses as well as introducing some negative changes.

The positive changes include:

i) allowing for the preservation of a debtor’s property and the appointment of interim trustees prior to a bankruptcy declaration; ii) permitting professional firms (in addition to individual persons) to act as administrators; iii) allowing creditors greater control over the selection and some of the actions of the liquidator (e.g., service contracts); and iv) introducing a more realistic and flexible fee structure for administrators.

However certain amendments have been subject to criticism. These include:

i) an amended definition for insolvency that is confusing and is likely to discourage rather than promote timely filings; ii) further erosion of the rights of secured creditors in realising or protecting their secured interests in the debtor’s property; iii) the possibility for the courts to dismiss the creditors’ committee without well-defined criteria; and iv) the introduction of special treatment for enterprises under the programme operated by the Revitalisation Agency.

In addition, the amendments now give courts discretion to decide whether general non-payment of liabilities is of an adequately “long period of time” to justify a declaration of insolvency. The amendments also restrict secured creditors’ rights by requiring that 30 per cent of net recoveries from the enforcement of collateral lose their priority and fall into the general creditor pool.

Unfortunately, the amendments do not address such pressing reforms as the need to align the bankruptcy treatment of secured creditors with commercial bargains and expectations, the need for a functional corporate rehabilitation process and the development of a functional regulatory system.

### Azerbaijan

**Legal Reform Projects**

**Securities Market**

At the request of the State Committee for Securities of Azerbaijan, the EBRD has undertaken a three-phase project to assist Azerbaijan in improving its laws and legal institutions governing the securities market in order to bring the Azeri laws into line with international practice and to facilitate the functioning of the Baku Stock Exchange. The project started in early 2001 and the first phase is expected to be completed during the course of the year.
Secured transactions

On 14 September 2000 a new law was adopted which provides, among other measures, a complete restatement of the Civil Code sections on pledge, yet without major practical changes. The new provisions, which entered into force on 1 January 2001, allow parties to create a valid pledge without dispossession of the charged assets from the debtor. Instead, there are two options: either the pledge can be registered on the ownership certificate in cases where transfer of title requires transfer of such a certificate, or the charged assets can be labelled with the name of the creditor on the debtor’s premises. This amendment clarifies the validity of these techniques under Czech law. These remain, however, of limited use.

LEGAL REFORM PROJECTS

Secured transactions

The EBRD has recently started discussions with the Ministry of Finance and the Ministry of Justice to explore the possibility of initiating a comprehensive reform of pledge legislation. The Central Bank and the Banking Association have both expressed their support. The Czech Republic is one of the few transition countries that has not undertaken comprehensive secured transactions reform since the beginning of the 1990s.

ESTONIA

LEGAL DEVELOPMENTS

Financial markets

In November 2000 the Ministry of Finance approved a draft of a new Securities Law, which is expected to take effect on 1 July 2001. The law has been forwarded to the Ministry of Justice for comments. It aims to further align the Estonian securities market legislation with European Union and international norms and covers, among other factors, public offerings.

FYR MACEDONIA

LEGAL DEVELOPMENTS

Pension reform

The government of FYR Macedonia has enacted a number of reforms, effective from September 2000, to the pay-as-you-go pension system. The legal framework for a fully funded mandatory second pillar is now in place and the system will be introduced over the medium term.

GEORGIA

LEGAL REFORM PROJECTS

Telecommunications

In July 2000 the EBRD launched a telecommunications regulatory project to assist the newly established Georgian regulator in drafting legislation in the areas of universal access, tariffs and licensing. However, the adoption of a sector policy defining the Government’s priorities and a complete re-registration of all existing licences (over 1,200) were necessary before legislative drafting could begin. The Georgian authorities are presently reviewing consultants’ reports on universal access, tariffs and licensing. Once the sector policy is adopted, efforts will focus on the drafting of the relevant legislation.

HUNGARY

LEGAL DEVELOPMENTS

Secured transactions

By Act CXXVII of 2000 on the modification of legal regulations on charges, Hungary has amended the provisions of the Civil Code on charges over movable assets. Although the structure of the new law is significantly different from the former Sections 251 – 269 of the Civil Code, the basic provisions remain similar but have introduced a number of features that were lacking previously.

LATVIA

LEGAL DEVELOPMENTS

Commercial Law

On 1 January 2001, a new Commercial Law entered into force. The new law provides for re-registration of enterprises and is expected to improve the business environment in Latvia.

Telecommunications

The Latvian Parliament again delayed the review of the new draft Telecommunications Law until March 2001. The decision to delay the review of the law was made in light of the legal dispute between the government and the Sonera-controlled consortium, which has a 49 per cent stake in Lattelekom, the fixed-line monopolist. During the privatisation of Lattelekom, the Government had given the company a monopoly over public voice services until 2013. However, during the World Trade Organisation (WTO) negotiations it was agreed that the monopoly period be shortened to 2003. This has given rise to a dispute with the consortium which claims compensation for the shortening of the monopoly period. The matter is currently before the International Court of Arbitration in Paris.

KAZAKHSTAN

LEGAL REFORM PROJECTS

Telecommunications

In September 2000 a telecommunications regulatory project was launched to assist in the creation of an independent regulator and the adoption of a modern regulatory framework compatible with WTO principles and capable of attracting investment. As part of the project, a complete sector overview and an analytical comparison of the telecommunication policies of some major countries was carried out.

The consultants have worked in close cooperation with the Kazakh authorities on the formulation of a sector policy, which has recently become available for public review, and all existing operators have been asked to participate in public hearings and provide their comments. A broader conference to present modern trends in international telecommunication policies and of attracting investment. As part of the project, a complete sector overview and an analytical comparison of the telecommunication policies of some major countries was carried out.

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POLAND

LEGAL DEVELOPMENTS

Financial markets

On 12 October 2000 the Lower House of Parliament amended the Law on Investment Funds. The amendments provide for the establishment
of venture capital funds, which will be the only funds with the right to invest in real estate.

**Telecommunications**

In August 2000 a new Telecommunications Law was finally adopted by the Parliament and signed by the President. The Law entered into force on 1 January 2001 and introduces competition in all telecommunication markets with the exception of international telecommunications services, which will be liberalised at the end of 2002. The Polish authorities have already awarded three “long-distance” licences to new entrants. The Law also provides for the creation of a Telecommunications Regulatory Authority that will become the sole independent regulator of the sector.

**LEGAL REFORM PROJECTS**

**Securitisation**

At the request of the Ministry of Finance of Poland the EBRD has initiated a project to conduct a feasibility study on the ministry’s plan to securitise impaired receivables of the Social Security Fund of Poland, Zaklad Ubezpieczen Spolecznych, in order to improve the Fund’s liquidity. Subject to the outcome of the study, the project will propose changes to Polish law necessary to implement the plan.

**LEGAL DEVELOPMENTS**

**Secured transactions**

The Electronic Archive of Secured Transactions has recently started its operations in the country. The Archive implements the 1999 Law “on the Legal Treatment of Security Interests in Personal Property”, which allows non-possessory charges to be established on a wide range of assets. The Archive ensures publicity of charges.

**RUSSIAN FEDERATION**

**Bankruptcy**

In July 2000 the first work-out of the indebtedness of a major Russian commercial bank pursuant to private contract was closed. This restructuring involved United Export Import Bank (Uneximbank), whose licence was withdrawn by the Central Bank of Russia in summer 1999 when a bankruptcy petition was filed against it.

In its position as lender, the EBRD acted as co-head of an informal steering committee of Western creditors of Uneximbank. Pursuant to a Restructuring Framework Agreement the obligations of creditors, domestic and foreign, were relinquished in exchange for a cash down-payment and a package of restructuring instruments. As part of the process of closing the restructuring, the bankruptcy proceedings instituted against Uneximbank in the Moscow Arbitration Court were terminated and the Central Bank of the Russian Federation restored Uneximbank’s general banking licence. This restructuring constitutes an important milestone in the development of Russian commercial bank insolvency administration.

**Company law**

Following the completion of an EBRD technical assistance project to assist the Russian Federal Commission for the Securities Market (FCSM) in revising the Russian Joint-Stock Companies Law, the proposed amendments have been passed by the State Duma. In order to become law the draft needs to be approved by the Federation Council (the upper chamber) and signed by the President. The draft has been rejected twice by the Federation Council in spite of the recommendation of a conciliatory committee of both chambers to the Parliament to approve the bill.

**Taxation**

On 1 January 2001 four chapters of Part II of the Tax Code entered into force. The adoption of the new chapters is part of long-term tax reform in Russia. The chapters deal with value added, excise, personal income and social taxes.

**Currency regulations**

On 12 October 2000 the Central Bank of the Russian Federation adopted Instruction 93-I “On the Procedure for Opening Bank Accounts of Non-residents by Authorised Banks in the Currency of the RF and Carrying out Operations with such Accounts”. The Instruction establishes new rules, introduces new types of accounts and replaces Instruction 16. It will enter into force on 7 March 2001 and will be applicable to all foreign investors in Russia. The Instruction affects the permitted currency of individual investments and the ability of a foreign investor to repatriate the proceeds of an investment.

**LEGAL REFORM PROJECTS**

**Secured transactions legislative reform**

In November 2000 a roundtable on secured transactions reform in Russia was held in Moscow. The roundtable, organised by the EBRD and the Private Law Research Centre under the President of the Russian Federation, was led by Professor Alexandre L. Makovsky, and included Russian experts and organisations interested in the field. Throughout the debates there was a general consensus that the present legal provisions do not work satisfactorily and that reform is necessary. The EBRD is now exploring possibilities for undertaking such reform with the support of the Russian Ministry of Economic Development and Trade.

**Corporate governance Roundtable**

As part of its efforts to help improve corporate governance in Russian companies, the EBRD has undertaken a number of initiatives involving other international financial organisations, Russian authorities and the private sector. These include active participation in the biannual roundtables organised by the OECD and The World Bank, the preparation of a corporate governance White Paper, and two legal technical assistance projects.

**Corporate governance ratings system**

This legal reform project, initiated in September 2000 and expected to be completed within 18 months, aims to assist the Institute of Corporate Law and Corporate Governance in developing the methodology for a corporate governance rating system and in applying it to a number of companies in Russia. This system would ultimately provide a clear indication of
those Russian companies applying best international practice of governance. The rating system will also create an incentive for companies to apply good governance standards in order to increase their attractiveness for potential investors. The ratings information will be made available to subscribers to the system. It is expected that investors, multilateral institutions and development banks will become subscribers to the rating system.

Corporate governance code

This project aims to assist the Russian FCSM to develop a Corporate Governance Code accompanied by an explanatory commentary that would be used as a central reference for issuers of securities.

The proposed code will be based on the OECD Principles of Corporate Governance and will provide guidance for improved corporate by-laws and operating procedures. The code will be developed and approved by the FSCM and its application is expected to be discretionary. However, the FSCM will require Russian companies to disclose the degree of compliance with the code’s provisions and justify any lack of compliance. It is hoped that the code, broadly publicised and accessible (through the assistance of other organisations), will ultimately serve as an important tool for the assessment by investors of Russian companies’ compliance with best international practices of governance.

LEGAL DEVELOPMENTS

Financial markets

On 1 November 2000 a new watchdog for the financial markets, the Financial Markets Office (FMO), took over the role of licensing and supervising the capital markets and insurance sector, which had been until then under the jurisdiction of the Ministry of Finance. The Office will decide on the rights and legally protected interests and duties of corporate entities and private individuals in both sectors. It is estimated that the FMO will take over pensions and banking regulation in 2002.

LEGAL REFORM PROJECTS

Secured transactions

The EBRD, in cooperation with the Office of the Prime Minister (Economic Affairs), has undertaken a project to improve the Slovak secured transactions legal framework (see Law in transition, Autumn 2000, p.72). The drafting of the new Civil Code provisions and related legislation, as well as preparations for their implementation, has begun. In particular, there are plans to create a central registry where all collateral transactions will be registered. It is anticipated that a draft law will be considered by Parliament at the beginning of summer 2001.

UKRAINE

LEGAL DEVELOPMENTS

Banking sector

On 7 December 2000 the Supreme Council of Ukraine passed a new Law on Banks and Banking Activity. The Law regulates the structure of the banking system, the economic, logistical and legal foundations of its activities and the establishment, reorganisation and liquidation of banks, as well as other financial and credit institutions. The adoption of the Law aims to bring the rules on creation, activity and liquidation of banks in line with international standards.

Telecommunications

On 13 July 2000 the Ukrainian Parliament, after long debates, adopted a law that permits the privatisation of Uktelecom, the country’s incumbent telecom operator. Under the new law 25 per cent plus one of the company’s shares can be sold to a strategic investor chosen through an open tender. Only companies with a proven capacity to operate fixed telecommunication networks can qualify as potential strategic investors. The law explicitly permits the transfer of management control to this strategic investor. The law provides for the creation of a privatisation committee whose tasks would include launching an open competition for the appointment of privatisation advisers.

EBRD’s Office of the General Counsel

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Craig Averch  Counsel, Corporate Recovery Team, bankruptcy
Hsianmin Chen  Counsel, financial market regulation
Frédérique Dahan  Counsel, Secured Transactions Project
Meni Styliadou  Counsel, telecommunications regulatory reform
Alexei Zverev  Counsel, concessions/Russia legal reform
Anila Gramshi  Associate, financial market regulation

LEGAL REFORM PROJECTS

Telecommunications

In September 2000 the EBRD commenced a telecommunications regulatory reform project, following the initiation of the privatisation of the Ukraine’s incumbent operator in the late summer of 2000. Telecommunications policy is at present the focus of attention in the Ukrainian Government. At the request of the Ukrainian authorities the EBRD organised a roundtable on 1 November 2000 on the fundamental principles of a market-oriented telecommunications law and policy. Presentations during this roundtable focused on some particularly sensitive issues of a telecommunications policy including service and access, licensing and interconnection. The roundtable also covered the main factors of a successful telecom privatisation. Under the Chairman of the State Committee for Communications, it was attended by senior members of the Ukrainian administration as well as senior representatives of most telecommunication operators. In parallel with the roundtable, the EBRD and its consultants have had bilateral meetings with officials of the State Committee to present and discuss a comparative analysis of telecommunication policies and law in other countries, as well as to put forward their recommendations for Ukraine’s regulatory reform.
IMC Forum on Broadcasting, Multimedia and Telecommunications, Sarajevo

On 7 June 2000 the Independent Media Commission (IMC) of Bosnia and Herzegovina (BiH) organised a conference on convergence among broadcasting, multimedia and telecommunications, and its implications for BiH. The IMC is an institution with the specific mandate of overseeing the democratic, pluralistic and transparent function of the media industry in the post-war BiH.

Conference speakers included representatives of the European Commission and other international organisations involved in telecommunications policy, as well as foreign and local investors and representatives of the local authorities. The EBRD was invited to participate in view of its long and active involvement in the development of the Bosnian telecommunications regulatory framework. Meni Styliadou, EBRD counsel, presented the telecommunications law of BiH. She explained how this law allocated powers and responsibilities among the various local authorities, and interfaced with broadcasting and media issues.

Conference on Corporate Governance Standards, London

In September 2000 the Institute of Management and a number of leading consultancy and law firms organised a conference on good corporate governance standards for high-level managers from some of Russia’s largest companies. Representatives from Gazprom, Lukoil-Perm, Norlisk Nickel and AvtoVaz participated. Alexei Zverev, EBRD counsel, made a presentation on international corporate governance standards and the work of the EBRD in assisting the development of such standards in Russia.

ITU Regional Seminar on Rural Telecommunications and Universal Access, Moscow

On 26 October 2000, the International Telecommunications Union (ITU) organised a seminar designed to raise awareness on the development of the rural networks generally and in the CIS countries in particular. Rural networks are often unprofitable and therefore unsustainable in a competitive environment. As a result, there is a need to design mechanisms that will permit efficient subsidisation without distorting competition. During the ITU conference Meni Styliadou, EBRD counsel, and Sofia Bianchi, Senior Banker in the EBRD’s Telecommunications Team, proposed and discussed the creation of a Universal Access Fund that would provide soft loans for the creation and operation of rural networks. The Fund would provide financing following open tenders and assessments of each proposal’s commercial viability and social impact.

UN Economic Commission for Europe, Public-Private Partnerships for Infrastructure Development: The Next Steps, Geneva

On 4-5 December 2000 the UN Economic Commission for Europe (ECE) convened a forum of representatives from the public and private sectors and international organisations to discuss ways to expand the use of public-private partnerships (PPPs) for infrastructure development in the transition countries of central and eastern Europe and the Commonwealth of Independent States. The forum was designed to discuss the work of the UN ECE’s Build Operate Transfer (BOT) Working Group and to solicit support for the launch of a number of new initiatives. The BOT Working Group described the development of its guidelines of best practices for PPPs in infrastructure, which were being finalised for publication. The Working Group also presented its Negotiation Platform, which takes the perspective of a transition country government that is supervising the development of a PPP project. The Platform is designed to serve as a tool to train and educate local public sector officials on the steps and techniques involved in PPPs.

During the forum it was agreed that the UN ECE would launch a Regional Flagship Initiative to promote PPPs among the countries covered by the Stability Pact for South-east Europe. The Initiative would help to improve
the legal framework for PPPs, develop local
capacity, identify pilot projects and improve
regional cooperation on PPP projects. The
Forum participants also endorsed the formation
of a PPP Alliance consisting of private com-
panies and regional and international organ-
isations. The Alliance would promote the BOT
Working Group’s principles and would encour-
age private funding of infrastructure projects in
the transition countries.

International Insolvency
Colloquium, Vienna

On 4-6 December 2000 UNCITRAL and
INSOL International, in collaboration with the
International Bar Association, held an inter-
national insolvency colloquium aimed at
assessing the status of the work carried out by
various agencies in the field of insolvency law
reform and providing guidance and recommend-
ations for the future work of UNCITRAL on
a possible model law on insolvency. Approx-
imately 170 delegates from 48 countries
attended the Colloquium. The delegates
included judges, international insolvency
practitioners and academics, as well as official
representatives from various nations, inter-
national lenders, global agencies and
international financial institutions.

The three-day Colloquium presented a number
of panels to consider the reports and the needs
of nations either undertaking or considering
undertaking reform of part or all of their
domestic laws relating to insolvency. The
Colloquium was also used to determine the
manner in which UNCITRAL and other inter-
national organisations could give the greatest
assistance in the furtherance of insolvency law
reform. Specific consideration was given to the
tools necessary to assist countries to enact
insolvency laws that provide a fair, equitable
and transparent process to resolve issues
facing financially troubled businesses.

Craig Averch, EBRD counsel, participated on
a panel that identified issues of importance to
countries about to reform insolvency law. He
presented the EBRD’s views on the status of
insolvency reform in central and eastern
Europe, as reinforced by the findings of the
EBRD’s most recent Legal Indicator Survey.
(See Law in transition, Spring 2000, p.34.)
Kamen Zahariev, EBRD senior counsel,
contributed to a panel discussion evaluating
and synthesising the submissions to the Coll-
loquium. He noted the difficulty in the imple-
mentation of the various proposals and opened a
debate about the direction of future work to
implement some of the initiatives discussed at
the Colloquium.

The participants unanimously agreed on the
importance of effective insolvency regimes
and on the need to coordinate the global and
regional initiatives aimed at improving the
functioning of those regimes. The Colloquium
concluded with an announcement that
UNCITRAL would establish a working group
to prepare, and disseminate for discussion,
detailed guidelines for effective insolvency
systems for businesses. Suggestions on the
scope and nature of the guidelines were
solicited from the delegates. The process to
finalise and obtain UNCITRAL approval of
the guidelines was anticipated to take at least
two years. Representatives from UNCITRAL,
however, indicated a desire that the working
group prepare a working draft of the guide-
lines within the following six months.

FD&A/CFA Global Finance
Conference, Dublin

On 5-7 December 2000 the Factors and Dis-
counters Association (FD&A) and the Com-
mercial Finance Association (CFA) held a Global
Finance Conference. In addition to discussing
the latest legal developments on factoring and
the profession in general, the Conference
included a session on global opportunities for
factoring. The effect of the draft UNCITRAL
Convention on Assignment of Receivables in
International Trade was discussed, as well as
the work of the UK Department of Trade and
Industry as part of the draft’s negotiations.
Frederique Dahan, EBRD counsel, presented
the EBRD Secured Transactions Project, high-
lighting the progress made in creating the legal
foundation for secured financing and the
potential for foreign investment.

Global Workshop on
Implementing Emerging
Financial Sector Standards:
A Public/Private Sector
Challenge, Versailles

On 18-19 December 2000 the World Bank and
the Bank of France held a conference on the
implementation of emerging financial sector
standards which consisted of six sessions of
presentations and panel discussions. The ses-
sions discussed the recent work of the Task
Force of the Financial Stability Forum on im-
plementation of standards. Several international
organisations reported on their assessment
initiatives and the relevant issues relating to the
implementation of financial sector standards.

World Bank Insolvency Initiative:
Working Group Meeting

On 15-16 January 2001 the World Bank con-
voked a working session of insolvency experts
from private practice and international organ-
isations to finalise its International Principles
and Guidelines for Effective Insolvency Sys-
tems. The experts met in six working groups
(credit/collateral/enforcement, legal frame-
work, institutional framework, regulatory
framework, corporate rescue and international
issues) to address the various aspects of an
effective insolvency system contained in the
draft of the Principles and Guidelines
(whl01018.worldbank.org/legal/gild/). This
second draft reflected comments received by the
World Bank during five regional work-
shops held since November 1999 and covering
approximately 75 countries. During the ses-
sions in London the insolvency experts
worked to distil clear principles and present
them in a form that provides developing and
transition country legislators and policy-
makers with a “road map” for building an
effective insolvency system. In particular, the
participants struck a balance between inter-
national best practice and the practical needs
(and limitations) of developing markets, and
identified links among the various facets of
an insolvency system.
The London meeting also helped to develop a series of annexes to the Principles and Guidelines which will contain supplementary materials, detailed guidelines for specific areas and lists of source materials. The participants discussed the development of an assessment template that will be used to evaluate and benchmark the development of insolvency systems against the Principles and Guidelines. The World Bank and IMF plan to conduct six regionally diverse pilot assessments using the template during the course of 2001. These assessments will be conducted as part of the WB/IMF programme of Reports on Observance of Standards and Codes (ROSC).

The finalised Principles and Guidelines and annexes were presented to the World Bank’s Board for approval early this spring.


On 15-19 January, the Hague Conference on Private International Law held a four-day meeting of experts to examine the feasibility of drawing up a new instrument on the subject of the law applicable to the transfer or pledge of securities held through indirect holding systems. The group comprised representatives from Member States, experts and international governmental and non-governmental organisations specialised in the field, such as ISDA (International Swaps and Derivatives Association), the IBA (International Bar Association) and UNCITRAL. Due to the practical importance of the issues discussed and the lack of clear conflict of laws rules in most countries, the Hague Conference has given the project high priority. The EBRD participated in the discussions and conveyed its support for the project.
SECURED TRANSACTIONS PROJECT

For the latest information on secured transactions laws and the work undertaken by the EBRD’s Office of the General Counsel in this area, visit the EBRD’s Web site (www.ebrd.com/english/st.htm). Here you will find:

- the Model Law on Secured Transactions, in English, German and Russian;
- the EBRD’s Core Principles for a Secured Transactions Law;
- the Regional Survey, which provides a short analysis of existing secured transactions law in the Bank’s 26 countries of operations;
- reports and working papers on a number of country projects, such as Moldova’s Registration of pledges under the Law on Pledge of 23 May 1996, June 1998; and
- other publications, such as the Glossary of secured transactions terms (English-Russian and Russian-English).

All this information may be accessed and downloaded free of charge.

The Secured Transactions Project welcomes all comments and suggestions – please send to SecuredTransactions@ebrd.com.

www.ebrd.com/english/st.htm
Law in transition

Advancing legal reform

Spring 2001

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Legal transition developments

Legal transition events

The European Bank for Reconstruction and Development (EBRD) is an international institution whose members comprise 60 countries, the European Community and the European Investment Bank. The EBRD operates in the countries of central and eastern Europe and the Commonwealth of Independent States committed to multiparty democracy, pluralism, and market economies. The EBRD’s countries of operations are: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, FR Yugoslavia, FYR Macedonia, Georgia, Hungary, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Poland, Romania, Russian Federation, Slovak Republic, Slovenia, Tajikistan, 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 EBRD 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.

Law in transition is a publication of the Office of the General Counsel of the EBRD. It is published several times each year and is available in English and Russian. The editors welcome ideas, contributions and letters, but assume no responsibility regarding them. Submissions should be sent to David Bernstein, Office of the General Counsel or the EBRD generally. Nothing in the articles should be taken as legal advice.


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