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APPRAISAL
of the Draft Law of Ukraine on the Special Rules Applicable to Lend-Lease and Concession Agreements for Water Supply, Heat Supply and Sewage in Municipal Property

Secretariat note

The present report was prepared by the Directorate of Democratic Institutions, Directorate General of Democracy and Political Affairs, in co-operation with Prof. Gérard Marcou, University Paris 1 Panthéon-Sorbonne, Director of GRALE (Research Group on Local Administration in Europe), France.

The draft Law on Special Rules Applicable to Lend-Lease and Concession Agreements for Water Supply, Heat Supply and Sewage in Municipal Property was first appraised by the Council of Europe (CoE) in 2007: DPA/LEX 05/2007, 21 December 2007.

The Verkhovna Rada adopted this draft in October 2010 in the second reading; the present paper is an assessment of this draft. It focuses on specific points that might be subject to further revision. The paper provides a summary of remarks from three years ago which remain valid, in particular:

- the coordination between the new draft and the laws in force on concession and franchise agreements;
- the provisions on competition and remedies;
- the protection of public interests in contract provisions.

I. Coordination between the new draft and the existing legislation

The laws on lend-lease agreements of 1992 and on concession agreements of 1999, amended several times[1], have set out the general legal framework for such kinds of contracts, and their scope included water supply, heating supply and sewage. The purpose of the present draft is to draw up special rules for these public services, which will remain partly governed by the general laws. In contrast to the general laws, the draft law is applicable to agreements approved/made by municipalities concerning objects (usually networks or elements thereof) within their property.

The Council of Europe has previously emphasised the difficulties arising from coordinating the general laws with the special law, in particular with regard to specific questions. The version adopted in the second reading states clearly that all questions not regulated by the new law will be subject to the provisions of the laws on concession and lend-lease agreements, as well as those of the civil code, the code of commerce, the land law code, and other pieces of legislation (Art. 2.2). This is a much better formulation than the former and ambiguous Article 3 of the initial version of the draft law.

Hence, where provision in the special law differs from the general laws on concession and lend-lease agreements, the provisions of the special law will always prevail. For example: where the general law on lend-lease agreements provides that the lend-lease agreement involves a set of assets constituting an economic unit that can be operated autonomously (art.4, par.1), the draft law may only involve “objects” of municipal property and their economic operation (art.2, par.1). The concept of the general law is based on an economic analysis that is not easy to translate into legal criteria, whereas the draft law’s formulation makes it easier to determine the object of the contract.

[1] The final provisions refer to the lend-lease law of 1995, whereas the said law was adopted in April 1992, subject to subsequent amendments, because the law of 14 March 1995 has edited a new version of this law, again subject to numerous subsequent amendments.

Furthermore, it is good to set out clearly the relationship between both levels of legislation. For example, with regard to contract terms, Article 8 sets out special requirements that are additional to those listed in the general laws on lend-lease and on concession agreements.

II. The provisions on competition and remedies

If a municipal authority decides to pass a concession or a lend-lease agreement, it has to comply with transparency rules and a competitive procedure. Otherwise, this authority may continue to operate the service by its own means, e.g. through a municipal enterprise. Transparency rules and a competitive procedure are the only way to achieve the best value for the service to be delivered and to avoid – or limit – the possibilities of leaking money through corruption or to political parties.

The general part of the draft law organises a competitive procedure applicable to concession and lend-lease agreements for water supply, heating supply and sewage (art.7) and regulates the provision and the registration of the contract (art.8-10). In particular, the amendment which makes it clear that the contract terms may not deviate from those for which the winner of the tender was selected (Art.7, para 17, last sentence) is a positive development.

However, some provisions of the draft law still make it possible to by-pass competition rules, as was the case in the first version.

According to Article 5 (para 3), the municipal authority is not bound to turn for advice to the Antitrust Authority before deciding to conclude a lend-lease or a concession agreement for objects covered by the draft law. As a consequence, turning for advice to the Antitrust Authority is left to the discretion of the municipal authority that is going to approve/conclude the contract. In an industry with a high level of concentration in the private sector through subsidiaries for the operation of local services, this provision is inadequate. It is clear that the obligation to submit all projects to the Antitrust Authority would be certainly overly cumbersome. However, such amendments would give sufficient guarantee of : 1) either the State administration in the *rayon* of the *oblast* (depending on the future legislation on local government reform) could refer the project to the Antitrust Authority; or 2) one third of the members of the local council could decide to refer the project to the Antitrust Authority.

The only case where it may be justified to avoid the tender procedure is when the municipal authority decides to operate the service through a municipal enterprise deemed to serve its own population. This is the purpose of “in house” companies as admitted by the Court of Justice of the European Union. Also acceptable could be the devolution of the operation of the service to users’ or workers’ cooperatives, but this option was abandoned in the new version.

The second provision open to dispute is paragraph 5 of Article 5. It is possible to grant a lend-lease or a concession agreement directly (without using the tender procedure) when the service is only to serve the consumers of the village municipality (*selo*), e.g. a village or a borough in a rural area. This provision is much better than the previous Article 7 (last sentence) that left it to the discretion of the municipal authority whether to organise the tender procedure . In the new version, tender procedures are obligatory in cities or for services organised by the *rayon* council. However, with this procedure the risk of arrangements detrimental to consumers being arranged with local entrepreneurs – or with subsidiaries of bigger firms established locally is too big, since there is no way of making sure that the conditions offered are the best. The village municipalities' discretion might even make it impossible for the *rayon* or the regional council to organise the service at the level of their territory (see Article 3), since the possibility opened by the paragraph 5 of article 5 enables the settlement municipality to opt out . Therefore, the recommendation is to delete paragraph 5 of Article 5.

The new version abandoned the possibility in the first draft of fixing the lease rent at a level which does not include the amortisation cost for the assets owned by the municipal authority and put at the disposal of the operator. This could be criticised because the burden of amortisation falls on the current expenditure of the municipal authority. However, paragraph 10 of Article 11 makes it possible to grant the operator under a lend-lease agreement any privilege on the rent to be paid. This provision is even worse on account of its vagueness. Therefore, the recommendation is to delete paragraph 10 of article 11.

As regards remedies, the draft law only states that litigation in respect of the tender procedure may be brought before the courts. This is not sufficient. The development of the law on public contracts in the European Union has been to strengthen the remedies offered to illegally eliminated competitors, in order to avoid the strategy of fait accompli, where a contract is enforced before remedies may be obtained. Therefore, the draft law should also include provisions on interim remedies for preventing signature, registration and implementation of a contract subject to a claim based on serious grounds. Alternatively a special law for this purpose should be prepared to amend accordingly the law on administrative courts.

Lastly, on the basis of Article 3 of the draft law, some disputable provisions of the general laws on lend-lease and concession agreements could still be applied. The preference right given to the operator under a lend-lease agreement by the law of 1992 on lend-lease agreements (Art.17, para 2) is unjustified and incompatible with competition rules. This provision should be ruled out by an explicit provision for contracts governed by the draft law on lend-lease and concession agreements for water supply, heating supply and sewage. Again, the provision of the law of 1999 on concession agreements giving a preference right to the concessionaire in case of privatisation at the end of the contract (Art.3, par.8) should

be ruled out by an explicit provision of the draft law under review. Later on, these provisions should be deleted from both general laws.

III. The protection of public interests in the contract provisions

The new version of the draft law provides for contract duration. For the lend-lease agreement, the duration must be from 2 to 10 years (Art.13, para 1). For the concession agreement, the duration must be from 3 to 50 years (Art.17, para 1). However, the draft establishes no relation between the duration of the contract and the investment of the contractor.

DPA/LEX 05/2007 has already pointed out that these provisions, that were already in the first version (Articles 17 and 25 respectively), were inadequate.

Such durations are far too long and will result in unjustified benefits, especially in cases when the concession or the lend-lease contract will be awarded without a tender procedure. Such a contract establishes exclusive rights based on a natural monopoly for technical and economic reasons, as is usual for network industries. However, such exclusive rights have to be subject to periodic competition, in order to avoid such abusively privileged situations. In the case of a lend-lease agreement, the assets remain in the municipal property and the operator has to pay a rent to the municipal authority for their use and amortisation. Considerations of efficiency and quality improvement, the time needed to set up the enterprise and bring it to the right level may justify the duration of the agreement for several years. For concession agreements, there are capital investments to be amortised by the operator. Therefore, the duration of the contract has to be based on the amortisation period of this investment. For water supply, heating supply or sewage there is no need for such long duration periods.[2]

Therefore, the recommendation is to amend the draft law with the following provisions: 1) the contract term has to be fixed on the basis of the amortisation of the assets due to the concessionaire's investments or of an assessment of the economic cycle in case of a lend-lease agreement; 2) the duration of the contract may not exceed 20 years, unless there are serious grounds for doing so which can be accepted by the competent council after scrutiny by the State financial administration.

[2] For example, the limit established by the law in France for similar contracts (water supply, sewage, waste management) is 20 years for a concession agreement. A longer term is subject to review by the Treasurer of the department (higher civil servant of the State finance administration), whose report is transmitted for information to the local council that has to decide.