

Unofficial translation into  
English from the Czech original

**Public Private Partnership**  
(Partnerství veřejného a soukromého sektoru)

Legal feasibility study  
in the Czech Republic

October 2003

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**ANNEX: OVERVIEW OF LEGISLATIVE BASIS IN THE KEY SECTORS**

## INTRODUCTION

This study was performed in connection with the preparations for the introduction of the Public Private Partnership concept as the Czech Ministry of Finance and the National Property Fund have been instructed by the Czech Government under the planned reform of the public budgets.

**The purpose** of this study is to analyse the legal environment in the Czech Republic in the light of the planned implementation of public services and public infrastructure projects by way of partnership between the public and private sectors, or Public Private Partnership ("**PPP**") and to provide recommendations concerning changes to be made in Czech law in order to create a legal environment facilitating the execution of such projects through PPP.

This study solely deals with the legal aspect of the issue rather than giving judgements as to the suitability or benefits of PPP for the provision of public service or public infrastructure. In fact, discussions of general economic feasibility would not be proper because PPP does not represent an all-embracing method, rather one of the options that the public sector can apply in order to implement certain **specific** projects. It is in connection with such specific projects that debates can be launched on their (socio-political) feasibility and (economic) suitability.

Similarly as this study fails to provide an analysis of the "pros" and "cons" of PPP, it does not provide an exhaustive definition of what PPP exactly is. This is because such definition in fact does not exist. PPP is a term that has been applied to a whole range of manners of provision of public services and public infrastructure – commencing with traditional road and railway, school and hospital development projects, up to prisons. The list of projects implemented by way of PPP in various countries has been growing and it is up to the public governments to decide whether a specific project should or should not be implemented as a PPP one. Although the term PPP cannot be defined in a satisfactory manner, it is possible to point out certain of its typical features: (1) it involves the private sector on the one hand (the "**Beneficiary**"); (2) and the private sector on the other hand (the "**Private Partner**" or "**Contractor**"); (3) with the Beneficiary and the Contractor having entered into long-term contracts concerning the provision of public services or public infrastructure.

This study could not have been drafted without the unselfish support and expertise offered to us by some other experts – mainly members of the individual government departments, who deserve sincere thanks. Special thanks belong to Ing. Kateřina Helikarová of the Czech Ministry of Finance.

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## 1. EXECUTIVE SUMMARY

### 1.1 Partial Readiness; Requirements for Change

Although the legal environment in the Czech Republic has not undergone any specific preparation in order to accept PPP projects, some projects could be implemented without any further amendments to Czech law.<sup>1</sup> However, the implementation of projects in some areas (e.g. the funding of medical or educational projects, the implementation of projects involving the collection of a fee (e.g. a toll) etc.) and any further expansion of PPP projects would be conditional on certain legislative amendments and an increase in the organisational readiness of the public sector.

### 1.2 Requirements for Legislative Amendments – General laws

Successful implementation of PPP projects would require certain material legislative amendments in the following spheres:

**Public procurement:** PPP projects involve public contracts and must comply with the provisions of the Public Procurement Act. This act (both the current act and the proposed bill reviewed by the Parliament) has not been drafted with a view to making public procurement of such scope and nature as that inherent in PPP projects; therefore it does not allow for special treatment of development contracts made by way of concession in compliance with EU directives. It is recommended to make use of any reliefs allowed (now or in the future) in EU directives.

**Public property:** PPP projects contain elements that exceed certain limitations currently applicable to the legal management of the Government's property, budgetary and contributory entities and territorial self-administration units (regions) – these limitations concern certain conditions applicable to the acquisition, disposal, encumbering and lease of property. It is recommended that the Ministry of Finance should be authorised to approve any required exemptions from any such statutory limitation.

**Concessions:** With the exception of brief provisions in certain legislation (e.g. the Roads Act) Czech law does not contain sufficient rules governing concessions. Such rules should cover the adoption of general provisions in respect of concession agreements, the rules governing their execution, and their enforcement by courts.

**Fee collection:** If a fee is to be collected from the direct users of any public infrastructure in connection with certain projects, the relevant legislation will have to be adopted along with a system for regulating the amount of such fee.

**Fiscal discipline:** There is, at present, no mechanism allowing for the monitoring or regulating of the creation of mandatory expenses from future budgets, arising by way of execution of long-term agreements over and above the current budget, as well as the three-year expenses plan. It is recommended to ban any acceptance of future costs over and above a certain limit without the approval of the Ministry of Finance, applicable to all tiers of the public administration, i.e., including regions. The introduction of PPP at the regional and community levels without regulation by the Ministry of Finance would be a fiscal risk.

### 1.3 Requirements for Legislative Amendments – Special laws

The preparation and implementation of PPP projects in individual sectors may also require amendments to be made to certain special primary or secondary legislation. A list of amendments required in those fields where PPP projects are very likely to expand is set out in the enclosure.

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<sup>1</sup> This is confirmed by projects implemented so far (e.g., Pražské vodovody a kanalizace, a.s.)

#### 1.4 Special PPP Legislation and Definition of PPP

PPP projects are affected by a wide variety of legal provisions that will have to be amended to facilitate PPP. A question remains of whether such amendments should be made separately in all relevant laws or whether special legislation should be introduced in respect of PPP. The legislators should enter into a debate to this effect when drafting the relevant material intent of such amendment or new legislation.

That solution also applies to the requirement for a definition of the term "Public Private Partnership". It may be necessary to define certain key features of regulated projects in connection with any proposed legal amendments and Government regulation but there is no need to introduce a general definition of the term of Public Private Partnership in Czech law.

#### 1.5 Fiscal Discipline and Future Mandatory Public Budget Expenditures

Contracts executed for PPP projects usually establish a liability of future public budgets (national, regional, and community) to make future mandatory expenditure. PPP projects will mean that the public sector will be capable of developing infrastructures that otherwise could not be funded from its current budgets, and/or debt, as applicable. The relevant public sector beneficiaries, however, may be facing a situation, as a result of liabilities created by their entry into PPP projects, where they would have to limit certain public services spending in the future, and in certain extreme cases (with self-administration bodies) risk insolvency.<sup>2</sup> Due to the above risks and also due to the below described limitations on creating public debt, it is desirable to set up controlling mechanisms in order to prevent future budgets from being "overloaded" with mandatory disbursements. The proposed mechanisms (see the above-mentioned amendments certain general legislation) would require approval by the Ministry of Finance of PPP projects, including those carried out by regions. The expansion of regional and community tier PPP projects unregulated by the Ministry of Finance would represent a major fiscal risk for the Czech Republic.

Representative bodies that manage their relevant budgets<sup>3</sup> may be seeking greater control over accepting long-term liabilities, i.e., mandatory expenditures from their future budgets. Such control may help eliminate fiscal risks but may also introduce a major obstacle to PPP. It is recommended to balance interests in fiscal control of future mandatory expenditures and interests in the development of public services and infrastructure by way of PPP, so that the relevant representative bodies would only set out absolute limits while the Ministry of Finance would keep the authority to finally approve individual projects within those limits.

#### 1.6 Fair Sharing of Public Debt Limitations

The total public debt must not exceed 60% of the Gross Domestic Product (GDP)<sup>4</sup>. With some PPP projects, their entire scope of future liabilities (i.e. the total volume of the executed investment or acquired funding) may be characterised as public debt. Moreover, public debt also incorporates debt generated by the regions. Some regions or communities that would become more active in developing their infrastructures through PPP projects could exhaust the entire authorised public debt limits, thus

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<sup>2</sup> The banks that would finance PPP projects would carry-out analyses to check that a region would not become insolvent due to a PPP project but this natural controlling function will not go beyond this point and would lack the aspect of protection of public interest.

<sup>3</sup> The House of Deputies with the state budget and regional/community councils with their respective budgets.

<sup>4</sup> So-called Maastricht Criteria contained in the EU Treaty dated 07/02/1992 (Treaty of Maastricht)

preventing the implementation of other PPP projects (or any other manner of infrastructure funding) by others.

It is desirable in view of the financial scope of potential PPP projects that the Government should regulate the manner in which its organisational bodies, as well as the regions, implement their PPP projects (or any other projects that generate public debt). Since the performance of self-administration of the regions may only be interfered with by law, such measures will have to be set out in the form of an act.

## 1.7 Insolvency of Regions and Communities

No immediate specific provisions governing the insolvency of regions and communities have been proposed in connection with PPP. In view of the on-going decentralisation and material self-regulation effect exercised by banks financing PPP projects over the economic management of the regions, if they believed that the Government would not provide assistance to insolvent regions and communities, it is recommended that a public debate be launched on the identification of a legal treatment of such insolvency of the relevant self-administration units.

## 2. PPP LEGISLATION

### 2.1 Special PPP Legislation?

The routine question that the task force has been confronted with during debates concerning PPP was whether, and if so, in what manner, PPP projects should be governed by special legislation. A simple answer is that **it does not matter whether a PPP project is or is not governed by special legislation**. Some European countries (Ireland, Portugal, Belgium) have chosen to adopt such special legislation. Some other countries, however, do not have any such special provisions (UK, France), yet they have been successfully implementing a number of PPP projects.

PPP projects and their implementation are governed by a number of pieces of legislation that govern, for example, public procurement, authorities of Government departments, authorities of the regions, etc. It is exclusively up to the legislators who would draft any new legislation whether they would opt for amendments to the individual acts or whether they would prefer a new all-embracing norm that might be described as a "PPP Act". Concession agreements will require the adoption of new legislation.

### 2.2 Definition of PPP

Another routine question related to the legal analysis was whether and how to define PPP<sup>5</sup> projects. A simple answer is that in general **there is no reason why a general definition of a "PPP project" should be introduced in Czech law**. The introduction of any potential legislation governing fiscal supervision, any special legislation governing concession-type contracts, or any concession legislation, may require certain eligibility criteria for projects to be specified or defined. Still, such criteria cannot be regarded as a global definition of PPP projects.

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<sup>5</sup> The term PPP (Public Private Partnership), or PFI (Private Finance Initiative – in the UK), PSP (Private Sector Participation) or PPI (Private Participation in Infrastructure) is a widely applied technical term describing a broad group of projects characterised by participation of both the private and the public sectors whose aim has been the satisfaction of requirements usually provided for by the public sector; at times, such terms may be applied in a somewhat unsystematic manner to any combination of the public and private sectors. e.g., regular supplies of goods or services.

It may be necessary to define projects that are subject to approval in connection with the regulation or fiscal supervision by the Ministry of Finance, such as: (1) any contracts made by public sector beneficiaries and private sector contractors, (2) under which the public sector accepts liabilities to make payments burdening any future budgets and being in excess of a determined percentage of the relevant current budget of the Beneficiary.

Although such definition would also cover regular capital investment projects that need not be of the PPP nature, a public interest in having those project regulated along with any PPP projects may be envisaged. In the absence of such interest, the definition may be limited or the Ministry of Finance may issue an *en bloc* exemption automatically licensing all projects that have been subjected to regulation by mistake.

### **3. PPP POLICY**

#### **3.1 General Public Sector PPP Exposures**

PPP projects may have benefits for the public sector but they may also create certain risks and additional burdens for the public sector. By executing PPP contracts to source public services and/or public infrastructure, the public sector will have shifted to the private sector a portion of its responsibility and also a portion of its exposure related to the development and operation of such project. However, if such PPP projects were implemented incorrectly, the public sector could be exposed to the risk of insufficient public services without any option to seek an efficient and effective remedy. Such exposure is increased particularly by the long-term nature of project contracts. On the other hand, it is this long-term feature that makes up the core of the partnership and that makes it advantageous for the public sector. Long-term provision of services makes the private sector seek similarly long-term solutions, efficient in view of the entire life of the relevant assets. The security of long-lasting projects and their long-lasting cash flows for a certain term also is important for the financing of projects by the private sector.

There are risks in the application of the PPP format to the provision of public services, but they can be well hedged by simultaneously employing the following two measures: (1) the introduction of the approval of the Ministry of Finance; and (2) the provision of good quality institutional support for the public sector so that it can act as an equal partner of the private sector in the negotiations and implementation of PPP projects.

#### **3.2 Minimum But Necessary Regulation**

The private sector investors that play an essential role in the implementation of PPP projects have been sensitive to (1) excessive regulation; and (2) legal uncertainty resulting from unclear regulation or policy. The public sector exposures described in this study may certainly be diminished by applying an "authoritative" approach and dictating to the private sector. Such an approach, however, would be counterproductive because it increases the risk or costs of the private sector, while the ability of the private sector to absorb such risk or costs is fairly limited, without shifting them to the public sector. If the Government or the Parliament were thinking of extending regulation of PPP projects over and above any measures identified in this study, it would be advisable if such measures were first consulted with members of the private sector in order to assess the impact of such measures on the terms and conditions of projects that could be acceptable by the Contractors.

Any attempts by the public sector<sup>6</sup> to regulate the PPP projects in an "authoritative manner" should be limited to the following:

- (1) Limiting the risk of inappropriate PPP contracts being executed, (see Institutional Backup)
- (2) Limiting the risk of breaches of fiscal discipline, (see Fiscal Discipline)
- (3) Limiting the drawing on public resources in the form of public debt limits, (see Fiscal Discipline)
- (4) Transparent and equal treatment/selection of partners, (see Public Procurement and Concessions).

The following table compares the most important elements of both the existing and recommended legislation.

Criterion	Level	Present state	PPP Recommendation
Authority to enter into concession agreements	State	In most cases unclear at all levels	Explicit open provisions providing for controlling authority of the MoF
	Regions		
	BudgOrg		
Authority to create future mandatory disbursements over and above approved budget deficit	State	Disputable at all levels	Explicit authorisation subject to approval of the MoF, and/or within limits set out by representative bodies.
	Regions		
	BudgOrg		
Transfers of property	State	Criteria of permanent lack of use or Govt. approval	No limitations, exemption to be set out by the Govt. and approved by the MoF
	Regions	For "arms-length price"	
	BudgOrg	Like the Govt.	Unambiguous authorisation
Acquisition of property	State	In a tender or based on expert evaluation	Remove the evaluation requirement
	Regions	No limitations	Remove the evaluation requirement
	BudgOrg	Like the Govt.	
Guarantees for financing	State	By law only	Special authorisation by law in specific cases, if necessary.
	Regions	To a limited scope	
	BudgOrg	No	
Pledge of property	State	No	With approval by the MoF
	Regions	With approval of relevant council	With approval of the MoF
	BudgOrg	No	
Involvement in private companies	State	Founding an "a.s." with approval of the Govt. No limitations to acquisition if approved by the MoF	No limitations, financial liabilities subject to approval by the MoF, exemption from statutory liability of controlling entity under the Commercial Code
	Regions	No limitations	
	BudgOrg	No limitations	

MoF - Ministry of Finance  
Regions - (Autonomous self-administration territorial units)  
BudgOrg - Budget Organisations

### 3.3 Approval Level

Simply speaking, the higher the required level of approval the higher the risk that the quality or feasibility of a project would be affected by political decisions and that a lower number of projects would be implemented. On the other hand, the lower the required approval level the higher the risk that the project would be factually or politically difficult. In view of the balance of risks and support to the application of PPP projects on the provision of public services and infrastructure it would be desirable that most of the projects – besides approval by the project originator – **should be subject to further approval only of the Czech Ministry of Finance unless the Government reserves the right of approval for certain projects.**

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<sup>6</sup> Yet another less risky way of regulation is represented by inserting provisions protecting public interest in PPP contracts. The public sector would thus be able to get the information about the "cost" for the required right immediately during negotiations about the contract.

Commonly repeated projects may be subjected by special rules issued by the Ministry of Finance facilitating their automatic approval ("*en bloc exemption*").

### 3.4 Institutional Backup

In order for a project to represent a genuine partnership the public sector must have comparable information and experience in implementing PPP projects as the private sector in negotiations and in drafting the project documentation.

Some other countries have found it useful to provide the public sector with a team of specialists for the analysis, negotiation and implementation of PPP projects (the "**PPP Centre**"). Since the operation of PPP Centres is closely interconnected with fiscal policy, they are attached to the Ministry of Finance and they work exclusively for the public sector in all countries where such PPP Centres exist.

A PPP Centre may exist in a number of forms but it should always be controlled by the Ministry of Finance. Because a PPP Centre "serves" a number of public sector members, they too should be given some influence over the PPP Centre's operations.

PPP Centres should not act as administrative bodies and should not be in either a supervisory or subordinated position to PPP Beneficiaries.

### 3.5 Fiscal Discipline

#### (a) Public debt and private funding of projects

PPP projects may sometimes be understood to represent private alternatives to the funding of projects that otherwise would have to be financed by the Government. It needs to be stressed that PPP projects in fact possess other advantages than merely private funding of public projects. From the point of view of their funding, PPP projects may not be more advantageous than public debt financing for the following reasons:

- (1) Private entities that initially fund the project (with their capital or with debt) expect a future return on their investment plus a profit margin (either from the public budget or from direct payments by the public);
- (2) Interest paid for funding of private entities is higher than the interest paid for funding of the public sector;
- (3) The transaction costs of funding PPP projects are higher than the costs for public debt;

In spite of the above-described disadvantages of private funding of PPP projects (whose impact can, after all, be limited) PPP projects have been considered an advantageous form of funding certain public services and public infrastructures for a number of other reasons. The main reason for this is that the application of PPP cuts down on the overall costs of the project over its entire life (so-called *whole life costing*). However, it is beyond the scope of this study to review any other reasons.

#### (b) Maastricht Criteria

The Czech Republic has acquired certain liabilities in order to achieve and maintain so-called Maastricht Criteria. Compliance with the Maastricht

Criteria means that the total public debt must not exceed 60% of the GDP and the annual public budget deficit must not exceed 3% of the GDP.<sup>7</sup>

Therefore, it is of crucial importance for the Czech Republic as to exactly how such PPP projects should be recorded in respect of the amount of both the public debt and the budget deficit. In some cases, public debt would not be affected by such future liabilities of the public sector while in other cases it will. The exact assessment should follow the methodology drafted by EUROSTAT. At the time of the work on this analysis, a discussion was under way concerning an alteration of the EUROSTAT methodology, specifically in connection with PPP projects. Its outcome is not yet known. However, the following criteria, *inter alia*, can be expected to be applied in deciding whether a PPP project would be reflected in public debt immediately and in full (or whether it would just burden future budgets with mandatory disbursements and would affect their deficit):

- (1) The type of services provided and the exposure rate of the individual parties;
- (2) The manner of determination of payments for the private entity and the ratio of "non-public" cash flow either from direct consumers of the service (e.g. toll or fare) or from any associated activities (e.g. lease of petrol stations);
- (3) The ownership of any relevant assets throughout the contracted term by the service provider, and the manner of the subsequent transfer of such assets;
- (4) The existence of a guarantee from the public sector for the financing of the private sector.

The above-described parameters may influence the feasibility of a number of PPP projects, and a concession over a single parameter (e.g. higher exposure rate for the private sector) may result in higher costs or concessions for other parameters. The question of whether the funding of a specific project reflects in the public debt or not should be one of the considerations in the determination of the structure of specific projects, and in the relevant approval process, although this consideration need not be a decisive one.

(c) Regions' Autonomy *versus* Fiscal Discipline

According to the Maastricht Criteria, public debt consists of both the Government (State) debt and debt generated by the regions. PPP projects implemented by a single community or a region therefore affect, indirectly but materially, the rest of the public sector, specifically by limiting its option to "draw on" public debt. At the same time, the regions have been constitutionally guaranteed self-administration and management of their own budgets.<sup>8</sup>

Since PPP projects, due to their major financial scope, may as a result substantially boost public debt, it is reasonable that the Government should be able to manage, and/or prevent, any such PPP projects that would have an unacceptable impact on public debt or deficit.

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<sup>7</sup> Clause 1, Protocol on the Excessive Deficit Procedure of the Treaty of Maastricht

<sup>8</sup> Clause 100(1) and Clause 101(3) of the Constitution of the Czech Republic

Side by side with increases in public supervision of public debt, certain controls should be imposed on the manner of "drawing on" the public debt by the individual sections of the public sector. It is obviously not in the public interest that certain future projects might be impaired by the previous implementation of other projects, often by other regions or communities.

As shown above, although the regions have been guaranteed their self-administration, the Constitution does, however, allow for Government interventions, though exclusively subject to enacted law.<sup>9</sup> Therefore, the provisions recommended here would need to be enacted as a law.

(d) Regulatory Measures

It is advisable in view of fiscal stability that contracts under which any entities making up the public sector (including regions and communities) would acquire liabilities in excess of statutory amounts, should be subject to approval by the Czech Ministry of Finance. Although this step may seem politically controversial in respect of the regions and communities, it is essential for the protection of the fiscal interests of the Czech Republic, and the regions and communities, from financially irresponsible acts by other regions and communities. Expansion of PPP at the regional and community levels which was unregulated in respect of the public debt and deficit would be a fiscal hazard for the Czech Republic.

### 3.6 Mandatory Expenditures from Future Budgets

Besides approval by the Ministry of Finance, administrators of the relevant budgets (the House of Deputies with the state budget and regional/community councils with their respective budgets) may also seek control over their future expenditures. Their interest in such control is understandable and can be expected. Control of expenditures by the lawmakers (and/or local representatives) represent one of their key authorities as well as duties. Control over accepting liabilities in respect of future payments can be exercised in several ways. The most transparent manner of control is represented by approvals by the House of Deputies or regional/local councils being separately required for each project. This manner, however, is the least suitable, too. The specific projects usually are very extensive and complex and they may be hard to grasp in detail within a short space of time. So hard that it cannot be realistically expected from members of the representative bodies to be able to understand them sufficiently in order to make a qualified and well-informed decision when assessing such individual projects. The time-exacting nature of assessing such individual projects – especially in the House of Deputies – would be a factor limiting the expansion of PPP.

A more practical manner of control by representatives over future mandatory expenditures would be by way of setting out certain general aggregate indicators<sup>10</sup> and all projects over and above them would have to be approved separately by such representative bodies. By setting out such indicators, the representative bodies maintain their certainty to control any payments from their future budgets (by having such payments strictly limited) while leaving the executive body flexibility to implement its PPP projects.

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<sup>9</sup> Clause 101(4) of the Constitution of the Czech Republic

<sup>10</sup> E.g., the total aggregate net value of all future liabilities of a specific budget (or its head) in respect of the amount of the regular budget when a project was approved.

### **3.7 Insolvency of Regions and Communities**

An important role concerning the healthy fiscal impact of PPP to the economy of regions and communities is taken by the financing banks. This is because the banks will be assessing the exposures of each and every transaction and would decline to finance projects where the Beneficiary might become insolvent in the future. Such natural "supervision" of the banks would be more complex the clearer the policy adopted by the country in question in respect of assistance – and/or its absence – extended by the Government to the regions and communities if they become insolvent. The best way to formulate such a policy would be to adopt special legislation governing the insolvency of regions and communities. We talk about "special" legislation because regions and communities are not – and cannot be – governed by the general legislation applicable to bankruptcy proceedings in respect of private businesses. With insolvent regions and communities, there is no simple solution of selling their assets and winding-up such insolvent region or community. Insolvency of territorial self-administration units therefore creates a very complex legal and political issue that has not been properly resolved in the majority of other European countries. It is not necessary to introduce provisions governing insolvency of regions and communities in connection with PPP because fiscal discipline would be sufficiently protected by other means, namely the requirement of an approval by the Ministry of Finance. In view of the above-described self-regulatory effect, ongoing de-centralisation and other factors, it is recommended that a public and expert debate be launched on the identification of a legal treatment of insolvency of self-administration units.

### **3.8 Privatisation and PPP**

PPP has also been mentioned in connection with privatisation. This link is not incorrect because a number of privatisation projects concern enterprises providing public services or operating public infrastructure. It seems to be beneficial to apply PPP when privatising such enterprises.

## **4. AUTHORITY**

### **4.1 Authority of PPP Project Originators**

With projects of such financial scope and social import as PPP projects, all parties involved are concerned about the issue of the contractual authority of the relevant public law entities.

Since this authority, with a few exceptions, has not been properly defined yet, the parties involved must base the relevant reasoning solely on certain generally binding principles governing the authority of administrative bodies.

It is recommended, in the interest of maintaining legal certainty, that the authority of individual components of the public sector to enter into concession contracts and delegate sufficient powers required to implement PPP projects be explicitly defined – either in special PPP legislation or in the individual rules governing their competencies (the community and regional systems and the act governing the establishment of Government Ministries).

### **4.2 Contractual Rights**

Project contracts always contain liabilities for the private partner that facilitate the quality control of such public services by the public partner. Those liabilities, if part

of a regular master-servant (administrative body–private subject) relationship, would have to be enacted as a law because they limit the subjective rights of private partners. However, in case of contractual relationships, private partners are free to negotiate their own contractual liabilities. Any accepted liabilities and any associated rights of the public partners thus derive from a contract rather than from law. The exercise of any related rights by the private partners does not represent the exercise of the authority of a relevant (administrative) body, but rather the exercise of certain contractual rights. Therefore, no specific amendment to the legislation is required.

### **4.3 Authority Limited by Budget**

The authority of public sector subjects to accept liabilities over and above their approved budgets represents a very complex administrative law issue.

It is one of the fundamental democratic constitutional rules that it is a representative body (the Parliament<sup>11</sup>) that sets out taxes and charges. Logically, the Parliament should also determine payments made by the public sector. It may be claimed that the logic and the purpose of those rules mean that the public sector is not in a position to accept liabilities over and above any approved budgets, thus that any contracts entered into by the public sector that bind it over and above any approved budgets are invalid because they are contrary to the law. It is not the purpose of this study to assess the probability of success of such a claim before a court. Uncertainty regarding the binding nature of any relevant contracts may result in a certain unwillingness of the private sector, especially banks, to provide funding. Also, if they do agree to provide funding, this uncertainty may have an impact on the price of such funding. It is therefore advisable to remove such uncertainty by adopting certain clear-cut legislation that would govern acceptance of liabilities over and above any current budgets as well as liabilities that will make mandatory disbursements in future budgets (see chapter "Mandatory Expenditures from Future Budgets" above).

## **5. CONCESSION CONTRACTS**

### **5.1 Practical, Historic and International Contexts**

PPP represents a partnership with strict internal rules with a concession contract setting out such rules placed at the very core of each PPP project. Therefore it is absolutely essential to have a clear legal framework of concession contracts facilitating the advancement of application of the PPP method.

Concessions as a legal tool were used as early as by the princes of the Přemyslid House (before 1300). Originally, they governed the distribution of special and exclusive rights, for example the right to brew. Later on – in the Austro-Hungarian Empire – concessions were also issued, for example to railway developers.

Currently, for many reasons, concessions have not been widely used in the Czech Republic in the development of public infrastructure, and the public sector has so far been more inclined to build such infrastructures on its own, with the help of budgetary funding. However, in Europe and elsewhere, public infrastructure has been, to a growing extent, significantly developed with the help of PPP concessions.

The current legislation may have accepted, to a limited extent, the concept of concessions as contracts made between the public and the private sectors.<sup>12</sup> However,

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<sup>11</sup> The state budget of the Czech Republic is solely adopted by the House of Deputies

<sup>12</sup> E.g., the Roads Act

it may be some time before there is any substantial expansion of such contracts, and the legal framework of concession contracts itself is either unclear or limits the expansion of PPP.

## 5.2 Contract or Authoritarian Act?

A concession can be viewed from two angles: a unilateral, authoritarian act or a bilateral contract reflecting the will of its parties. The authoritarian option has certain limitations, the primary one being that a public administrative body is incapable of binding a concession holder to do anything that such public administration body has a statutory power to do. This type of concession does not seem to be suitable for PPP projects – as against some other fields where it is applied in the sense of granting concessions to perform certain activities. It is recommended to apply contracted concessions in the implementation of PPP projects.

## 5.3 Closed and Open Concession Policy

In respect of concession contracts, the legislators may take a dual approach: (1) an open one where the public sector is free to enter into any concession contracts with the exception of those in areas that are subject to restrictions; or (2) a closed one where the public sector may enter into concession contracts only in specific and explicitly approved cases.

A closed approach<sup>13</sup> limits the risk of the entry into concession contracts that may have an unpredictable impact on the public interest. At the same time, though, it means a material limitation on the expansion of PPP projects because it would be time consuming to require statutory authority to execute a concession contract, and once obtained, it may not cover all of the options that may appear in practice. The open approach helps advance PPP projects, at the cost of a higher risk of uncontrolled impact on the public interest. In view of the Government's stated interest in the advancement of PPP projects and in the interest of the achievement of the targets of the public budget reform, it is recommended that the open approach to concession contracts should be opted for. Any risks for the public sector would be limited by the work of the PPP Centre as well as the suggested requirement for approval by the Ministry of Finance to implement any specific PPP projects. If the Government wishes to apply stricter controls to the execution of concession contracts, it may, for example, reserve the right to determine certain "closed areas" where such open approach would be excluded and that should remain subject to governmental or parliamentary approvals.

## 5.4 Legal Relations between Concession Holders and Consumers

A private partner authorised to operate certain parts of public infrastructure would come into direct touch with consumers using such infrastructure. There is a special issue that needs to be resolved in connection with the introduction of concession contracts, namely the legal relationship between the concession holders and consumers. In some cases, such as operation of roads, it may be that only the issue of liability for, e.g. bad maintenance of the road needs to be resolved. However, such a relationship would be more complex if a fee is collected. A special category should be made up for these types of cases where a very close relationship exists between the concession holder and consumers, for example, in concessions to operate municipal transport.

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<sup>13</sup> This approach has been applied to public law contracts in the Government Bill of the new administrative code

Success in certain PPP projects, however, may require special statutory provisions that would govern relations between the concession holder and the general public.

### 5.5 Private Law Nature of Contracts

If concessions are to be issued in the form of agreed concession contracts it is not necessary specifically to create any new legislation to govern the related contractual issues, because private law already has well-tested legislation in place. In some areas, concession contracts may have to comply with special rules (e.g. the contracts must be in writing and made as a single deed) that serve the protection of public interest, but in principle the contractual freedom of parties must be observed. It is therefore recommended that private law contractual rules should be interfered with as little as possible, and any changes should always be made with a proper assessment of their resulting impact.

### 5.6 Protection of Public Interest

PPP project contracts are made for very long terms. The legislators may therefore wish to protect the public interest, for example, by giving the public sector special rescission rights.<sup>14</sup> Most contracts would include such right along with the rights applicable to the compensation of Contractors and settlement of claims by the financing banks. Still, if such right is specified directly in legislation, that might eliminate a debate on the conditions of withdrawal and compensation and may prevent the implementation of PPP projects. If there is any risk of rescission without compensation, no respectable contractor or financing institution would opt for PPP projects.

It is recommended that, in respect of concession contracts for PPP projects, statutory rights of rescission in the public interest, and any similar rights of the public sector, should be excluded and the public sector should instead rely on the terms of the individual contracts to protect the public interest, in keeping with the specific conditions of individual projects. Such contracts would be entered into in the form of certain standard contracts drafted by the PPP Centre so it should be expected that the public interest will be properly protected in them.

### 5.7 Judicial Review

A predictable and objective system serving the enforcement of rights under concession contracts and the resolution of potential disputes concerning the content of contractual liabilities represents an essential condition of the feasibility of PPP projects for the private sector – as well as of protection of the public sector.

The private sector would find it more desirable for concession contracts to be reviewed by the courts, rather than by any other administrative body. If the enforcement of any claims and resolution of disputes were to be the responsibility of bodies belonging to the executive power, that would violate the balance of the fundamental PPP principle, namely partnership. It may be recommended that concession contracts should be subject to the regular jurisdiction of general courts of justice with the option of appeal as with regular private contracts. At the same time there is no reason to eliminate the use of arbitration clauses by the private sector that would govern the role of arbitration tribunals or experts, although each individual case would require a separate assessment as to the impact of such alternative manner of resolution of disputes.

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<sup>14</sup> See, e.g., the provisions contained in the Government Bill of the administrative code, s.142 et seq.

## 5.8 Draft Administrative Code

At the time of drafting this study, a draft of the new Administrative Code<sup>15</sup> was in its second reading in the House of Deputies of the Czech Parliament. The draft contained, *inter alia*, certain general provisions governing public law contracts made between the public sector and the private sector. The draft envisages the following:

- The introduction of a closed system of public law contracts to be made in certain specific cases instead of making administrative decisions.
- Contracts made between the public and the private sectors should be subject to review by a superior administrative body.
- The introduction of certain provisions governing the rescission of contracts that may prove harmful to PPP projects.

The provisions governing public law contracts in the Administrative Code draft aim at governing legal relations other than those emerging in connection with PPP projects, and seem to be totally improper for PPP projects. It is therefore recommended that in addition to public law contracts governed by the Administrative Code, a specific category of "concession contracts" be created and subjected to different rules.

## 6. PUBLIC PROCUREMENT

### 6.1 Just Treatment and Need for Flexibility

Basically, every PPP project<sup>16</sup> contains an obligation of the public sector to pay the private sector for the provision of certain public services. Therefore the relevant contracts will be for "Public Procurement" and should be categorised accordingly.

This chapter sums up an analysis of the Public Procurement Act<sup>17</sup> in respect of PPP projects and certain European rules applicable to public procurement and distribution of concessions.

PPP projects must be placed in a transparent and just manner but it is essential for their success that the public sector has as much flexibility as possible in the execution of contracts that the public procurement rules often lack to provide. Therefore it is important that the Czech Republic should at least allow maximum flexibility in the placement of orders in connection with PPP projects that conform with the relevant European directives.

### 6.2 EU Rules

The system of categorising public procurement in the EU Member States focuses on the type of services provided, and the orders that meet such criteria are then subject to the relevant order placement under the EU Directives:

- (a) Construction<sup>18</sup>

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<sup>15</sup> Parliamentary Paper no. 201/0 submitted to the Parliament by the Government on 04/02/2003

<sup>16</sup> Projects fully paid for from collected fee may constitute an exception; however, such projects, too, usually contain to a certain extent title to payments from the public sector.

<sup>17</sup> At the time of drafting this study, the Parliament reviewed a new Government Bill governing public procurement. This study therefore reviews any currently available wording of the above bill as if it were in force.

<sup>18</sup> 93/37/EEC dated 14 June 1993

Orders in excess of EUR 5 million are subject to the European regime. However, orders considered "**concession contracts**" are subjected to a less strict regime that only incorporates the duty of making a notification in the Official Journal of the European Communities.<sup>19</sup>

(b) Services<sup>20</sup> and Supplies<sup>21</sup>

Orders of supplies of services and goods in excess of EUR 200 000 are subject to the European regime.

(c) Water, energy, transport, telecommunications<sup>22</sup>

Orders for supplies to the public sector or for holders of exclusive rights in the above-described sectors are subject to the European regime if in excess of EUR 200 000.

Projects involving waste water cleansing plants and roads fall within the "construction" category.

A construction contract will be considered a concession contract if the relevant costs are "covered" in full or in part by the provision of rights to exploit it. No binding ratio has been established between the amount of revenue from such exploitation and the amount of any direct payments from the public sector but the ratio of revenue from "exploitation" must be more than negligible. Each project would have to be assessed on a case by case basis and all criteria would be taken into account.

Even if a construction is classified as a "concession contract" the Government, as well as the so-called "joint rules of notification", cannot be released from its duty to respect certain common rules<sup>23</sup> on equal treatment, non-discrimination, proportionality, transparency and mutual respect.

### 6.3 Future EU Rules

At the moment, the European Union is witnessing a process of changes to the system of directives governing public procurement that, in several months' time, should result in the adoption of new directives. The new directives will, in the majority of cases, only simplify the existing directives in a formal manner; however, they are expected to introduce certain alterations that are of importance for PPP projects.

The most important of them comprises the relaxation of the rules relating to the manner in which very complex tenders are made. This will allow for multi-stage tenders under which the beneficiaries will be able to discuss the conditions of the relevant public tender with the bidders prior to making their decision.

Furthermore, the future rules will retain the existing exemption applicable to "construction concessions".

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<sup>19</sup> The Official Journal of the European Communities (OJEC)

<sup>20</sup> 92/50/EEC dated 18 June 1992

<sup>21</sup> 93/36/EEC dated 14 June 1993

<sup>22</sup> 92/13/EEC dated 25 February 1992

<sup>23</sup> Treaty establishing the European Community dated 25/03/1957 (Treaty of Rome)

## 6.4 Public Procurement Act

At the time of drafting this study, a draft of the new Public Procurement Act was in its second reading in the House of Deputies of the Czech Parliament. Since it is expected that the proposed legislation will be in force at the time of implementation of the first PPP projects, this analysis is already based on the proposed draft bill rather than the existing act.

To promote the feasibility of PPP projects, it would be desirable to apply the existing directives, as well as the current practical approach on the part of the European Commission, and to amend the Public Procurement Act:

- by freeing the process of tender offerings so that the beneficiaries could enter into detailed talks concerning certain less material, but still important, aspects of concession contracts prior to the making of bids (in several rounds);
- by introducing an exemption applicable to "construction concessions".

In certain special cases the public sector may find it suitable to offer the private sector partial reimbursement of costs of bidding. It is recommended that this option be introduced into the new act as well.

Since the public sector also incurs considerable costs in the tender process of PPP projects, it would be advantageous to give it certain mechanisms guaranteeing a "serious" approach by bidders. The deposit bond currently being proposed seems to be sufficient.

## 7. PAYMENTS BY USERS OF SERVICES (CUSTOMERS)

### 7.1 Taxes and Public Charges Payable by Law

It has been the sole authority of the Parliament to impose taxes and public charges.<sup>24</sup> A fee collected in connection with public services (e.g. a toll) provided as a result of PPP projects could be viewed as a type of public charge. Therefore the collection of such a fee must be either governed by a law or such payment must, beyond any doubt, represent a fee for services rather than a public charge, so that it would not require statutory backing.

### 7.2 Boundary Line between "Public Charge" and "Fee for Services"

It is claimed that as well as taxes and public charges that may be collected solely by law there is a further category of payments for services by their users that can be collected in the absence of any special statutory provisions. In order for this payment not to be considered a public charge pursuant to clause 11(5) of the Charter of Basic Rights and Liberties, it would be necessary to show that users are not automatically entitled to such public services. This may be fairly difficult for a number of such services.

The requirement for the introduction of legislation governing the collection of charges within the framework of PPP projects is obviously very limiting and the implementation of the first such PPP project in any relevant sector will be conditional on the enactment of such legislation.

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<sup>24</sup> Clause 11(5) of the Charter of Basic Rights and Liberties (no. 2/1993 Collection of Laws)

Since it is not possible to define a clear boundary line between a "public charge" and a "fee for services" it is recommended that for projects requiring payments to be made by their users, the relevant governing legislation be enacted unless there is no doubt that the fee will not be classified as a public charge.

### **7.3 Amount of Charges**

From the public sector angle, it would be unacceptable for any such charges to be determined without public control. The private partners, as well as their funding institutions, will however require a level of certainty in respect of the amount of charges. Therefore the amount of the charges, or at least the exact manner of their determination, must be set out in the relevant PPP contracts. If the public sector reserves the right to interfere with the amount of the charges, it would have to bear in mind that the private partners would probably require compensation, payable from the budget of the public partner, in the event of any reduction in the charges.

## **8. MANAGEMENT OF PUBLIC SECTOR ASSETS**

### **8.1 Public or Private Ownership**

One of the fundamental issues that needs to be resolved in connection with PPP projects concerns the ownership of the relevant infrastructure. The ownership of the infrastructure could remain with the public sector, while the infrastructure is managed by the private sector. Alternatively the infrastructure could be privately owned, with ownership returning to the public sector upon the expiry of the contract(s). Both models have advantages and disadvantages and it is hard to make a general statement that PPP projects should prefer one over the other. The partners to any single PPP project should be able to opt for whichever presents the best solution of ownership. Therefore, the legislation should allow both: either maintained public sector ownership of the relevant infrastructure while establishing a long-term right of use for the benefit of the private partner, or the transfer of ownership title to the private partner with a reassignment option upon the expiry of the contract(s).

### **8.2 Government Property**

The acquisition, disposal, or any other management of Government property is governed by strict statutory rules.<sup>25</sup> PPP projects mostly contain an element of acquisition, lease, or disposal of property by the beneficiary (the Government in many instances) or a combination of these. At the same time, ownership of infrastructures by private entities may be of importance (e.g. in assessing whether their development costs should form part of the public debt, or if the relevant contract is a concession contract or just a construction contract).<sup>26</sup> The act governing the management of the property of the Czech Republic and its involvement in legal relations may therefore have a limiting effect upon the implementation of PPP projects, specifically by the following provisions:

(a) **Statutory Evaluation**

Under s.12(4) of the State Property Act the price payable for the acquisition of property for consideration must not exceed the valuation of that property pursuant to special legislation. Although the State must be protected in some

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<sup>25</sup> Act no. 219/2000 Collection of Laws governing the management of the property of the Czech Republic and its involvement in legal relations (the "State Property Act").

<sup>26</sup> This difference is of importance in respect of the scope of the European rules governing the placement of public procurement that should also govern PPP.

way, this provision seems to be counter-productive and fails to provide adequate cover.

Although this provision may not be applied in the majority of cases, because the relevant contracts will be executed pursuant to the Public Procurement Act, there may be circumstances where the Government only deals with a single bidder, in which case section 12(4) may apply.

The uncertainty of this provision could be removed and Government protection maintained (or even improved) if the relevant provision instead required that the price agreed must be the market value under all relevant circumstances. At the same time the Government would retain its right to reimbursement of any difference between the price paid and the market value.

(b) Duty to Enforce Liabilities and Late Interest/Charges

This is covered by S.14(5) of the State Property Act. If any delay should occur in relation to a PPP project, either in respect of delivery or payment by the private partner, the public sector partner should have an option as to how it responds. In some cases it may be in the public interest to postpone enforcement of late payment charges. As a result, Government agencies should have an option to refrain temporarily from enforcing their statutory rights. In order to protect the public interest properly, any such postponement/refraining should be subject to approval by the Ministry of Finance.

(c) Limited Conditions for Transfers of Government property

Under S.21(1) of the State Property Act, property may be disposed of by the Government only if it has **permanently ceased to be used**. Any exemptions are subject to Government approval. Here, it may prove practical to delegate, by law, the making of such exemptions to the Ministry of Finance.

Under S.22(1) of the State Property Act, property may be sold for a usual market price and not for less. It may be transferred without consideration only if it is in the public interest to do so. Although PPP projects may automatically comply with the public interest condition, the Ministry of Finance should be authorised to allow further exemptions to this section.

(d) No Lease-purchase

Under S.24(1) of the State Property Act, property cannot be lease-purchased. This provision may be essential for fiscal discipline, but at the same time it smothers PPP projects that may be formally considered to constitute lease-purchase. The Ministry of Finance should be able to allow exemptions to this section.

(e) No Encumbrance

Under S.25 and s.26(1) of the State Property Act, government property cannot be pledged. Easements may only be established for consideration and subject to approval by the Ministry of Finance, which can only be granted if there are "material reasons". Some PPP projects may contain pledges and easements of Government property. As a result, the Ministry of Finance should be allowed to grant appropriate exemptions. Making an exemption

conditional on the existence of "material reasons" may be tricky though, because it is a very subjective test not embedded either in the legislation or in legal practice. That is why it would be advisable to remove this condition.

(f) Limited Lease

S.27 of the State Property Act sets out limits on leases of Government property in respect of the reason for the lease (property must temporarily have ceased to be used), term (5 years), and rent (market rent). These conditions may not be applicable in connection with certain PPP projects. The Ministry of Finance can grant an exemption, but such exemption is conditional on the existence of "material reasons" for granting the exemption. It has already been mentioned how tricky such a subjective test may be. It is advisable that the condition be removed.

(g) Right to Cancel Exemptions

Exemptions duly granted may be cancelled under s.44(5) of the State Property Act. A decision to cancel an exemption would not even be open to appeal or judicial review. Project sponsors and financiers would probably request higher regulatory comfort, i.e. at least the right to judicial review.

The above-described statutory limitations to the expansion of PPP are understandably relevant for the regular handling of Government property. Therefore it is not suggested that they should be cancelled, rather that an exemption should be sought for PPP.

At present, the right to an exemption is limited, in that it is currently granted "on a case by case basis".<sup>27</sup> In order to make the administrative procedure easier for the Ministry of Finance, the Ministry of Finance or the Government could be authorised to issue a decree or an order setting out a global approval applicable to certain types of transactions involving Government property (sometimes also referred to as "*en-bloc* exemption").

### 8.3 Property of Government-owned enterprises

In some cases, Government-owned enterprises may also participate in PPP projects. It is recommended that similar amendments to those proposed to govern handling of state property be also incorporated in the State Enterprise Act.

### 8.4 Property of Regions and Communities

There are no significant limitations imposed on the regions and communities (the autonomous self-administration territorial units) in the management of their property with the exception of the condition of a "usual market price" applicable to transfers of property and the requirement to "explain" any deviations from such price; still, they do not represent a material obstacle to feasibility of PPP projects.

### 8.5 Public Sector Involvement in Private Entities

Certain PPP structures may require the founding of joint ventures (usually in the form of a SPV) co-owned by public and private sector entities. The legislation should not

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<sup>27</sup> S.44(1) of the State Property Act.

limit this option. It is recommended to relax the regime governing the founding and acquisition of participations in commercial corporations at the Government level.

## 8.6 Risk of Concessionaire's Insolvency

In the event of transfers of title to certain public infrastructures to concessionaires, the Government should be able to hedge against the risk of their insolvency. If a concessionaire goes bankrupt, its property and rights would pass to the bankruptcy estate, in order to satisfy its creditors' claims. That would be unacceptable for most public infrastructure. The public sector may consider various ways of how to protect public infrastructure, but always subject to the (1) protection of acting in good faith on the part of other creditors; and (2) protection of the interest of financing banks. No legal measures have been proposed in this regard. The public interest would be protected by way of a first refusal right in rem in respect of the infrastructure in question belonging to the Beneficiary and/or some protective clauses contained in so-called direct support agreements entered into by the Beneficiary and financing banks.

## 9. PROJECT FINANCING

### 9.1 Principles of Project Financing

It is typical of PPP projects that any initial costs of the underlying infrastructure are covered and funded by a private sector. The public sector would then pay to the private partner a regular fee pursuant to the concession contract.

The private partners usually apply their own funds only to a minor portion of the projects. Most of the funding would be provided by financiers – commercial banks and international financial institutions.

The ability of projects to attract funding (so-called "Bankability") – is one of the key issues to be resolved by both the public and the private sectors in connection with the feasibility of their PPP projects. The essential parameter tested by the banks relates to secure future cash-flow. **Non-bankable projects are not PPP-feasible.**

### 9.2 EU Funds

Some PPP projects may in future be co-funded from the structural funds and from the cohesion fund of the EU. We wish to point out in this regard (1) the requirement that the relevant projects be placed in keeping with the EU public procurement rules; (2) the co-funding requirement; and (3) the requirement that drawing funds must be for "public" projects – with the associated issue of ownership title to such co-funded infrastructure. The initial stages of any PPP project should include the assessment of whether there is a co-financing potential from EU funds in accordance with the EU rules.

### 9.3 Secure Cash Flow and direct support agreements

A "bankable" PPP project must offer sufficient certainty in respect of factors that influence its future cash flow. It is anticipated that the PPP Centre would assist the public sector in removing any potential uncertainty. Since such future cash-flow often does not depend on the specific PPP Beneficiary but rather on another entity, Contractors and financiers may require in addition to a concession contract the execution of a so-called direct support agreement with that entity that would govern future cash-flow (often the Government, the regulator, or the founder of a contributory entity). Such agreements – similarly to concession contracts – are not

governed by the existing legislation so it is recommended that they should be governed by the same regime as concession contracts, i.e., by the regular private law norms, that they can be freely executed and that they are subject to a two-tier judicial review authority.

#### **9.4 Security**

Project bankability will require that any receivables and assets obtained within the framework of the project are pledged to the financiers. The existing legislation excludes any such concept, banning as it does the pledging of any property of the Czech Republic and the offsetting of its receivables.

#### **9.5 "Step-in" Statutory Provisions**

In some cases (e.g., military or penitentiary projects) the public sector may statutorily reserve special rights to interfere in such projects. The wider the scope of such rights the higher the risk of reduced "bankability" of projects in that field. Any special "step-in" provisions should be limited as much as possible to specific concession contracts and any such statutory provisions should be duly consulted with the private sector and financiers.

#### **9.6 Government Guarantee**

It may be useful in some cases to provide Government guarantees covering liabilities of regions, communities, and/or other subjects not statutorily eligible to receive Government guarantees.

As against the above-described direct support agreements that are routine with PPP projects, Government guarantees only appear exceptionally. Therefore there is no need to propose any general exemptions for PPP from the existing rule under which Government guarantees need to be provided by law.

### **10. HUMAN RESOURCES, ETC.**

#### **10.1 Membership of Bodies of Private Entities**

Participation of members of public bodies in private entities may involve certain risks both for the Government and for the relevant individuals. Specifically, there is a so-called risk of "liability as a shadow director". Under sections 66 and 66a of the Commercial Code, persons influencing the performance of a company in a material way are liable to the same extent as if they were members of its bodies. Since it is fairly certain that the public sector would influence, in the public interest, entities involved in certain PPP projects (although such influence will be of a nature different from that envisaged in the relevant provisions), PPP projects may have an exemption from that rule. It needs to be added in general that both membership of representatives of the public sector in corporate bodies of project members and influence exerted by the Government in respect of those companies should only occur exceptionally.

#### **10.2 Transfers of Staff between Public and Private Sectors**

Certain PPP projects may require transfers of employees that previously were employed in the public services in question by the public sector. Such transfers may give rise to difficulties if those employees enjoyed special privileges that a private partner cannot easily offer (e.g. under the Public Service Act) because employees

have a statutory right to maintain their privileges<sup>28</sup>. Since it is not probable that public servants would be transferred under PPP projects, it is not currently necessary to take any precautions. However, in the future, substantial expansion of the PPP model to the provision of public services and public infrastructure may also involve the transfer of certain (privileged) tiers of the Government. The success of PPP projects could then require a discussion about transfers of public servants who enjoy, e.g., certain privileges under the Public Service Act.

## 11. STATE ASSISTANCE

The Czech Republic has been bound by the European rules<sup>29</sup> that prohibit public assistance – with few exceptions.

Although the development of public services and infrastructures through PPP does not involve public assistance at first glance (at least, public assistance is not its purpose), it may arise as a side effect of certain structures applied in those projects. In order to prevent any negative effects either for the project or for the Government if such project is later on classified to fall within illegal public assistance, every project must be thoroughly reviewed in view of this aspect.

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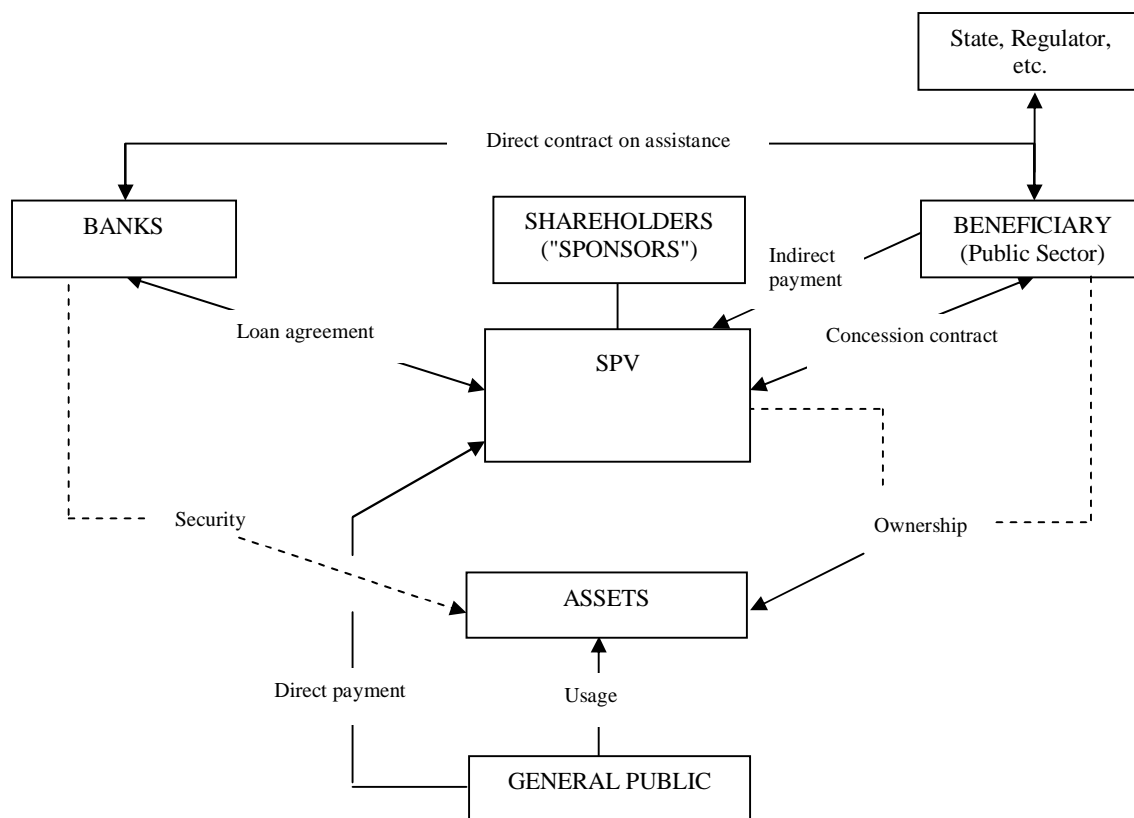
<sup>28</sup> S.249(2) of the Labour Code no. 65/1965 Coll., and 77/187/EEC.

<sup>29</sup> Clause 64 of the Association Agreement between the Czech Republic and the European Communities, dated 4 October 1993, Luxembourg (the European Treaty) and Clause 87 (ex. clause 92) of the Treaty of Rome.

## 12. PROJECT IMPLEMENTATION

### 12.1 Structures Employed

The structure depicted in the following chart is typical of PPP projects:



Still, PPP projects would always be implemented depending on their specific circumstances so it is hard to claim that they should follow a certain pattern. Project patterns may differ, especially in the following parameters:

Parameter	Options
Service provider format	<ul style="list-style-type: none"> <li>• SPV</li> <li>• Contractor in their own name</li> </ul>
Ownership of infrastructure during life of contract	<ul style="list-style-type: none"> <li>• Maintained by Public Sector , Contractor solely operates in order to fulfil contract</li> <li>• Acquired by Contractor that holds it for the term of contract</li> </ul>
Ownership of infrastructure after end of contract	<ul style="list-style-type: none"> <li>• Transferred to the Public Sector</li> <li>• Retained by Contractor</li> </ul>
Payments by public sector made in respect of:	<ul style="list-style-type: none"> <li>• Availability</li> <li>• Utilisation rate</li> <li>• Quality</li> </ul>
Term of contract	<ul style="list-style-type: none"> <li>• Long-term, subject to project</li> </ul>

## 12.2 Breaches of Contract; Consequences

PPP projects are governed by contracts subject to the normal rules applicable to agreements between private parties. Still, contracts entered into by the public sector in order to arrange for the provision of certain services have some specific features. Therefore, they contain special provisions governing claims for breaches of contract.

The usual private law claims for breaches of contract would include the following:

**The right to require actual reinstatement** – this right is important, but if a private partner chooses to breach its primary obligation it may be unwilling to comply with the obligation to reinstate;

**The right to claim damages/default interest/contractual penalty** – this right may represent a negative incentive to a private partner, but it still need not guarantee the public sector exactly what it wants, i.e., due discharge of public services;

**The right to rescind the contract** – this represents an extreme option; its application would always bring about the high additional costs of switching private partners, blackouts in provision of public services, etc. Still, this threat represents a strong incentive for Contractors to discharge their contractual liabilities, multiplied by the involvement of financiers.

Because each of the consequences of breaches of contract remains questionable, the public sector must seek special supervision and control rights under the contracts that would help prevent such breaches of contract and their consequences. It is recommended that the PPP Centre should draft standard contracts that would contain the relevant provisions.

## 12.3 Accounting; Taxes

Book keeping (accounting) and payment of the appropriate taxes for PPP projects make up a separate chapter. PPP projects have certain specifics that could not have been taken into account in the drafting of the current tax and accounting standards. They mainly concern the system of write-offs and creation of provisions for maintenance and renovation of infrastructures, payment of real property transfer taxes and VAT. It is recommended to have the relevant legislation amended accordingly.

Besides certain alterations to be made in the accounting and tax systems, discussion may be launched – in view of the complexity of any associated tax issues and limited transactions – about amending the tax and accounting systems applicable to PPP subjects by way of an agreement to be entered into in specific cases by, e.g., the Ministry of Finance or the Government.

## 12.4 Application of Commercial Code

Under Czech law, contracts are made under two codes: the Civil Code and the Commercial Code. By law<sup>30</sup>, all contracts made by the public sector in connection with the satisfaction of public requirements are governed by the Commercial Code. It is recommended that contracts continue to be governed by the regime governing private law commercial contracts with any differences to be governed by a Concession Contracts Act.

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<sup>30</sup> S.261(2) of the Commercial Code

**13. PRELIMINARY ANALYSIS OF SECTOR STANDARDS**

Besides the above-described generally binding legislation, applicable to all sectors where PPP projects may eventually be introduced, the feasibility of PPP projects also needs to be checked against special legislation applicable to the individual sectors.

The enclosure lists some fundamental parameters of such "sector" legislation applicable to those fields where PPP projects would most probably be implemented.

Sector	Typical PPP project	Originator	Special Feasibility Obstacles	Sources of Cash Flow	Recommendations
Road transport	The private partner builds or repairs a road and operates it for a specified term. In exchange, a genuine or shadow toll is collected	<ul style="list-style-type: none"> <li>• Motorways and Class I roads.– Ministry of Transport</li> <li>• Class II and Class III roads – Regions</li> <li>• Local roads – Communities</li> </ul>	The existing Roads Act only governs concessions in respect of motorways and is rather restrictive.	<ul style="list-style-type: none"> <li>• State Fund of Transport Infrastructure</li> <li>• Toll</li> </ul>	Adjust and extend concessions to apply to all roads. Identify sources of funding.
Railway transport	The private partner builds or repairs a portion of a railroad and operates it for a term. In exchange, railway operators pay a fee. The private partner establishes and operates a service along an existing route.	<ul style="list-style-type: none"> <li>• Railways Administration</li> <li>• Ministry of Transport</li> </ul>	Not identified.	<ul style="list-style-type: none"> <li>• State Fund of Transport Infrastructure</li> <li>• Fee for use of railways</li> </ul>	Formulate the policy of privatisation of Czech Railways and clarify the system of subsidies.
Municipal transport	The private partner builds or is transferred a portion of infrastructure (e.g., one route of the underground train or operation of trams) and operates it for a specified term.	<ul style="list-style-type: none"> <li>• Communities, municipalities, municipal transport enterprises</li> </ul>	Uncertainty in respect of determining fares and availability of subsidies	<ul style="list-style-type: none"> <li>• Community budget</li> <li>• Fare</li> </ul>	Clear up system of subsidies
Health care	The private partner builds, repairs, or is transferred an operational (not medical) portion of a hospital and operates it for a specified term.	<ul style="list-style-type: none"> <li>• Regions</li> <li>• Ministry of Health with specialised hospitals</li> </ul>	Uncertain cash flow	<ul style="list-style-type: none"> <li>• Health insurers</li> <li>• Regional budget</li> <li>• State budget</li> </ul>	Formulate state policy in health care and introduce a transparent and foreseeable system of payments to hospitals
Development projects	The private partner builds, or reconstructs or renews a building for the public sector and operates it for a specified term for a fee.	<ul style="list-style-type: none"> <li>• Ministry for Local Development</li> <li>• Regions</li> <li>• Communities, municipalities</li> </ul>	Limitations on the availability of EU funds for revitalisation projects	<ul style="list-style-type: none"> <li>• State budget</li> <li>• Regional budget</li> <li>• Community budget</li> <li>• Fee paid by users</li> </ul>	
Housing	The private partner develops blocks of flats to be rented under specified rules. Communities of the Government may co-fund the development.	<ul style="list-style-type: none"> <li>• Communities, municipalities</li> </ul>	Unclear cash flow, unclear policy, unclear regulation of rent	<ul style="list-style-type: none"> <li>• Housing Development Fund</li> <li>• State/community budget</li> <li>• Rent</li> </ul>	Adjust rules governing subsidies rules from the Housing Development Fund, formulate state policy
Universities and colleges	The private partner develops university/college/dormitory buildings and operates them for a specified term.	<ul style="list-style-type: none"> <li>• Universities and colleges</li> </ul>	Not identified.	<ul style="list-style-type: none"> <li>• State budget</li> <li>• Fee paid by users</li> <li>• Income generated by universities/colleges</li> </ul>	
Secondary and elementary schools	The private partner develops or is transferred building(s) housing a secondary or elementary school and operates it for a specified term.	<ul style="list-style-type: none"> <li>• Regions for secondary schools</li> <li>• Communities for elementary schools</li> </ul>	Not identified.	<ul style="list-style-type: none"> <li>• Community budget</li> <li>• Regional budget</li> </ul>	
Defence	The private partner develops and operates army logistics, or purchases a repair shop from the Government in order to continue to repair army hardware.	<ul style="list-style-type: none"> <li>• Ministry of Defence</li> <li>• State enterprises</li> </ul>	Protection of information, issue of public interest in potential abrupt reassignment to the army	<ul style="list-style-type: none"> <li>• State budget</li> <li>• Extra revenues</li> </ul>	Resolve the issue of both introduction and at the same time limitation of the "step-in" right
Water utilities	The private partner builds a water cleansing plant and operates it for a specified term for a community. The private partner is transferred the water mains and sewage by its operator and operates it for a specified term, including upgrading them as set out.	<ul style="list-style-type: none"> <li>• Communities</li> <li>• Community enterprises</li> </ul>	Not identified.	<ul style="list-style-type: none"> <li>• Community budget</li> <li>• State Environmental Fund</li> <li>• Fee paid by users</li> </ul>	