

Implementing public-private partnership projects in the Baltic states

This article examines the legal and policy environment for implementing public-private partnerships (PPPs) in the Baltic states – Estonia, Latvia and Lithuania. The article also provides an overview of PPP projects which have already been implemented in these countries and defines current trends.

Introduction

Over the past several years, public-private partnerships (PPPs) have become an increasingly important financial instrument for the funding of public sector projects. Private entities are showing more and more interest in PPP projects and view them as a form of safe and reliable investment. Public entities perceive PPPs as a good way of attracting private investment in public projects and carrying out their functions without taking all of the related risks. However, to date there have not been many PPP projects in the Baltic states and the public sector often lacks the ability to manage such projects with the necessary level of expertise.

The concept of PPP

In the Baltic states, as well as throughout the European Union, PPPs are understood to be contracts between private and public entities. Under these contracts, a private entity performs the functions traditionally undertaken by a public entity. The parties to the contract also agree to share the risks related to the project.

Usually the parties to PPPs enter into long-term contracts (normally between three and 30 years) under which the private partner undertakes to develop a public infrastructure project. The private partner is also given the subsequent right to operate this infrastructure. Alternatively, the private partner may be given the right to operate an existing public infrastructure project and will undertake to renovate and maintain it and provide certain public services.

The private partner is compensated for its undertaking either by receiving income from end-users of the infrastructure or by being paid a fixed amount by the public partner. Alternatively, a mix of these two types of compensation may be paid. The main feature of PPP projects is the distribution of risk whereby the private partner must take all or part of the risk associated with the project, whether it be construction, availability or demand risk or a combination of these factors.

A significant level of technical assistance was provided by the European Bank for Reconstruction and Development (EBRD) to Latvia and Lithuania between 2002 and 2006. This assistance has helped the countries upgrade their PPP legal frameworks. The legislation of each of the Baltic states generally follows the PPP formats described above, however, it does not establish a statutory definition of a PPP.

Broad definitions of PPPs can be found in non-binding legislative instruments. In 2005 the Cabinet of Ministers of Latvia adopted guidelines for facilitating PPPs in the country. Under these guidelines a PPP is described as "...cooperation between a public entity and a private person, within which any public service is assigned to the private partner on a contractual basis for a certain period of time and on the condition that the private partner will provide public services and attract resources from the private sector".



Dovilė Burgienė,
Lideika, Petrauskas,
Valiūnas ir partneriai
LAWIN



Viive Näslund, Lepik
& Luhaäär LAWIN



Annija Švemberga,
Klavins & Slaidins
LAWIN

Quite a similar definition has been adopted by several institutions in Estonia. The Estonian Accounting Standards Board, for instance, issued guidelines in which a PPP is defined as a “long-term cooperation project between a public entity and a private entity according to which the private sector partner constructs, renovates or acquires assets for a specific PPP project (PPP assets) and provides services of the agreed scope and quality that are based on the use of such created PPP assets and where the public sector partner is the main purchaser of the services provided by the private sector partner”.

The legal form of PPP contracts

Generally, private and public entities can enter into PPPs in three main ways:

- by undergoing a concession granting tender and subsequently concluding a concession agreement
- by undergoing public procurement procedures and concluding a procurement agreement¹
- by concluding a civil law contract between the public and private partners.

Legislation in the Baltic states does not require PPP contracts to be in one particular form. In Lithuania, for instance, public and private entities can enter into PPPs under the first two forms indicated above, either as a concession agreement or a public procurement agreement. In theory a civil law contract is also possible, but only in cases where the project cannot be classified as either a concession or a public procurement contract. This is due to recent legal developments which have introduced a very broad concept of concession and the changes in public procurement legislation which allow long-term public procurement contracts.

Future PPP projects in Lithuania will be implemented by way of public procurement. This is due to the permitted length of procurement contracts being prolonged. Prior to the revision of concessions and public procurement legislation, all PPP contracts in Lithuania were concluded in the form of civil law contracts (for example, the lease of the Vilnius central heating company and the Hales market reconstruction and long-term lease).

Following the revision of the laws, the situation substantially changed and now a number of PPP contracts that involve risk sharing and/or compensation from end-users have started to be entered into as concession contracts. These include the Trakai heating system concession agreement and the construction of the Panevėžys fitness centre.

According to the guidelines facilitating PPPs in Latvia, public and private entities can enter into PPP projects either by concluding concession agreements under the Law on Concessions, or under any other agreement (for example, a service agreement, a design construction agreement, or a maintenance agreement) by way of public procurement.

In contrast, the legislation of Estonia adopts an even wider approach. PPP contracts in Estonia can be entered into as

ordinary civil law contracts in which the parties agree on the distribution of their rights and obligations. Examples of this type of PPP agreement include municipal housing projects and the renovation and maintenance of secondary schools in Tallinn, which were concluded in the form of lease agreements.

Institutions most interested in PPPs

According to legislation in the Baltic states, PPP contracts can be entered into by central or municipal governments. However, according to accepted practice, central government institutions treat PPPs with great caution and remain reserved about them. In clear contrast, municipal governments have indicated a high level of interest in and initiative towards PPP projects.

Currently in Lithuania there are a number of pending concession granting procedures including a project for the construction, maintenance and operation of a tramway in Vilnius, a project for the renovation and maintenance of schools in Vilnius and Kaunas and a project for the provision of primary health care services in Vilnius. In addition, a project for the construction of sports arenas in Kaunas and Šiauliai and a project for the operation of a sports arena in Panevėžys are also being considered. All of these projects are being implemented at the municipal level. One of most important factors driving the municipalities towards concessions is the municipalities' limited ability to borrow and fund projects by way of traditional procurement.

Similar situations have also arisen in Latvia and Estonia. According to data from the Register of Enterprises in Latvia, up until June 2006, 13 concession agreements had been concluded and all of them had been entered into at the municipal level.

PPP guidance institutions

Currently Lithuania and Estonia do not have strong institutions responsible for monitoring and providing guidance on PPP projects. However, appropriate steps have been taken to rectify this situation. The parliament of Lithuania recently adopted amendments to the Law on Concessions whereby it allowed the establishment of a single institution which would be responsible for the provision of methodological support for concession projects.

In addition, Lithuania's Ministry of Finance launched a separate initiative and established a special unit which is responsible for the fiscal supervision of PPPs. However, this institution does not produce products which would facilitate PPP type investments, such as policy guidelines or plans of areas which would be good for PPP type investments.

In Estonia the establishment of institutions responsible for the guidance of PPP projects is in the project phase. It is projected that these types of institutions will be established in Estonia in 2006-07 and shall accumulate best practices and statistics and provide consulting on the implementation of PPP projects.

The most advanced Baltic state in this sphere is Latvia where the responsibility for PPP projects has been assigned to two main institutions:

- the Ministry of Economics, which is responsible for developing PPP policies and coordinating their implementation
- the Latvian Investment and Development Agency (LIDA), a state agency which implements PPP projects, draws up proposals to facilitate PPP development, and supports the implementation of PPP projects.

According to a February 2006 briefing on the implementation of guidelines facilitating PPPs in Latvia, the Ministry of Economics stated that it plans to create an Advisory Board on PPP issues in 2006 and set up a PPP web site which will include interpretative materials, laws and regulations, methodology and guidelines, standard documents, current events, executive updates, information from abroad and useful links. The Ministry also plans to organise informative seminars for public institutions on the methodology behind the PPP project management cycle and on standard documents necessary for the development of PPP projects.

LIDA has also been active. It carried out research on five pilot projects submitted by municipalities. LIDA also plans to develop methodology on the PPP project management cycle, to make frequent updates and to develop a standard agreement for PPP projects. To date, LIDA has developed a series of methodological materials, including a description of the PPP project cycle, recommended content for a standard agreement for PPP projects, an overview of the advantages and drawbacks of the most common PPP agreements and a questionnaire on the project concept.

In this respect, Latvia is ahead of the other two Baltic states in monitoring and providing guidelines for PPPs. Lithuania and Estonia have made no significant attempts to draw up guidelines or model agreements. However, this situation is expected to change in the near future, as Lithuania and Estonia make steps toward establishing institutions which will be responsible for the support and accumulation of best practices.

PPP projects being undertaken in the Baltic states

Estonia

Only two major PPP projects are being undertaken in Estonia:

- Six hundred and fifty new apartments are being developed and maintained over the next 30 years by a private partner. The municipality has agreed to provide the private partner with additional land that can be used for commercial needs and to pay a yearly service payment. The approximate amount of investment is €25 million.
- Ten secondary school buildings in Tallinn are being renovated and maintained by a private partner. The municipality has agreed to pay a yearly service payment for the services. The approximate amount of investment is €33 million.
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Latvia

Several interesting PPP projects have already been undertaken in Latvia. In addition, five pilot projects will be implemented, pursuant to research carried out by LIDA. These include:

- In Salaspils, a private partner has agreed to construct 150 apartments, 50 of which are designated for the needs of the municipality. The municipality will provide the private partner with the land necessary for the construction of the houses. The approximate value of the project is €6.6 million.
- In Cesis, a private partner will construct and manage a preschool educational establishment. The municipality has agreed to provide the private partner with the land necessary for construction and to pay a monthly fee for the provision of services. The approximate value of the construction is €4.6 million.
- In Jekabpils, a private partner is set to modernise and operate the local heating system. The municipality has leased the heating system to the private partner for 30 years and has granted it the right to receive income for the services from end-users. The approximate amount of investment is €4.3 million.

Various Latvian institutions, including the central government, are currently considering the implementation of extensive PPP projects. These include the reconstruction and management of state main roads (valued at approximately €960 million), the construction of the administrative centre of the Riga City Council (approximately €61 million), the renovation of the Riga light system (approximately €283 million) and the construction of the Via Baltica northern corridor in Riga (approximately €1.3 billion).

Lithuania

Three key PPP projects have been implemented in Lithuania:

- The Siemens arena, water and amusement park in Vilnius involved the investment of €38.5 million by a private partner for the construction and operation of the facility. Ten per cent of arena operator shares have also been transferred to the municipality. The municipality provided the private partner with a 61 hectare plot of land without charge and invested €4.5 million in road infrastructure.
- The heating system of Trakai has been leased to a private partner. The private partner has taken over all of the debts of the municipal company which previously operated the heating system and has been granted the right to receive income for services from end-users. The private partner will also modernise, operate and maintain the infrastructure and pay to the municipality a concession fee amounting to €2.1 million over a 25 year period.
- The concession contract for the Panevėžys fitness centre stipulates that the private partner will construct in the area assigned by the municipality a fitness centre for three major sports, maintain and operate it and ensure the provision of sports services. The municipality is required to lease to the private partner the land required for the construction.

In addition, there are several municipal projects currently in the initial stages of development. The most interesting include the design, development, maintenance and operation of the tramway in Vilnius, the provision of primary health services in Vilnius, the construction of arenas in Kaunas and Šiauliai and the reconstruction of transport intersections in Kaunas.

PPPs in the future

Although the legal basis for the proper implementation of PPP projects is quite well developed in the Baltic states, to date not many PPP projects have come to a financial close. However, a number of very interesting projects have been launched and are ongoing. It can be anticipated that in the future PPPs will become an increasingly important instrument for funding public sector projects. It remains to be seen whether the Baltic states will manage to avoid the past failures of other countries where PPPs were sometimes based on incorrect revenue and market assumptions or where project costs were underestimated. The Baltic countries must learn from the best examples of PPPs; projects which have provided good value for money for the public sector as well as a fair return for private investors.

Endnotes

- ¹ Procurement is included in the concept of PPP for the purpose of this article, although the authors appreciate that in most articles, commentaries and assessments, PPPs and conventional procurement are treated separately.

Contacts

Dovilė Burgienė
Lideika, Petrauskas, Valiūnas ir Partneriai LAWIN
Jogailos 9/1, LT-01116
Vilnius, Lithuania
Tel: +370 52 681888
Fax: +370 52 125591
Email: dovile.burgiene@lawin.lt
Website: www.lawin.lt

Viive Näslund
Law Office of Lepik & Luhaaar LAWIN
Dunkri Street 7
Tallinn 10123, Estonia
Tel: +372 6 306460
Fax: +372 6 306463
Email: viive.naslund@lawin.ee
Website: www.lawin.ee

Annija Švemberga
Law Offices of Klavins & Slaidins LAWIN
Elizabetes 15
Riga, LV-1010
Latvia
Tel: +371 781 4848
Fax: +371 781 4849
Email: annija.svemberga@klavinsslaidins.lv
Website: www.lawin.lv