Main findings and lessons learnt from performance-based contracts between municipalities and water utilities in selected EECCA countries

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Structure of the presentation

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Objectives of the project

- To provide support to selected EECCA municipalities in improving the performance-based contracts by analysing existing contracts or contracts under preparation against internationally recognised criteria and benchmarks.

- To deepen the analysis contained in the Guidelines on PBCs in order to further improve their relevance to EECCA countries so as to ensure a wider dissemination of best practices in this area.

- The project – financially supported by EU Tacis and implemented jointly with PwC.
Types and definitions of performance-based contracts

- **Service contract (Contracting out):** The client contracts out services to a company for a specific package of work (e.g. customer billing, specific maintenance tasks) for a fixed fee. The operator’s role is limited to its tasks. (e.g. currently in Kupyansk, Ukraine)

- **Management contract:** The operator takes over responsibility for part of the operations (e.g. all of operation and maintenance) for a fixed fee; the client retains the responsibility for system expansion and other capital works (e.g. Armenia, Armenia Water Utility)

- **Lease:** The operator is responsible for providing agreed levels of service to customers and for providing working capital for repairs. The main tasks are operation and maintenance but with a greater degree of autonomy than for management contracts. The operator pays a fee to the public sector (e.g. Armenia, Yerevan Water Utility)

- **Concession:** The operator is responsible for financing the investment costs of the system, including system expansion, as well as for all of the operation and maintenance, in order to achieve some prescribed service delivery objectives. The operator pays a fee to the public sector (e.g. Ukraine, Berdyansk, Kupyansk)

- **Full divestiture (privatisation):** In addition to responsibilities for service delivery, the ownership of existing physical infrastructure of the water system is transferred from the public to the private sector (e.g. Shymkent, Kazakhstan). In the arrangements previously described, ownership of assets remains with the public sector
Allocation of public/private responsibilities across different forms of PBCs in water services

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**Key:**
- Dark grey = public responsibility
- Light grey = shared public/private responsibility
- White = private responsibility
Introduction of the case studies

• Armenia:
  ➢ Lease contract (10 years) with Veolia for the Yerevan Water Utility
  ➢ Management contract (4+2 years) with SAUR for the Armenian Water Utility

• Ukraine:
  ➢ Concession contract between Berdyansk City and Chistaya Voda (30 years)
  ➢ Concession contract between Kupyansk City and a domestic operator (50 years) – contract under preparation

• Kazakhstan:
  ➢ Privatisation - Shymkent Water Utility sold to Water Resource Marketing Ltd.
Major findings (1/5)

- General findings
  - As part of the water sector reform, all four countries have opened the way for private sector participation in one form or another
  - The role of the governments has changed – from a provider to a monitoring entity
  - Reviewed countries have chosen different paths but with a preference for domestic operators (Armenia is an exception)
  - Low penetration of PBCs in NIS-7 countries compared to other regions of the world
  - Hybrid models of PBCs
Major findings (2/5)

- Legal and institutional issues

- Even though the legal and regulatory basis has been significantly strengthened in all countries – e.g. Concession Law in Ukraine (with a model concession contract), Kazakstan – Law on Natural Monopolies, but these need further strengthening
  - discrepancies arising at the implementation level between the contracts and the regulatory basis in Armenia

- Institutional framework has been improved as well
  - e.g. both Armenia and Kazakhstan have established multi-sectoral regulators to approve and monitor tariffs, in Ukraine – this responsibility is left to municipalities
  - but both Ukraine and Kazakhstan do not have special water bodies at a national level which could set overall service standards for the sector
  - In Armenia – a Management Board and Contract Management Unit to oversee contracts implementation
Major findings (3/5)

- Contract preparation
  - It takes time to prepare a well-designed contract and negotiate it (Armenia)
  - Use of consultants in preparation of tender documentation and draft contracts
  - Most often, selection criteria are not clear and the selection process is politicised (Ukraine)
  - Accuracy of the baseline data and information during the negotiation period, need to adjust them
    - Assets transfer and valuation
  - Re-negotiation of contracts or numerous amendments
Major findings (4/5)

- Performance indicators
  - Generally well-designed performance indicators for the contracts in Armenia
  - Lack of performance indicators in Kazakhstan, only general objectives, Ukraine – the only indicator is the level of investments
  - Problems with monitoring of indicators – definition, methodology
  - Use of an independent auditor in Armenia
  - Need for reviews of indicators in relation to investment plans
  - Lack of provisions on a bonus or a penalty if the operator exceeds or fails to achieve its objectives (except in Armenia)
  - Lack of clearly specified reporting requirements
Major findings (5/5)

• Tariff setting and tariff yearly revision
  ✓ Countries have introduced both price-cap and cost-plus methodologies
    ✓ Annual tariff revision in Armenia
    ✓ In Kazakhstan, the Symkent operator is the only one that succeeded to complete the procedure for having the tariff set on the basis of a price-cap methodology – 100% metering
    ✓ Depreciation in Ukraine
  ✓ Postponement of tariff revisions
  ✓ Tariff revision formulae not included in contracts
  ✓ The lease fee in Yerevan – included in the tariff
Major recommendations

- Carefully review all relevant legislation before the contract is signed in order to avoid future conflicts.
- Include performance indicators (based on easy measurement and existing reliable data) in the contract in order to assess the actual level of improvement of the service.
- Include a tariff revision formula directly in the contract to increase transparency of tariff revision and in order to facilitate the implementation of a credible financing strategy.
- Include revision mechanisms for adjusting targets, investment plans and tariffs.
- Carefully define monitoring and reporting requirements.
- Involve a third party (independent regulator and/or auditor) in the monitoring process.
Concluding remarks

- Armenian experience shows that implementing PBCs is not an easy and straightforward process.
- To be successful the process requires a high-level political support and consensus of the whole government.
- It is not possible to regulate every single aspect of the contract - need for clearly defined procedures.
- When the contracting authority is not familiar with Public Private Partnerships, it is advisable to start first with a management or lease contract in order to gain experience with the private sector before entering into complex and long agreements.
- It is too early to draw any definitive conclusions on the success of these contracts.