

Public Private Partnership: Alternative Way of Attracting Private Sector to Infrastructure Projects in Azerbaijan



Seymur Niftaliyev
Law Practice Manager,
KPMG Azerbaijan

Introduction

Where governments face constrained budgets and lack of infrastructure, they tend to turn to public private partnerships (PPP), which can help with bringing necessary financing and improved quality. Generally, PPPs are alternatives to public procurement, where the former uses private sector's financing and the latter public funds.

As a result of financial crises, fall of oil prices or other events and processes that result in decreasing budgets, some economies had sought other means to finance infrastructure or other projects, in order to ease the burden on their budgets. In Azerbaijan, this became more relevant after the fall in oil prices in 2014, which resulted in decreased foreign currency return in Azerbaijan.

In this article, we will discuss notion of PPP in general, cover some history of PPP development, explain main models of PPPs and their benefits. In addition, this article will provide information on current legal framework on PPPs in Azerbaijan, covering main gaps and advantages that current legislation offers.

What is PPP?

Although, the term PPP found wide usage in 1990s in the United Kingdom, participation of private sector in infrastructure development dates back to 18th century. For example, private participation in road development turnpike in Pennsylvania, US. However, the role of private sectors participation diminished over time and was generally limited to involvement through public procurement. Nevertheless, participation of the private sector came to spotlight in 1980s in the United States, where the Virginia state began to explore the possibility of private sector participation in highway development. There are also other examples of early PPP project in the UK, which is considered one of the pioneers of development of such partnerships.

Generally, there is no single definition of PPP that is widely accepted. Below are several definitions of PPPs proposed by various scholars:

- Public-private partnerships (P3s) are contractual agreements formed between a public agency and a private sector entity that allow for greater private sector participation in the delivery and financing of transportation projects.¹
- A form of structured cooperation between public and private partners in the planning/construction and/or exploitation of infrastructural facilities in which they share or reallocate risks, costs, benefits, resources, and responsibilities.²
- Contractual arrangements in which certain risks are transferred from public agencies to private firms – as a way to fund these [funding] deficits, accelerate competition, improve operating efficiencies, and reduce operating costs.³

As per World Bank's definition, "PPP is a mechanism for government to procure and implement public infrastructure and/or services using the resources and expertise of the private sector".⁴ In simple words, under PPP private sector enters into a long term contract with the public sector, where the former undertakes to fund, build, operate (depends on the model of PPP, see below) the project (e.g. school, road, bridge, dormitory etc.), receive revenues from the project for defined period of time and transfer (depends on the model of PPP) the project to the public sector.

Use of PPP can be beneficial for the parties, in case it is well-structured, analyzed and right model is selected. The main benefits of using PPPs are the following:

- (a) Improving service delivery due to the merger of both public and private sectors;
- (b) Value for money – public-private enterprises are managed effectively;
- (c) Improving cost-effectiveness – due to vast experience and flexibility, public-private partnership delivers public services more cost effectively;
- (d) Increased investment in public infrastructure – hospitals, schools, highways, reduce government capital cost, helping embrace the gap between the need for infrastructure and financial capacity;
- (e) A higher level of service through innovation;
- (f) Reduces public sector risk – public private partnerships shift the risk from public to private, which in most cases is better managed by the private sector;
- (g) Deliver capital projects faster – private investors

1. Alexandru Roman, NIGP, The Institute for Public Procurement, 2015

2. Koppenjan, 2005

3. Page, Ankner, Jones & Fetterman, 2008

4. www.worldbank.org



are more flexible in nature and have greater access to financial resources from financial institution;

(i) Make better use of assets – private sectors maximize fully the potential and returns in investments.

Indeed, use of PPP can be beneficial for public sector, private sector and consumer/public itself. However, the parties shall analyze the possible structures of PPP and choose the right model to proceed with.

Types of PPP models

Over the years, a number of PPP models were developed:

Build–Operate–Transfer (BOT)

Under BOT model, the private partner builds, operates and transfers the project to the public sector. Hence, the private sector is responsible for construction of the project, maintaining of the project during the term of the contract, therefore mobilization of massive investment from the private partner is required, which is to be repaid from the revenues collected from consumers/users of the infrastructure object (project). In addition, private partner is responsible for transfer of assets to the public entity (body) at the end of the operation period.

Design–Build (DB)

This model is a combination of two operations in one contract. Under DB model, the contract is awarded to private partner for design and construction of the project. Generally, under public procurement, design and construction are awarded to different companies. Thus, under this PPP model the public sector saves time and cost compared to traditional procurement.

Design–Build–Finance–Maintain–Operate (DBFMO)

Under DBFMO, the private sector designs, builds, finances, operates an asset, then leases it back to the government. Generally, it is a long-term lease for 20-30 years. Public sector long-term risk is reduced and the regular payments make it an attractive option to the private sector. This option can be used for prisons, schools, necessary transport stations etc.

Apart from above models, there are variety of PPP structures

available, including Design-Build-Finance, Design-Build-Operate-Maintain, Build-Own-Operate and others.

PPP in Azerbaijan

PPP was introduced in Azerbaijan recently. In 2016, the Law on the Implementation of Special Financing for Investment Projects in Connection with Construction and Infrastructure Facilities (“the Law”) was adopted. The PPP legislation in Azerbaijan, generally, provides mechanisms for the potential financing of the BOT model, without referring to other models. Having said that, the PPP legislation also includes Rules “On the implementation of the infrastructure projects by investors under the build-operate-transfer model, requirements to the investor, terms and conditions of the contracts and determination of the cost of goods and services produced under the investments” approved by the Presidential Decree, later in 2016. These Rules envisage more specific regulatory framework and requirements for implementation of BOT model in Azerbaijan, including the following:⁵

1. conditions for implementation of investment projects;
2. requirements to the investors based on the type of construction and infrastructure facilities;
3. terms and conditions of agreements concluded with investors;
4. rules for the determination of costs of goods and services produced as a result of investments.



Definition of BOT under the Law

The Law defines BOT as repayment of investment costs (including income earned) under the investment projects regarding construction and infrastructure facilities to the investor by means of purchasing goods or services by the consumer.⁶ Investor is responsible for the design, financing, construction (including current and capital repair, renovation and restoration), as well as operation of the BOT project.⁷ The Law also envisages non-exhaustive list of construction and infrastructure facilities, which may qualify for BOT financing, including, but not limited to the following:

- bridges;

⁵. Article 4 of the Law

⁶. Article 2.0.2 of the Law

⁷. Article 5.1 of the Law



- tunnels;
- dormitories;
- educational, health, cultural and tourism facilities;
- industrial parks;
- highways;
- underground stations;
- other projects⁸

The Law also limits the term of BOT agreement to 49 years, which shall be executed between the investor and public sector (Ministry of Economy of the Republic of Azerbaijan is the authorized body to execute BOT agreements, supervise PPP projects etc.).⁹ After expiration of the period set forth in the agreement, construction and infrastructure facilities will be transferred to the management under the Ministry of Economy, free from all debts and obligations of any kind and suitable for the intended use.¹⁰ In accordance with the Law, the facilities may be purchased from the investors prior to the expiration of the term for state needs, provided that all their costs and expected revenues from the project will be indemnified.¹¹

Under Azerbaijani PPP legislation, BOT private partner selection process is a separate procedure and regulated under the Rules. In addition, provisions of the Law of the Republic of Azerbaijan "On State Procurement" are not applicable to the BOT projects.¹²

In order to look into the PPP framework more specifically, we have identified main advantageous provisions of the legislation and main gaps that should be addressed.

Main advantages

The main advantages of PPP legislation include the following:

- Public sector may provide additional guarantees to the investor (such as, covering the budgeted payments that consumers should have paid during the operation of the BOT facility);
- The private sector is exempt from payment of state duties;
- The state provides guarantees for the liabilities of public

8. Article 3.1 of the Law

9. Article 6.2 of the Law

10. Article 8 of the Law

11. Article 9 of the Law

12. Article 13.1 of the Law

sector under the BOT agreement;

- The Law "On Public Procurement" does not apply to PPP projects.

Main gaps

Considering that the PPP itself is new to Azerbaijan and that the PPP legislative framework has been recently adopted, there are some gaps that shall be addressed in order to make PPP more popular and preferable tool for investors to be involved in infrastructure and other massive projects in Azerbaijan. The gaps include following:

- The PPP legislation only recognizes BOT model. This is one of the main issues that limits private sectors participation in the project under other PPP models. The legislation shall provide broader freedom;
- Ownership over the project during the construction and operational period is not defined. Therefore, is it not clear, whether public or private sector shall have ownership over the project;
- The role of other bodies to present public sector is defined, apart from Ministry of Economy. Hence, this can lead to procedural and bureaucratic hindrances. In addition, other state bodies that in fact orders infrastructure facility to be constructed on the private sector funds through PPP model have little impact over supervision during contract implementation term, which can result in lower quality of the project and services.

Conclusion

As seen from the above, PPPs can help governments to proceed with infrastructure and other important projects with shared responsibilities and at a minimum cost. This is also beneficial for the private sector, considering the guarantees from the public sector and shared responsibilities between the parties.

The fact that Azerbaijan has introduced BOT model is a starting point to involve private sector in participation of important infrastructure projects as a stakeholder and only as a contractor. This will be also helpful to decrease budget spending on projects that can be covered by private sector, given guarantees are in place. However, in order to attract investors, we will need to improve PPP legislative framework, namely, address existing gaps, provide mechanisms for other PPP models, apart from BOT and constantly inform the private sector, whether local or international, on work being done in relation to improvement of PPP framework.

Author's biography

Mr. Seymur Niftaliyev is a Manager within Law Practice at KPMG Azerbaijan. He is currently involved in advising clients with legal assistance on corporate, M&A, banking, agricultural, FATCA/CRS, PPP, migration, contract and other areas. Seymur was also involved in development of various internal policies for leading companies, including conflict of interests, procurement and other policies.

Mr. Niftaliyev holds LL.M. in International Commercial Law from City University London and Bachelor degree in International Public Law from Baku State University.