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Glossary

CIVITAS: a municipal property management company fully owned by the City of Komárno.

Final Beneficiary: a body Organization or administrative unit which benefits from the project.

FM: Financial Memorandum, agreement on provision of non-repayable financial assistance concluded between the Commission and the Slovak Republic, for the benefit of the Slovak Republic

EIB: European Investment Bank

IA: Implementing Agency. Authority established with the pertinent Ministry (Ministry of environment of the Slovak Republic) or with a designated authority for ISPA program, responsible for technical and fundamentals of project implementation pursuant to the valid rules and regulations of the EU and the Slovak Republic.

IFIs: International funding institutions (EIB, EBRD, WB, etc.)

IRR : Internal Rate of Return; an indicator utilised in financial and economic analysis of projects.

KOMVaK : Komárno Water Works and Sewer System Company, owned by the City of Komarno.

MoA: Ministry of Agriculture of the Slovak Republic

MoE: Ministry of Environment

MoF Ministry of Finances

MoP: Ministry of Privatisation

NAO: National Authorising Officer is responsible for overall financial management of ISPA.

NEAP : National Environmental Action Programme

NF :National Fund. Department of the Ministry of Finance of the Slovak Republic, under the direct responsibility of the National Authorising Officer who is providing for the overall financial management of ISPA program resources

NIC: National ISPA Co-ordinator: Co-ordinates preparation and implementation of ISPA Program.

NPF: National Property Fund

NPV : Net Present Value; an indicator utilised in financial and economic analysis of projects.

PE : Population - Equivalent; an indicator of the amount of biological load to be treated in a WWTP.

PPP: Public-Private Partnerships

TA: Technical Assistance

TVK: Joint Stock Municipal Water Company (see §2.2.1.5 and chapter 3 - Trencin, Martin)

TVS: Name of a private Operating Water Company (see §2.2.1.5 and chapter 3 Trencin)

VAK, see also Zsvak, Zvak: Regional State owned water company

WWTP: Waste Water Treatment Plant

ZsVAK: One of the current 5 Regional State owned water company.

ZVAK: One of the current 5 Regional State owned water company

Executive Summary

Consultant tasks

1. This report concerns six environmental ISPA projects in Slovakia providing new or upgraded wastewater treatment plants, and associated upgrading or extensions to sewerage networks. The consultant's TOR involve several points, including documenting the previous and current ownership of assets related to these six projects, an estimate of the ongoing or future transformation of the ownership of the assets, and a description of the proposed ownership structure, including whether a part of the ownership has been, or may be, given to private investors. The TOR call also for similar descriptions of new or envisaged water management structures. In the case that water management was or may be given to a private company, the terms and conditions were to be summarized and an estimation given as to whether there is scope for making undue profit. Conditions under which any private operating concessions were awarded are to be described. Lastly the TOR require the Consultant to formulate conclusions and recommendations on (i) corrective measures necessary to protect European ISPA investments, (ii) the need for PPP advice, and (iii) the need for policy advice to the Slovak authorities.
2. The work included a two week mission to Slovakia by a team of seven international Consultants supported by a local legal counsel. The team visited each of the six ISPA projects and held numerous meetings with national, municipal and water sector organisations and authorities (refer to Appendix 1 for a full list of meetings). The team collected extensive documentation on the status of the six ISPA projects and on the ongoing transformation of the water sector in Slovakia. Initial conclusions have been elaborated based on this information, and were presented and discussed in Bratislava on March 8th 2002 with relevant Slovak and EC officials. While a comprehensive overview of the situation was given, despite the efforts made by the team it was not possible to obtain specific documentation clarifying certain issues regarding commercial loan agreements and the award of a private operating concession in Trencin. As a result, it was agreed that officials from the Ministry of Environment should assist the Consultant in obtaining the required documentation. It was requested that this information be provided by March 15th. If this information is (a) available, and (b) provides further clarifications and/or new elements, appropriate modifications will be made to the Final Report.

Background

3. As a result of the extensive socio-economic transformation since 1989, the water sector in Slovakia – and more specifically the drinking water and sewerage sector – has been traversing a transition period for several years. Although the general trends and objectives for the transformation of the sector were stated in 1994, the process has not yet been completed. The remaining institutional uncertainties jeopardize the sector's development and consequently undermine the fulfillment of the sector's essential social mission and parallel contribution to the general economic development of Slovakia.

4. The current State owned regional companies (the five “VAKs”) operating the public water and wastewater services have not been able during last years to respond with efficacy to the increasing demand for improvement, particularly concerning treatment and disposal of wastewater. Reasons for this include: the shortage of operating and capital funds for State owned assets, the significant increase of operating costs and also a sometimes unclear knowledge of the basis and objectives of the transformation process in the mean and high management level of the sector.
5. Facing this stagnating situation, some more ambitious municipalities (alone or in groups) have undertaken to implement changes without waiting any longer for the completion of the transformation process. To do this, and more specifically to secure and/or to have access to commercial loans, needed to fund projected investments, they sought the direct transfer of ownership of the appropriate production assets. In accepting such demands, the Government has created so-called “pilot projects ” (e.g. Komarno and Trencin) in 1998 and other "exceptions" more recently (e.g. Nitra) that appear at least to be inconsistent with the originally proposed transformation.
6. ISPA Environmental funds in Slovakia are essentially devoted to the improvement of wastewater collection, treatment and disposal, in order to facilitate the fulfillment of the corresponding EU directives - notably the urban waste water Directive. As grants, these funds are perceived as a unique opportunity to acquire significant capital funding necessary to undertake costly investments. Most of the six projects covered by the present Report are high ranking in the National ISPA Strategy priority list. For three of them (Nitra, Komarno and Trencin) the beneficiaries are the "pilots" or “exceptions” mentioned above. In the case of Martin, the beneficiary is a further candidate seeking to obtain the same status of “exception” from the Government . The other two (Banská Bystrica and Zvolen) have as beneficiary the current State owned company. Basic data concerning the six projects are included in Table ES-1.

Table ES-1
Profile of the six ISPA Projects

Location <i>population equivalent</i>	Final Beneficiary (as in FM)	Eligible Cost €	Type of Improvements
Nitra <i>115.000</i>	ZsVaK	10.354.200	WWTP upgrade
Komárno <i>43.200</i>	Municipality of Komárno	8.043.700	Sewer network extension / rehabilitation / WWTP upgrade
Martin <i>114.000</i>	TVK Martin	12.364.474	Sewer network extension / rehabilitation / WWTP upgrade
Trencín <i>30.100</i>	TVK Trencín	7.936.732	New WWTP
Banská Bystrica <i>163.000</i>	STVaK	45.468.667	Sewer network extension / WWTP upgrade
Zvolen <i>80.500</i>	STVaK	10.967.050	WWTP upgrade

For the six projects, ownership and management profiles are summarised in Tables ES-2 and ES-3.

Table ES-2
Ownership Profile of the six ISPA Projects

Project Location	Previous Ownership	Current Ownership	Future Expected Ownership
Nitra	ZsVaK	Municipality <i>Since February 02</i>	Municipality
Komárno	ZsVaK	Municipality <i>Since January 98</i>	Municipality
Martin	SEVaK	SEVaK	Regional Jt.Stock Co. <i>Expected June 02</i>
Trencín	ZsVaK	TVK Trencin <i>Since August 98</i>	TVK Trencin
Banská Bystrica	STVaK	STVaK	Regional Jt.Stock Co. <i>Expected June 02</i>
Zvolen	STVaK	STVaK	Regional Jt.Stock Co. <i>Expected June 02</i>

Table ES-3
Operation/Management Profile of the six ISPA Projects

Project Location	Previous Operation	Current Operation (as of March 2002)	Future Expected Operation
Nitra	ZsVaK	ZsVaK	Regional Jt.Stock Co./ New Regional Operator
Komárno	ZsVaK	KOMVaK <i>(a Municipal Company)</i>	KOMVaK or possible private operator
Martin	SEVaK	SEVaK	MicroRegional Jt.Stock Co./ New m.Regional Operator
Trencín	ZsVaK	TVS <i>(a Private Company)</i>	TVS <i>(a Private Company)</i>
Banská Bystrica	STVaK	STVaK	Regional Jt.Stock Co./ New Regional Operator
Zvolen	STVaK	STVaK	Regional Jt.Stock Co./ New Regional Operator

Conclusions

Transformation process

7. In order to preserve the coherence of the current Government strategy for the water and sewerage sector, the most urgent issue is the satisfactory completion of the transformation process creating six autonomous, regional water companies. However, transformation itself is not the final objective: the creation of the new water companies must be accompanied by sufficient funding and appropriate management capacities, in order to be really viable and to facilitate the possible future participation of investors both domestic and foreign in the operation of the assets under PPP, as intended in the Government's strategy. This private sector participation is to be seen essentially as a concrete instrument to solve or at least to mitigate the persistent lack of investment funding for rehabilitation and upgrading.
8. Until the VaKs (and their six successor regional companies once transformation is completed) are financially viable, ambitious municipalities will have little choice but to remove their assets from the integrate and regional VaKs systems and operate and maintain them themselves. While popular, the long term viability of this option is not evident. Moreover, it could seriously jeopardise the implementation of the Government's national water resources strategy by encouraging the continued disintegration of the former regional companies. This trend, if allowed to continue, would introduce management difficulties and lack of coherence and also obstruct the necessary solidarity between different geographical sub-sectors with different costs for providing water and sewerage service.
9. One of the key factors driving the transformation process appears to be the Government's intention to reduce the scale of funding in the environmental sector. Notwithstanding other demands on limited State resources, the Government should recognize their important responsibilities in this sector including the continued provision of State funding for appropriate priority projects as well as facilitating cheap loans from the IFIs. The commercial banks should only be used as a "last resort". It should also be recognized that in the future it is member States who have responsibility for compliance with EC Directives.

Affordability

10. Significant differences exist in costs required to provide public water and wastewater services between localities and regions, and between rural and urban contexts. An adequate national policy on tariffs must ensure not only the transparency of the method for setting tariff structures but also the solidarity between profitable and less profitable zones in order to guarantee universal and equitable access to the water and wastewater services. This requires an assessment on the affordability of all proposed investments in the sector, at least at the regional level.
11. The Ministry of Finance currently sets the maximum tariff level for water and waste water invoiced to households. Individual Water Utilities must not exceed this cap but are free to set different tariffs for different customer groups. The practice to date has been for over-recovery of costs from industrial customers and under-recovery from domestic. However, and although tariff

increases have been put in force in the last years, information available indicates that the current average tariff level is significantly below the current average operating cost (the gap is estimated to be between 35 - 40%, not including provisions for rehabilitation/extension of the utilities).

12. Moreover, according to available financial analysis, all six ISPA projects require substantial increases in tariffs (up to 300% in some cases). Taking into account that macro-economic indicators suggest that present tariff pressure is relatively high already (the turnover of the water + wastewater sector was near 1% of the GDP in 2001), the social and political feasibility to effectively increase tariffs in the short and medium term appears doubtful.
13. While a future regulatory regime is already proposed for the water and wastewater sector, it is important that this regime is truly independent and properly funded. This regulatory regime must also have access to adequate instruments and tools, such as an updated assessment and evaluation of the water and sewerage market at national level. Such an assessment would provide to other relevant institutions of the sector, elements to determine where and how PPP could be utilised, together with the corresponding probable amounts of private capital injections.

PPP

14. While there is no evidence that any of the 6 ISPA projects covered by this mission have any direct private sector involvement at present (apart from the operation of the Trencin assets), the Government of Slovakia wishes to consider future private investment in environmental assets as a means of increasing the financing available and reducing its dependence on expensive commercial loans, but need policy assistance in this regard.
15. While the National ISPA Environment Strategy gave clear indicators of the level of state funding to be made available to ISPA projects, ISPA applications received to date did not reflect this. It is important that a clear funding strategy be established for the proposed joint stock companies being established under the transformation process to own the production assets, including adequate state funding, maximization of cheaper IFI funds (not included in any ISPA environmental project to date), proper tariff setting and using commercial bank borrowings only as a "last resort".
16. All environmental projects proposed for ISPA funding should be selected and evaluated by the Government of Slovakia using the same economic and other criteria used for selection and evaluation of all Government Capital Expenditure. These criteria should cover the financial and economic methodologies and techniques to be used to assess project viability and affordability and also official forecasts of necessary economic parameters.

Nitra case

17. The ownership of the Nitra WWTP (but not other water and sewerage assets serving Nitra) has been transferred from the state owned water utility, ZsVAK to the Municipality of Nitra. As the Financing Memorandum (FM) for this project names ZsVAK as the final beneficiary, there is a

need for this to be amended in the FM. ZsVAK came recently to an agreement with the Municipality and will continue to be responsible for the operation of the WWTP. In this context, we recommend that the current version of the financial Memorandum should be amended to show Nitra Municipality as the beneficiary, provided that it also satisfies the following conditions: (i) The Municipality, as owner of the asset, should negotiate contractual conditions with any operator appointed to manage and operate the WWTP ensuring that all financing costs, relevant economic rent and any other associated costs of ownership are to be recovered through the rent to be paid by the operator and that such operator will in turn be able to recover these and all other operating costs through the water tariff. (ii) At least until the wastewater treatment tariff reaches the level determined in the financial analysis attached to the ISPA application, the Municipality of Nitra should commit itself to take the appropriate planning measures to reserve part of the amounts available via the housing fund to cover the cost of interest and loan fees during the construction period, and to subsidise at least during several years the WWTP's operating costs. If these conditions can not be agreed, the alternative to reduce the pressure on the Municipality's finances is to increase the State grant for the project, currently at 12.5%, up to 25% as it is the case in other similar projects.

Trencin case

18. In the case of Trencin, the Consultant team was informed that the selection of the private operating concession was, "selected by a commission of the Dpt. of Control and Transition of State Owned Property of the Slovak Republic from a list of applicants". Documentation regarding the case revealed the operating status followed from the privatization of the operating assets, in which connection TVS had apparently been the only interested buyer.
19. The contract between TVK and TVS gives TVS 20 year exclusivity as operator and is accompanied with a TVS loan of up to 1 million Euro. The contract requires close co-ordination between the parties regarding major repairs and new investments, and the loan as well as the main part of the rent from TVS to TVK are earmarked for covering such costs. The contract allows TVS to include a profit margin of 15 % based on its operational costs, the operational costs, as well as the rent, to be covered by the tariff. As full relevant inflation is allowable annually on operational costs, there is no incentive for TVS to improve its operational efficiency. Allowing recovery of a 15% profit margin on unregulated operational costs may open up opportunities for TVS to make unreasonable profits, and is not in the best interests of the consumer. A detailed review of the conditions of contract between TVK and TVS is given in § 2.2.1.5.
20. Finally it is to be noted that the TVK/TVS contract concerns lease and operation combined with financing. It is a type of PPP scheme which combines elements of lease and concession and which is fairly widely used. It is considered to be most appropriate where there is scope for significant gains in operating efficiency but only limited need or scope for new investments. In other words, not ideal in the context of any of the six projects. We recommend that TVK, as Final Beneficiary, should renegotiate the contract with TVS in order to reduce the current advantages of TVS that may increase to a point where profits could be considered undue (refer

to detailed enumeration in § 2.2.1.5). At least a commitment of TVK on this matter should be asked for and made available in the very near future

Martin case

21. As mentioned before, further exceptional transfers of assets to municipalities could seriously jeopardise the implementation of the Government's national water resources strategy by encouraging the continued disintegration of the former regional companies. This trend, if allowed to continue, would introduce management difficulties and lack of coherence and also obstruct the necessary solidarity between different geographical sub-sectors with different costs for providing water and sewerage service. In this general context, and considering the Martin project, ISPA funds should be used to reinforce the SeVaK (North Slovakian Water Supply and Sewerage Enterprise, which is also one of the future six new share holding regional companies), and not only one of its subsidiaries. Moreover, the current proposed Final Beneficiary, as defined in the Financing Memorandum, has no assets and has not operated yet as a Company. We recommend that the Final Beneficiary in the FM should be changed, and this role should be given to the current SeVaK. However, in the perspective of reinforcing the SeVaK as precursor of one of the new regional companies, it should be also convenient first to assess the priority of the Martin project in the more general framework of the SeVaK development.

ISPA projects selection and policy/priorities

22. In response to the various situations encountered by the Consultant team, a prioritized set of recommendations has been proposed (see chapter 4). These recommendations address specific areas of risk for the protection of European investments, as well as the need for PPP and policy advice. In addition, as discussed in the March 8th presentation, the review of the present situation suggests the need to re-address the environmental investment strategy and update the priorities.
23. The current environmental ISPA strategy sets out broad guidelines for prioritizing the wastewater investments but does not provide any details. Furthermore, the prioritising of future ISPA wastewater projects would benefit from taking proper account of the Water Framework Directive requirements generally and specifically in relation to fully integrated water management including downstream water use.

1 INTRODUCTION

1.1 PURPOSE AND SCOPE OF THE MISSION

This report concerns six environmental ISPA projects in Slovakia. The consultant's TOR involve several points, including documenting the previous and current ownership of assets related with these six projects, an estimate of the ongoing or future transformation of the ownership of the assets, and a description of the proposed ownership structure, including whether a part of the ownership has been or may be given to private investors. The TOR call also for similar descriptions of new or envisaged water management structures. In the case that water management was or may be given to a private company, the terms and conditions were to be summarized and an estimation given as to whether is a scope for making undue profit. Conditions under which any private operating concessions were awarded are to be described. Lastly the TOR require the Consultant to formulate conclusions and recommendations on (i) corrective measures necessary to protect European ISPA investments, (ii) the need for Public-Private Partnerships (PPP) advice, and (iii) the need for policy advice to the Slovak authorities.

The work included a two week mission to Slovakia by a team of seven international Consultants - including engineers, economists, legal and procurement experts - supported by a local legal counsel. The team visited each of the six ISPA projects and held numerous meetings with national, municipal and water sector authorities (refer to Appendix 1 for a full list of meetings). The team collected extensive documentation on the status of the six ISPA projects and on the ongoing transformation of the water sector in Slovakia. Initial conclusions have been elaborated based on this information, and were presented and discussed in Bratislava on March 8th 2002 with relevant Slovak and EC officials. While a comprehensive overview of the situation was given, despite all efforts made by the team, it was not possible to obtain specific documentation clarifying certain issues regarding commercial loan agreements and the award of a private operating concession in Trencin. As a result, it was agreed that officials from the Ministry of Environment should assist the Consultant in obtaining the required documentation. It was requested that this information is provided by March 15th. Some documents were effectively sent to the Consultant, and the subsequent analysis and results are included in this Final Report. In the meanwhile, a complementary mission was organized in order to asses the long term impact on the financial viability of the Municipality of Nitra if it were to become the Final Beneficiary for the proposed ISPA funded rehabilitation and extension of the city's WWTP. Conclusions and recommendations issued from this mission are also included in this Final Report.

1.2 STRUCTURE OF THE REPORT

An overview of the Slovak water and sewerage policy and legislation is given in Chapter 2, including a description of the current transformation process, the current Government policy concerning PPP in the sector, the effects on ISPA strategy, and the Consultant corresponding observations. Chapter 3 covers specific information concerning the six ISPA projects, according to data collected during the site visits and the answers to the questionnaire addressed to each final

beneficiary (see Appendix 2). Conclusions and recommendations on all the issues identified in the TOR are detailed in Chapter 4.

1.3 DISCLAIMER

The Consultant team has done everything reasonable to establish the relevant facts including policies and exceptions to those policies in accordance with the TOR during its mission to Slovakia and believe the situation to be as presented in this Report without any significant uncertainties. As indicated above, the team has held numerous meetings, collected extensive documentation, and visited ISPA beneficiaries in each of the six municipalities. In addition, key issues have also been discussed with all relevant Ministries and other parties including the EC Delegation. In many cases, follow up meetings have been held in order to resolve discrepancies or confusion and requests for additional documentation and clarification have been made. In spite of these efforts it has not been possible to obtain information clarifying all unresolved issues during the team's stay in Slovakia.

Given that they have already been approved by the Commission, the Consultant team has not revisited the assessment of the six ISPA WWTP applications themselves in depth. However, in response to a number of apparent weaknesses (common throughout the ISPA applications from Accession Countries in the Consultant Team's collective experience), a series of recommendations concerning future ISPA applications have been made. Nitra represents a special case where the final beneficiary on the Financial Memorandum requires modification. As such, it is recommended that the economic and technical viability of the new final beneficiary be reviewed.

Finally, some recommendation are made regarding Government Policy. Some of the recommendations may be part of Government policy already, but not available in the literature reviewed during the assignment.

2. OVERVIEW OF SLOVAK WATER AND SEWERAGE POLICY AND LEGISLATION, AND ISPA

2.1. RELEVANT MINISTRIES

The ministry with main responsibilities for the sector is the Ministry of Agriculture, who has the responsibility for overall policies and legislation concerning water resources. The Ministry of Environment is for reasons of the heavy environmental component also an important partner. The Ministry of Finance sets tariff limits according to the current Act No. 18/1996 on Prices, and its resolutions are published in the Official Gazette. It is planned that tariffs will be regulated until the year 2006. In connection with the transformation process, the Ministry for Privatisation, who coordinates and approves privatisation projects and the National Property Fund, who executes these projects, play a crucial role.

2.2 LEGISLATION

2.2.1 Legislation concerning ownership and selection of operators

To determine the degree of transparency in the transformation of each of the wastewater facilities, including both property and operative aspects, the following questions are relevant:

- How is ownership of property secured?
- How are State owned assets transferred to others, including municipalities?
- Under what conditions can municipalities and private companies take decisions regarding transfer of property?
- Who selects the operator and in what manner?

It must be noted that the Slovak laws are in a state of transition. In such a context, the views and opinions expressed below are based on the best available information and experience elsewhere.

2.2.1.1. Transfer of property. The general rules for transfer of property in Slovakia resemble the ones known in the rest of Europe. Thus, a distinction is drawn between "immovables" (land, buildings) and "movable" assets (machinery, tools, vehicles etc.). No distinction is made between State property and private property.

The transfer of ownership is relatively formless as regards movables. Transfer of ownership of "immovables", on the other hand, requires first of all a written contract between the parties. The Slovak Civil Code defines immovable as land and the buildings joined to the land by the solid foundations. The component of the immovable is everything belonging to it and which cannot be split off without damaging the immovable. The building is not a component of the land but an immovable in its own right.

According to the Act 162/1995 on Real Estate Registry (Cadastré) the immovable property right is created, changed or terminated upon registration in the Cadastré book. Registration of ownership covers not only the building or the plot of land as such but also fixed installations, machinery, etc.

The registration procedure is regulated in detail in the above Act. A registration is according to the law not supposed to take longer than 30 days. Several cadastré offices are not practically able to meet this requirements. The registration system is well established and is considered by Government officials to be quite reliable. This is confirmed by the design and level of detail of the sample registry extracts, which were examined during the mission. The extracts were annexes to an agreement on transfer of property between the National Property Fund and the municipality of Nitra. This agreement was clear and reflected normal practices in this field.

2.2.1.2. Transfer of ownership of State property. Special procedures are required according to Law No.92/1991. Essentially, any transfer involves the government body administering the state property, the Ministry for Privatisation (MiP) and the National Property Fund (NPF).

In the typical case of transfer of the assets of a State enterprise, the founder of the enterprise (the competent Ministry) submits a privatisation project to MiP. The project contains *inter alia* specifications of the assets in question. MiP essentially verifies the ownership details, evaluates the property and issues a decision on the privatisation. This decision also specifies the approved privatisation method, which can be either direct sale, public tender or public auction. The decision on privatisation through direct sale to the pre-selected buyer is required to specify the procedure for selection. Decisions on privatisation through public tender or public auction can be approved solely by MiP. Decisions on privatisation through direct sale have to be approved by the Government. Decision on the privatisation of an enterprise, which is "by nature a monopoly", is always approved by the Government after parliamentary consultation.

The above procedures are regulated by specific legislation. Public auction is regulated in the Governmental Decree No. 568/1990 Coll. on Public Auctions in transferring the state owned assets to other legal or physical persons. Public tenders are regulated in article 281 et seq. of the Commercial Code.

NPF is the body who effectively executes the transfer. Transfer of assets to a municipality is specifically mentioned as an option. The assets can be transferred to the Municipality direct or NPF may form a joint stock company and transfer the assets to this company. The shares of this NPF-owned company are then the subjects of the transfer.

After the transfer, the State enterprise in question is either "abolished" by the founder immediately following the transfer of assets to NPF or may continue to exist on the basis of the assets that remain. State enterprises are restricted in their right to transfer assets from the point in time where a privatisation project is planned.

Transfer of water and wastewater assets free of charge to the municipal sphere is not privatisation, but the law also covers this type of "transformation". Because of the monopoly nature of the transformation within this sector, the Law on Large Scale Privatisation also comes into play.

This process does by its nature not lend itself to tender procedure. The Government has accordingly - and because of the scale of the transformation - taken the necessary decisions by means of Resolution 35/2001 and subsequent Resolutions 217/2001 and 542/2001. These resolutions set out the overall reasons/criteria for the transformation of water facilities and specify the general approach. No specific reasons for the approach chosen in the cases of Nitra or Komarno are provided.

In the case of Trencin, the transformation took place according to a set of Government and Parliament resolutions issued during the period 1995 – 97. They were specifically aimed at the water sector and were perceived as exceptions from the normal procedures of Law 92/1991 on Privatisation. Essentially, the rules lay down a so-called “special concept” whereby infrastructure assets serving one municipality were to be transferred free of charge to the municipality. When such assets served several municipalities the free transfer went to a jointly owned company, provided all municipalities agreed. Operational assets on the other hand could be sold to such municipal companies at a so-called “balance price”. In case such companies are not interested, the assets would be subject to the normal procedures of Law 92/1991.

The documentation shows that the decision in the Trencin case was approved on Prime Minister level. However the documentation does not in a clear manner show the reasons behind the “special concept” but describes the Trencin case as a pilot project.

Comment: The specific case of Trencin

In one specific case, namely that of Trencin, the transformation of assets from State level to the company owned by the municipalities, i.e. TVK, was accompanied by a parallel privatisation, whereby operating (i.e. "movable") assets were transferred to TVS against payment. This case is therefore special because of the isolated transfer of operational responsibilities beyond the municipal sphere.

The documentation shows that in late May 1998 the Ministry of Agriculture issued an opinion on direct sale of the Trencin operational assets “to a predetermined interested party”. The implication was therefore that the municipally-owned TVK had had no interest in acquiring the assets and that the normal procedures of Law 92/1991 therefore were used. This might be the reason why the decision needed to be approved on Government level.

A proposal for privatization in this manner was then submitted to Ministry of Privatisation late June the same year and information about the submission was then publicized in the national press in the start of July. It is not clear whether the publication was an actual call for tender but a few days later an expression of interest from TVS was received. No other expressions of interest were apparently received.

Towards the end of July, the competition authorities issued an opinion on the privatization, which presumably also covered the proposed manner of tender and they had no objections.

In the course of July and August the sale to TVS was approved. There had clearly not been established any selection or award criteria in advance. In the final decision the reasons for selection of TVS was firstly, that it had been the only party showing interest in buying. Secondly, that TVS has the qualifications to operate and that the business plan was of good quality. The decision is not subject to administrative or judicial review.

2.2.1.3. Decision-making in municipalities and joint stock companies. There is a special law (Act No. 138/91 on Municipal Assets) which sets requirements for the handling of municipal property. The overall obligations of municipalities in this respect are to 1) use and preserve the assets, 2) protect them against damage, destruction, loss and misuse, 3) use all legal instruments and procedures to protect the assets and 4) keep account of the assets according to the relevant legislation. The law allows municipalities to transfer the assets to a foundation/organisation, which they have established (and therefore control) or to a commercial company, including a joint stock company. The latter requires approval from the Municipal Council. The Law must be understood as requiring that approval from this political level is obtained for any transfer beyond the legal sphere of the municipality. Therefore, transfer of municipal property can take place but requires a certain political consensus.

In cases where the assets belong to a company owned by one or several municipalities, the status of the assets can be affected in two ways:(1) the company may take a decision to sell the assets, or (2) the majority of shares shift from the municipalities to private persons.

Joint stock companies and other commercial companies are regulated by the Commercial Code (Act. No. 513/1991). The rules correspond to a large extent to the ones prevailing in the rest of Europe. The position of minority shareholders depend to a large extent on the decision powers allocated to the General Assembly. These powers are clearly defined in the Commercial Code and concern for example all decisions regarding the increase of the registered capital, public sale of shares, sale of significant parts of the assets and liquidation and finally of course the amendment of the company Statutes. In other words, any substantial transfer of assets and new emissions of shares require the involvement of the General Assembly. The Statutes can go beyond the law and allocate more power to the General Assembly and requirements regarding a particularly high majority can be introduced as a means to protect minority interests.

The ability of shareholders to sell their shares to persons outside the company depends on the type of shares. If shares are so-called registered shares (as opposed to bearer-shares), the sale requires that the new owner be recorded in the company's list of shareholders. The Statutes will consequently often state that any sale of shares requires the consent from the other shareholders, eventually coupled with an obligation for them to buy the shares. The shares in TVK (Trencin) are in fact protected in this way.

According to information supplied at the start of the mission, a set of general standard statutes for the future municipal owner-companies were envisaged. However, it appears that the responsible body, NPF, has not taken such initiatives yet. It could of course be said that such a standard would

have limited value, since it is in the power of the company to change them. The power in question is however according to Slovak company law in the hands of the General Assembly. Changing of Statutes is therefore not that easy and will automatically trigger debate amongst shareholders.

When generally considering the risk of assets going astray from municipalities or joint stock companies it should be recalled, that the individual pieces of machinery are part of the property sphere of the buildings/installations and therefore subject to the fair degree of transparency of the registration system (see §2.2.1.1).

The above risk will be greater the more the decision power is in the hands of specific persons or interests. The chance of that happening is obviously less in the proposed regional water companies following the transformation process, where the ownership of specific assets is replaced with a non-specified share of the total water and wastewater infrastructure within a certain geographic area. But even in companies the composition of municipalities may result in voting power being concentrated on one or a few large municipalities. The Slovak company law contains some minority guarantees to protect against abuse of majority power and further guarantees could be included in the Statutes.

The ultimate protection of assets can only be obtained by introducing in for example the new law on Water Supply the requirement that any transfer of assets be approved in advance by the future Regulatory Agency, see §2.2.4.

2.2.1.4 Selection of operator. The system existing up to now had ownership of the water and wastewater assets as well as their operation entrusted to state enterprises founded by the Ministry of Agriculture, the so-called "VAK's".

The current transformation process will in virtually all cases result in a separation of owner and operator. In most cases, the interests behind owner and operator will be identical, because the municipalities will own both (through the new regional Joint Stock Companies). The separation gives rise to essentially two questions: Is the owner required to use specific tender procedures for selecting a new operator and what is the situation for the selected operator?

The public procurement rules will need to be examined first. The first Slovak rules on public procurement were introduced by Act No. 263/1999 on Public Procurement. The law aims at implementing the EC directives and includes the normal catalogue of award procedures (public tender, select/restricted tender and negotiated tender). The responsible authority is the Office for Public Procurement, which is a Central State Administration Body with the head of the Office (President) and the deputy head (Vice President) being appointed directly by the Government. The Office is therefore in terms of hierarchy in a strong position towards the ministries, etc.

In line with the EC directives the law covers amongst others any legal entity conducting activities within water management by operating water systems and sewerage and water treatment plants, when the municipality exerts decisive influence over the legal entity in question.

The concept of decisive influence covers in line with the directives the cases where the municipality owns a majority of shares or appoints more than half of the statutory/control organs of the legal

entity. However, the Slovak law goes further than the directives by including also cases where a legal entity (including a privately owned one) is carrying on the activity using municipal assets on the basis of leasing, lending or administration agreement.

The EC directives only include private entities in cases where they benefit from a special or exclusive right given by the public sector. The very important point of Slovak law is that any operating company using municipal assets will be covered by the public procurement rules. They are because of such agreements considered to be within the influence of the municipality and therefore required to use tendering procedures in its subcontracting activities.

The public procurement rules are aimed at the more straightforward relations with the private sector, where specific goods, services or works are needed and where the awarding entity pays the price and takes over the deliveries without further involvement of the private enterprise.

The types of long-term relations with more complicated sets of mutual obligations between owner and operator of water infrastructures are only partially covered by public procurement rules and only as regards certain publication formalities. This does not mean that such contracts fall outside EC law. The directives are merely expressions of general principles of EC law, such as equal treatment, transparency and competition. These principles are by their nature not pinned out in specific procedural requirements, but must nevertheless be applied when the public sector deals with enterprises.

This together with the generally positive effects gained from traditional public procurement has particularly in recent years prompted many EU member states to apply rules similar to the procurement directives to contracts on for example concessions and public private partnerships, which are not or only partly covered by these directives.

A similar trend as regards concessions can be detected in Slovakia. There is a Law No.119/1996 on concession procurement, which applies to the specific case of private participation in the construction, maintenance and operation of certain buildings designed to serve the public interest. Water facilities would undoubtedly be covered by the law. The main procedure for selecting the concessionaire is public tender. The law strictly defines the cases when direct sale can be used. The public tender is announced in Slovak Commercial Gazette and if applicable also in the foreign press.

Despite these provisions and the principles they embody, the procedures used so far for selecting operators in the projects reviewed have not in the perspective of EC law allowed for sufficient competition. Lack of competition, for example as a result of owner-operators being too closely linked, may concretely result in unnecessary/unfair cost increases. When procedures have been used which in reality only has resulted in contacts with one prospective operator, the risk of undue contract terms increases, see § 2.2.1.5.

Both in the case of Trencin and Komarno, the selection of operator is intertwined with and virtually predetermined by the transformation process as such. TVS obtained de facto its operator status in a privatisation closely linked to the transfer of assets to TVK, see §2.2.1.2. KOMVaK was

established as a spin off from another municipality owned company CIVITAS for the specific purpose of operating the assets transferred to the municipality.

The water sector has up to now been characterised by a structure of state enterprises, which owned and operated the water infrastructures within their respective regional spheres. It could be argued that a tender, at least on the national level, would not lead to useful results because of the monopoly/partitioned nature of the market. The new draft law on water resources launches a global licensing system, which is presumably aimed at breaking down the partitioning and thus facilitating competition between operators, (see further in 2.2.3 and 2.2.4.)

2.2.1.5 Conditions for private operators and the TVK/TVS agreement. The only one of the six projects with a private partner involved is Trenčín, where the privately owned company TVS - as a result of the privatisation process described above in §2.2.1.4 - was de facto selected as operator for the municipality's owned TVK. The agreement between TVK and TVS was made in October 1999, one year after the privatisation. The terms of the agreement were therefore apparently not a criterion in the selection process and must therefore have been negotiated separately ex-post.

Overview of the Agreement between TVK and TVS

Essentially, the agreement gives TVS a 20 year exclusive right to operate the infrastructure assets owned by TVK against payment of rent. TVS performs routine maintenance on a cost plus fee basis, which is included in the tariffs, which TVS bills and collects. Rent and tariffs are decided by TVK after consultations with TVS and in accordance with detailed provisions in the agreement.

As part of the contract, TVS provides a loan of up to 1 mio. Euro to TVK. Interest rate for this loan is not indicated in the available documents. This loan as well as the main part of the rent is earmarked for funding major repairs and investments of the water infrastructure. TVS co-operates with TVK in setting up these plans. For the subcontracting required for implementing the plans the agreement draws a distinction between A- and B-contracts. A-contracts are funded through the rent and the contracting partner is TVS. B-contracts are funded through other means, including the TVS loan and here the contracting partner is TVK. In both cases TVS is responsible for the preparing of subcontracts and supervision of subcontractors, and TVS is involved in the selection of these subcontractors as well. In the case of B-contracts TVS is entitled to a management fee calculated as a percentage of the works in question.

In the case of A-contracts TVS has the option to do the necessary works itself without involving a subcontractor. For all A-contracts it is TVS who pays the subcontractor up front. TVS then invoices TVK for the subcontracting, including an organisation fee equal to a certain percentage of the subcontracting.

As regards liability, TVS is not liable for sufficient supply of raw water of adequate quality or – as a point of departure - for the current/future state of the infrastructure, for example because planned major repairs or investments could not be made due to lack of

funds. TVS is only liable for consequential damages in case of intent, gross negligence or gross breach of operating rules (annexed to the contract). Some of these provisions are not in accordance with the Slovak Commercial Code, which prohibits exclusion in advance of liability for future damages. The total liability for TVS has been limited to a “maximum aggregate liability” of 20 mio. SKK.

A number of cases of material breach has been defined where TVK can terminate the agreement prior to expiry. They concern general and partial interruptions, repeated failure to provide water of sufficient quality or drops in water pressure. Material breach presupposes that the events have not been caused by insufficient infrastructure or lack of raw water.

The agreement can be negotiated when changes of circumstances (such as changes in legislation) “materially alter the economic and financial balance of the agreement”. If TVS and TVK can not agree on required amendments each party can terminate the agreement.

The contract concerns lease and operation combined with financing. It is a type of PPP scheme which combines elements of lease and concession and which is fairly widely used. It is considered to be most appropriate where there is scope for big gains in operating efficiency but only limited need or scope for new investments. In other words, not ideal in the context of any of the six projects.

The following is an overview of the basic financial facts of the agreement.

Overview of Tariff Calculation - TVK/TVS Agreement

X + R

X = Operating Expenses including,
All costs of TVS in performing the Services and performing Routine Maintenance
Cost of depreciation of all TVS assets
15% profit margin

R = Rent (covered in Annex 6 – not seen)
Financing of Major Repairs and Investments including debt service of TVS Loan,
And all other TVK loans for MRI plan
Plus TVK overheads.

Full annual inflation based on

Electricity	17%
Labour	32%
Construction	25%
CPI	26%

X and R are split between Domestic and Other users based on volume supplied.

(Worked examples are included in Annex 7 – not seen)

Long Term MRI Plan (Included in Annex 1 – not seen)

Long term Major Repairs and Investments plan prepared by TVS and approved by TVK describing Major Repairs and Investments necessary during the first years of the Term for the

purpose of making or keeping services and infrastructure in the Territory compliant with Slovakian & European Standards in respect of portable water and wastewater treatment and to improve the quality of service to subscribers.

Annual MRI Plan

The plan signed by both parties setting out the Major Repairs and Investment to be implemented in any given year. This plan will be financed from Rents (Use of Rent for investment by way of A-Contractor contract between TVS and a supplier, contractor, engineer, consultant), and Other Funds. Use of Other Funds (TVK) for B-Contractor, contract between TVK and a supplier, contractor, engineer, consultant).

Long – Term Financing Strategy for implementing MRI is revised annually and used in calculating Rent.

Where the amount of Rent, plus any grants available to TVK plus, in the case of the MRI specified in the TVS Loan Agreement to be financed through the initial TVS Loan – the proceeds of the Initial TVS Loan will not be sufficient, TVS shall assist TVK in providing for any additional loan to finance the shortfall in order to obtain in particular the assets to be payable out of the Rent to pay debt service.

Overall budget for MRI:

Cost of implementing MRI funded from Rent including organisation fee

Cost of implementing MRI funded from Other Funds including project organisation fee

Contingency of 10% of aggregate of above costs for cost overrun

Debt service payable to TVK in respect of initial TVS loan plus in respect of any additional loan as notified by TVK to TVS.

It has been said about this type of contract that “their administrative complexity and the demands they place on governments for commitment are nearly as great as those of concessions, so a lease is a much bigger first step than a management contract.”

As regards risk, the following point has been made: “In these options for private sector participation the contractor retains the tariff revenue it collects from customers in exchange for operating the water and sanitation system. This arrangement provides an incentive for the contractor to improve the efficiency of operations and investments. But in the presence of monopoly power, it also creates a risk that the contractor will reap windfall profits by charging excessive tariffs or reducing service quality. “

Generally, the risk of unfair profits decreases to the extent that a contract encourages and even rewards operating efficiency. In addition, a fair share of the risk must be borne by the operator in return for the flow of tariffs. Whether this risk goes beyond what is acceptable depends on the actual conditions of the country/region. The conditions in Slovakia are presently characterised by lack of capital and an apparent preference for expensive commercial loans to cheaper EBRD/EIB facilities. The scope for covering costs over the tariffs is limited due to the legislative “cap” and political constraints.

It is difficult to estimate whether any of the parties – TVK or TVS – reap particular benefits at present. In the long term, however the 20 year exclusivity will give TVS an advantage on an increasingly competitive market for operators, see §2.2.4 and §2.6 on future market regulation.

Moreover, the contract explicitly regulates the situation where TVS and TVK take over neighboring infrastructures, thus expanding the monopoly.

In addition, the following elements of the agreement (ranged according to subject rather than importance) may increase the advantages to a point where profits could be considered undue:

- The tariff covers *inter alia* operating expenses, major repairs and investments plus a fixed 15% profit margin calculated on the basis of these expenses. The reasonableness of such a fixed purely cost-related profit will depend on the efficiency of costs. There is no element of the calculation method which encourages efficiency. On the contrary, the agreement allows TVS to recover full relevant annual inflation. Normally, and in order to encourage efficiency, only a partial adjustment is allowed.
- While TVS bears the commercial risk associated with tariff collection, the agreement does include a clause which allows for a review of major repairs and investments (annual MRI Plan), where tariff collection is less than forecast as being necessary for TVK to meet its financial obligations. Actual operating costs from the previous year are included in annual tariff adjustments to ensure that TVS's profit margin does not vary from 15%.
- The tariffs cover debt service on the TVS loan. Debt service is not an unusual component. However, since the lender is TVS the overall reasonableness will depend on the conditions for the loan. The loan agreement is annexed to the TVS/TVK agreement but was unfortunately not available to the Consultant team.
- The TVS management and organisation fees in connection with subcontracting are fixed percentages of the contracts in question and without mechanisms to encourage reduction of TVS-costs in this respect.
- TVS runs the daily operation and is at the same time implementing major repairs and investments. There is an inherent risk in these schemes of undetected transfers between these two functions. The risk is somewhat minimized by the fact that the TVS subcontracting will be covered by the Slovak public procurement rules, even though TVS is a private company, see § 2.2.1.4.
- It is probable - and critical for maximizing efficiency - that the operating guidelines and performance standards for TVS, which are annexed to the agreement, have been to a large extent defined by TVS.
- The agreement defines cases of material breach and the scope for TVK to react. The agreement does on the other hand not provide TVK with measures in cases of delays in maintenance or construction, in other words cases of anticipated material breach. This may be linked to the fact that TVK has only limited powers to monitor the activities of TVS (annual TVK-inspections of infrastructure and annual reporting from TVS).

2.2.2 Current regulatory responsibilities

There is currently a Government Regulatory body for regulating prices in certain privatised Utilities including the energy sector but not the water and wastewater sector. This existing Regulatory body is expected to take on the regulation of the water and wastewater sector following the completion of the transformation process and the passing of the Act on “Regulation of network industry (Act No. 276/ 2001 on regulation of network branches). The state regulation in network branches includes the following key functions :

- Decision-making in connection with commercial conditions related to regulated activities.
- Issuing preceding approval for construction, reconstruction or liquidation of objects designed for regulated activities.
- Decision-making about access to the networks according to special regulation
- Execution of state supervision on regulated business activities.
- Execution of Price regulation (which shall come into force on 1 January 2003)

The Ministry of Agriculture publication “*The Concept of Water Policy of the SR till 2005*” refers to regulation in relation to price control (p13) and to the establishment of a “regulator” to secure the cooperation of producer and customer in the field of prices for water management products.

In the field of water mains and sewerage systems, the document continues: “*Price setting will be done by the regulatory authority. Framework principles are outlined in the act on regulation of network industries that is under preparation (being prepared by the Ministry of Finance)*”

Comment: The new regulatory body will need to determine prices (i.e. tariffs) equitably between producer/operator and customer in accordance with best international practice. The Regulatory body will need to be adequately funded and independent with some flexibility for action as circumstances inevitably change. The regulatory system adopted can effect the willingness of the private sector to participate and the costs of its participation.

2.2.3 Future Regulation of the Slovak Water Industry - The transformation process

At the time of this Report the Slovak water industry is finally undergoing a radical transformation following a long gestation period (since 1994). It seems that this is triggered by the general policy of decentralisation, including a change of legislation in the late nineties, whereby the responsibility for drinking water and effluent wastewater quality was moved to the level of municipalities.

The transformation is to be accompanied by a new Law on Water Supply (LWS), which is presently under consideration in the Legislative Board of Government and. It seems clear that the Government will press on to have the proposal presented to parliament before June, 2002 in order to have it dovetail the transformation process.

The transformation process is described in Government Resolution No 35 of 17th January 2001 . A follow up Resolution No 217 dated 7th March 2001 sets the conditions and particular steps and deadlines. Essentially the transformation process comprises the following steps:

- Transfer of State owned water and wastewater assets to the National Property Fund (by end of June 2002)
- Establish six Municipal shareholding Companies and transferring the water and wastewater assets to those Companies without charge.
- Transform the existing five Regional water and sewerage authorities (VAKs) into six operating companies who will manage and operate the water and wastewater assets¹

Several “exceptions” to the transformation process have been permitted to take place by the Government notably in Trencin and Komarno (as two pilot projects in 1998) and in Nitra more recently A further exception not relevant to the current ISPA Applications was in Hlohovec Municipality (1998) The following goals of transformation are provided in Government Resolution No. 35:

1. *To ensure through Ministry of Agriculture the conditions of State shared responsibility for the development of water systems and sewerage systems as the obligations that arise from the Association process:*
 - *In the process of planning the regional development in the water supply systems, sewerage systems and water treatment systems in conformity with the State Water Management policy*
 - *In creating the conditions for the implementation of State sponsored programs in conformity with the State Water Management Policy and according to the tasks arising from the Association process in creating the favorable legislative conditions for the future development of the Public Water systems and Sewerage systems*
2. *After transformation the foreign capital investments are presumed, the form will be the increasing (of) the capital assets of the companies*
3. *To preserve the technological- operational functionality of the existing Water Systems*
4. *To employ the present staff of water companies in order to present the high professional skill level*
5. *To allow the fusion or creation of new companies while observing the conditions of preserving the technological-operational functionality of the new system and avoiding the unreasonable growth of living costs*
6. *All the municipalities can participate in the transfer of the assets*

The overall framework for the transformation process is as follows:

¹ Further details of the transformation of the STVAK Regional Operating Authority in Central Slovakia as provided by STVAK during our meeting in Banska Bystrica on 3^d March 2002 (and understood to be typical of the other five “VAKs”) are included in Appendix 3.

- The adoption of a river basin management approach to water management (in accordance with the Water Framework Directive 2000/60/EC)
- The harmonization of tariffs as far as possible between different regions

A further objective as described in the “*Concept of Water policy of the SR till 2005*” document dated June 2001 is to concentrate the funding of future water and wastewater investments on Municipalities’ and Associations’ *”own financial sources as well as other sources”*. Private sector participation in investing in the water and wastewater assets is expected to support this transformation process in the future as detailed in resolution No 35 item 2 as discussed in § 2.3.

Comment: The MoA Paper “Concept of water policy till 2005” clearly states that:

“The cost of water management investments will be covered by the owners” (p27)(i.e. the Municipalities not the Government)

“Financial resources would be dependent on the speed of the transformation process of VAK s.e. entry of foreign companies into their operation and development, on loans from both domestic and foreign banking institutions and last but not least from the financial possibilities of the of municipalities, depending mainly on changes in allocation of shared taxes. The volume of funds that would be annually requested from the state budget and from out-of-budget resources would be specified every year.” (p 29)

This “concept” as outlined in the document:

1. Appears to limit or absolve the Government from the responsibility to provide resources in the future for investing in the water and wastewater sector.
2. Implies the possibility of e.g. Build, (Finance), Operate and Transfer (BOT) type projects for financing and managing the construction and operation (i.e. the “development”) of new production assets. It is understood that this BOT type of approach may meet ISPA conditions. BOT could provide a suitable platform for getting priority investments funded with foreign capital via e.g. the international operating companies whilst deferring repayment of the investment through higher tariffs for a few years i.e. until the Slovak economy and more specifically the customers affordability have time to pick up in the future.

Private sector participation in investing in the water and wastewater assets is expected to support this transformation process in the future as detailed in resolution No 35 item 2 as discussed in § 2.2.4.

The transformation is to be accompanied by a new Law on Water Supply (LWS), which is apparently about to be ready for submission to parliamentary debate. LWS is still a draft and the following is merely an outline based on the most recent draft version from the end of February 2002. LWS basically moves the administration of water in under the same structures, which today exist for the energy sector. The center of these structures is a Regulatory Office for Network Branches, which has considerable powers to issue rules, including tariff calculation rules, to take decisions on access to the networks (presently electricity, gas and heat) as well as to supervise in general. LWS also introduces a special licensing system (see §2.2.4 below) and lays down a basic distinction between owner and operator of water and sewage systems.

The obligations of the owner are first and foremost to ensure continuous delivery of water and to ensure the required level of environmental requirements. He must in addition fulfil the relevant targets of development plans. It is possible for the owner to operate the water facilities if he has the required license. Otherwise, he must contract to an operator. The draft law does not require a certain selection/tender procedure. It is apparently assumed that the rules on public procurement of services would apply. The draft specifies *inter alia* that the operator must:

- operate the system according to the technical requirements of water related legislation as well as to special municipal requirements and the requirements in the contract with the owner (the draft does not propose anything regarding the content of this contract);
- provide the owner with information on water quality;
- service (i.e. maintain) the water system;
- include other water systems under the operation when so requested by the competent regional authority (this is intended to cover the situations where a "neighboring" operator goes bankrupt or otherwise becomes unable to perform his obligations).

Comment: It is apparently the intention in this division of responsibilities to have the owner as mainly responsible for operations in relation to central/regional authorities (i.e. the Regulatory Agency). It could be argued that the right of these authorities to replace the operator points towards the opposite conclusion.

2.2.4 License of State Water Management and Sewerage companies

The Bill on Public Water Supply and Public Sewerage, which has been submitted to the legislative Council of the Government for discussion, details the license for the operation of the assets of future municipality water management companies. The Bill is without prejudice to the operation Act No. 119/ 1996 Coll. on licensed based Procurement, as amended by later regulations, it enables the construction and operation of water and wastewater management establishments, and upon the lapse of the period for which a license is granted, the structure will be handed over to the procurer.

- The License-granting procedure is detailed in the Bill on Public water supply and Public Sewage. In principle, it may be noted that a Regulatory Office will take the decision for Networks Branches. This later is currently a State administrative body. It defines the regulatory policy and the instruments for the implementation. It will select one of the professionally competent candidates.
- The applicant shall be selected without tendering procedure. The selected candidate shall fulfill some conditions such as residency, diploma, professional ability, exam.
- The License granting cannot be assigned and it is valid for the whole Slovak Republic.
- The License granting cannot be sold, encumbered or transferred neither can be its administration handed over to a third person and be leased or borrowed to the third person. The procurer cannot transfer the ownership of the Public Water Supply and Public Sewerage to a another legal entity or physic person during the license period.

- The License period is stipulated in the license, under which the licensee operates the Water Supply and Public Sewerage. Its length depends on the profitability of the operated Water Supply and Public Sewerage and it shall be at least the period which secures the restoration of the finances invested to construction and operation and reasonable profit.
- As to the relationship with the owner of the State owned assets to the ownership of municipality, it shall make sure that the quality of water and effluent wastewater complies with the related regulation . It shall ensure proper planning of networks, it shall keep records of assets, shall provide all information related to the investment plan to the operator. The owner shall be able to operate the assets only if it has been granted a license. If it is not the case, an operator currently acting as a licensee shall operate the assets.
- As to the operator, it shall operate the assets according to the Bill on Public water Supply and Public Sewerage systems, as to the Municipal rules as well as to the Agreement between the parties (no contrat cadre is provided). The Operator shall maintain and develop the professional level of its employees.
- The Regional Office to the Public Administration Authorities in Public Water Supply and Public Sewerage Systems may ask the said operator to take over the Management of a neighboring water system (in case of bankruptcy).
- It is actually the intention of the legislator to emphasis on this responsibility of the owner in relation to both authorities.
- The license cannot exceed 10 years.

2.3 GOVERNMENT POLICY ON WATER AND WASTEWATER PPP

Government Resolution No 35 of January 2001 on the Transformation of the State Management of Water and Sewerage Companies to Municipality ownership gives five goals including as the second goal:

“2. After transformation, the foreign capital investments are presumed, the form will be increasing the basic capital assets of the companies.”

Comment: It is not clear what form the investment in assets using foreign capital could take. It is assumed that this could take the form of Build Operate and Transfer (BOT) schemes. Such schemes have been applied elsewhere and will reduce the scale of State funding. However crucial affordability issues and funding issues discussed elsewhere in this report will need to be addressed if BOT schemes are to be adopted successfully in Slovakia.

This goal is confirmed in the Ministry of Agriculture *“Concept of Water policy of the SR till 2005”* document dated June 2001 on page 22, which sets out the following aims in connection with the Transformation process:

“-Transfer the State owned assets administered by water management and sewerage enterprises (i.e. the current VAKs) to municipalities that will enable municipalities to perform their legal

function - to provide for water supply, connection to the sewerage system and waste water treatment,

-after transformation to create preconditions for entry of foreign capital into reconstruction, upgrade and development of these assets”

On page 27 of the above document it states under “*Estimated cost of Implementation of Plans contained in the concept*”:

“Own resources

*Transformation of state enterprises for water and sewerage systems will affect the status of tangible fixed assets. Responsibility for development in drinking water supply and sewerage will be transferred to municipalities and funding of development and operation will be made from **own sources of municipalities and associations**, as well as other sources.*

State Funds

Provision of grants will depend on creation of sources of this fund. In this field it can be expected that development can be supported also in the form of revolving funds

Loans

As a follow up to the previous years development of water management will depend on simplification of access to SKK denominated loans and foreign currency loans. Transformed entities would have more opportunities. To what extent the access will be simplified would also depend on the development level of loan activities by the commercial banks, development of situation in the field of public funds and increased capability or repay loans, as well as international position of the Slovak economy.

*With the introduction of the new owner relations **the cost of water management investments will be covered by the owners.**”*

(Note Section in **bold** are shown thus in the MoA document)

Comment: One of the key factors driving the transformation process appears to be the intention to reduce the scale of Government funding in the environmental sector. Notwithstanding other demands on limited State resources, the Government should recognize their important responsibilities in this sector including the continued provision of State funding for appropriate priority projects as well as facilitating cheap loans from the IFIs. The commercial banks should only be used as a last resort. It should also be recognized that in the future it is Member States (i.e. National Governments) who have responsibility for achieving compliance with EC Directives and accounting for any incident where full compliance is not achieved.

2.4 SUMMARY OF ISPA PPP POLICY

As stated in the EU ISPA Manual, *“The involvement of private finance in the development of infrastructure is an important objective of Community policy...The use of ISPA resources in a public-private partnership requires verification of the existence of an appropriate legal framework and of appropriate regulatory conditions for this partnership, including the following aspects:*

- *Equal opportunity for all relevant companies in the same sector;*
- *Respect of competition rules in awarding concession;*
- *Respect of competition rules in awarding the investment contracts;*
- *Respect of conditions of the concession (service to consumers, maintenance, etc.);*
- *Absence of disproportionate remuneration on capital.*

While there is no evidence that any of the six ISPA projects covered by this mission have any direct private sector involvement (apart from the operation of the Trencin assets), the Government of Slovakia may wish to consider future private investment in environment assets as a means of increasing financing available and reducing dependence on commercial loans.

2.5 NATIONAL ISPA ENVIRONMENTAL STRATEGY AND NATIONAL ENVIRONMENTAL ACTION PROGRAMME

2.5.1 ISPA Strategy

As part of the ISPA process, the Government of Slovakia approved a National ISPA Strategy in 2000. This strategy outlines the procedure for selecting and prioritizing environmental projects for ISPA funding. This document also identifies the sources of funding which are proposed to co-finance these investments. This document anticipated ISPA projects to be funded as follows:

- ISPA 50-75%
- State Budget contribution 25% (Max)
- Budget & loans of municipalities 25%

Where State Funding is proposed it is only to bridge the gap created by the EC in approving ISPA funding less than requested. Table 2.1 summarises the financial profile of the six projects concerned by the present Report. The information given in this table illustrates the impact of lack of IFI funding and limited State support on the necessity for commercial funding.

Table 2.1
Financial Profile of the six ISPA Projects

Location	Eligible Cost €	ISPA Grant €	State Grant €	IFI Loan	Local Commercial Loan (€)
Nitra	10.354.200	5.177.100 50%	1.294.275 12.5%	0	3.882.825 37.5%
Komárno	8.043.700	4.021.850 50%	2.010.925 25%	0	2.010.925 25%
Martin	12.364.474	7.418.685 60%	1.697.250 14%	0	3.248.539 26%
Trencín	7.936.732	3.968.366 50%	992.092 12.5%	0	2.976.275 37%
Banská Bystrica	45.468.667	22.734.334 50%	11.367.167 25%	0	11.367.167 25%
Zvolen	10.967.050	5.483.525 50%	2.741.763 25%	0	2.741.763 25%
TOTALS	95.134.823	48.803.860	20.103.472.	0	26.227.494
	100%	51.3%	21.1%	0%	27.6%

Comment: The ISPA Strategy and applications are all silent on the issue of IFI co-financing. It is difficult to understand why expensive commercial loans are being used to finance ISPA projects when the EBRD, the World Bank, and others all provide funding for such projects at a much lower rate of interest. Appendix 5 includes a table showing the terms and conditions of the proposed commercial loans. It also contrasts the cost of proposed commercial borrowing with typical IFI funding. In all cases the cost of borrowing is more than double what one would expect from IFI funding. It has to be also noted that in the case of Banska Bystrica and Zvolen the lending back is relying on a guarantee from the Ministry of Agriculture that the final beneficiary, StVak, will remain financially viable. During discussions with officials in the Ministry of Finance it was established that negotiations are nearing completion with the EIB for the provision of a € 30 mio global facility for environmental projects. This provision will be made available through a state owned bank which will distribute it to projects with a capped mark up of 1%. This avoids the necessity for the provision of a Government Guarantee (the Government is constrained by its budget deficit to the amount of Government Guarantees it can make available to secure IFI loans). The EIB facility is to be welcome and similar funding from the other IFI's should be seek by the Government..

The ISPA Strategy prioritizes the wastewater sector projects according to a scoring system. The criteria for selection of priority projects is set out in section 6 of the Strategy.

Section 6.3 gives the following criteria for prioritizing wastewater projects:

- Reconstruction and upgrading of the existing wastewater treatment plants in municipalities above 2000 population equivalent (PE).
- Upgrading of the existing waste water treatment plants with technologies for removal of nitrogen and phosphorus
- Reconstruction of existing sewerage networks that are connected to waste water treatment plants that meet EU standards
- Construction of sewerage systems to be connected to waste water treatment plants that meet the EU standards
- Construction of new waste water treatment plants in agglomerations above 2000 PE.

Comment: In practice these criteria embrace all the requirements of the urban wastewater Directive. This Directive covers all plants above 2000 PE but generally imposes tighter discharge standards on bigger (i.e. “urban” plants) where the benefits to the environment are most effective. Thus the above “priorities” are in reality a restatement of the overall scope of the Directive. In reality the ISPA environment projects proposed to date represent the urban wastewater treatment plant upgrades or new plants serving relatively large agglomerations ranging from 30,000 PE (Trencin) to 163,000 PE (Banska Bystrica).

The criteria do not include any reference to either the new Water Framework Directive (2000/60EC). In some circumstances it may be necessary to include additional treatment e.g. disinfection of the final effluent where the water is used for bathing or drinking water abstraction downstream.

The criteria for ranking wastewater schemes may require updating in the light of recent EC Directives, specifically the requirements of the Water Framework Directive (which requires transposition of legislation in all Member States by 2003). Implementation of the Water Framework Directive is the subject of a number of forthcoming Twinning projects in Accession countries funded by Phare including the Czech Republic.

Section 7.1 of the strategy indicates that the selection of projects was done “based on the ‘Ranking List of Urgency of the Construction of Wastewater Treatment plants in the Slovak Republic’ prepared by the Research Institute of Water management”. It does not elaborate on the method adopted for allocation of points or any weighting mechanism but indicates that the point sources of pollution (i.e. the treated effluent discharge) were evaluated using multicriteria analysis (11 criteria) including: size of pollution source, discharged load, treatment process, type of pollution with emphasis on organic micro-pollutants and heavy metals, impact on human health, recipient and downstream water uses, biodiversity, etc. The selection of priority wastewater projects as set out in section 7.1 of the Strategy indicates that the Ranking List is harmonized with the NEAP II programme as outlined in the next section.

The six ISPA wastewater projects feature amongst the highest scores in the 95 cities included in the schedule as Annex A with the significant exception of Martin which is not scored. Priority wastewater projects associated with some other cities in Slovakia (e.g. Michalovce and Porad) score higher than the scores given for some of the other five ISPA projects.

2.5.2 National Environmental Action Programme

The Government’s National Environmental Action Programme (NEAP II) is set out in a document dated 2000 and approved by the Slovak Government Resolution No 1112 dated December 16th 1999. Section B of the report is entitled “Protection and Rational Use of Waters” covers water and wastewater investments for the period to 2003 and beyond. The projects are not prioritized. See section above.

2.6 SOME COMMENTS ON THE IMPLEMENTATION OF THE GOVERNMENT POLICY AND ITS EFFECTS ON ISPA PROJECTS

2.6.1 Affordability of the proposed improvements

The Ministry of Finance currently sets the maximum tariff level for water and waste water invoiced to households. Individual Water Utilities must not exceed this cap but are free to set different tariffs for different customer groups. The practice to date has been for over recovery of costs from industrial customers and under recovery from domestic.

For the future, it is proposed² that rational regulation be applied to:

- The price of surface water (i.e. raw water),
- The price of treated water and wastewater,
- Harmonizing prices for households and other users
- Setting conditions for charging for water force and used for electricity generation
- Setting binding conditions for recovery of costs related to activities realized in the public interest,
- Revising the system of funding water management development investments,
- Setting the principles and criteria for providing subsidies from the State Budget into water management operation and capital construction,
- Setting generally binding legal norms, dealing with the issues of receivables and payables.

The office of the regulator has yet to be fully determined (as mentioned in §2.2.2, there is some suggestion that responsibility for above regulation may be assigned to the existing regulatory authority or it could be vested in a separately appointed water regulator).

Although tariff increases have been put in force in the last years, information available indicates that the current average tariff level is significantly below the corresponding average operating cost (the gap is estimated³ at 35 - 40%, not including provisions for rehabilitation/extension of the water and wastewater assets).

Significant differences exist in costs required to provide public water and sewerage services between localities and regions, and between rural and urban contexts. An adequate national policy on tariffs must ensure not only the transparency of the method for setting tariff structures, but also the solidarity between costly and less costly systems/zones in order to guarantee the universal and equitable access to the public service. This requires an assessment on the affordability of proposed investments in the sector, at least at the regional level.

According to available financial analysis, all the six ISPA projects require substantial increases on tariffs (up to 300% in some cases). Taking into account that macro-economic indicators suggest that present tariff pressure is relatively high (the turnover of the water + sewerage sector was already

² In the Ministry of Agriculture document "The concept of Water Policy of The SR Till 2005" Bratislava, June 2001.

³ Information verbally given by the General Manager of ZsVaK, Bratislava.

near 1% of the GDP in 2001), the social and political feasibility of a significant increase in tariffs (by means of an increase of the Ministry of Finance set cap, see above) in the short to medium term appears at least doubtful.

While a future regulatory regime is proposed in the Government strategy, it is important that this regime is independent and properly funded to ensure full and equitable cost recovery. The regulator must also be provided with adequate information and tools, such as an updated assessment and evaluation of the water and sewerage market at national level. Such an assessment should include a determination of where and how PPPs in the sector could be utilised, together with the corresponding probable amounts of capital injections.

2.6.2 National Economic and Financial criteria for project evaluation

A comparison has been made by the Consultant concerning the assumed parameters in the financial evaluations in the feasibility studies corresponding of each of the six projects. This comparison shows some disparities on, for instance, the discount rate (10% in the case of Nitra, 5% in Martin), or the period covered by the analysis (7 years for Banska, 28 years for Zvolen). Table 2.2 resumes the comparison. As shown in the table, an economic analysis has been carried out only for three projects, and in two of them the discount rate is the same for both the financial and the economic analysis without any specific explanation.

The consideration of the elasticity in the water demand (and consequently in the wastewater effluent) has been systematically omitted. Some applications include an assessment on the financial viability of the beneficiary, others do not consider this issue.

Similar disparities arise when considering the affordability of the project by the customers. If mean household incomes may vary in the different regions, the definition of the affordable levels should be homogeneous.

It should be also noted that two of the six projects show negative financial NPV, and parallel economic NPV has not been at least estimated.

Table 2.2
Review of economic/financial parameters in Application Feasibility Studies

	Nitra	Trencin	Martin	Banska	Komarno	Zvolen
Financial analysis						
period (yr)	30	up to 2022	up to 2029	7 yr 2001-2007	15 yr 2001-2015	28 yr 1998-2025
discount rate (%)	10%	6% ⁴	5%	5%	5%	5%
inflation (annual)	10%			N ⁵		N
initial mean tariff (WW, €/m ³)	0.07		0.136		0.10	
increase in mean tariff %	217% ⁶	252 %	200% ⁷ 343%		N	350% for households
Elasticity	N	N	N	N	N	N
NPVf	-1 595 203		-6 546 589	4 400 000	4 531 517	3 256 834
marginal cost (project) €/m ³	N	0.22	N	N	N	N
Customers affordability						
initial mean household income (€)	375	N	128–210 for low income group	307	307	418 (1998)
supposed increase in household income	N	N	2% and 3%/yr in real terms	N	N	34% over all the period
affordability criteria	not explicit	N	4% of mean inc. (W+WW) and 2% WW only	5% of mean household inc. ⁸	N	N
affordability level (only WW)	0.69%	N	0.76 %	2% since 2003	(W+WW): 3.71%	0.64% 2005 1.06% 2025
Economic analysis						
discount rate	N	IRR ⁹ 18.1%	N	5%	5%	N
NPVe	N		N	19 000 000	12 186 219	N
Assumed growth of GDP	N	2.5%/yr	N	N	N	N
Assessment on beneficiary financial viability						
	N	Y		Y	N ¹⁰	Y

⁴ Feasibility Study (FS) page 40

⁵ N: not considered

⁶ Application page 24: from 0.07 to 0.19 in 2005

⁷ In real terms (FS page 33), but 343% indicated in the annexed spreadsheet

⁸ FS, Financial part, page 6

⁹ According to FS ; in the Application page 18, IRRe = 17.9%

¹⁰ Only balance sheets (1999) of the Municipality and the operating company are provided in Appendices 13 & 14 of the application.

As ISPA is merely a form of funding for capital expenditure in the Environment and Transport Sectors, all projects proposed for ISPA funding should be selected and evaluated by the Government of Slovakia using the same criteria used for selection and evaluation of all Government Capital Expenditure. Criteria should ensure:

- That capital rationing techniques are used to optimize scarce financial resources.
- That all technical solutions are identified for each proposed project.
- That the least cost financial solution is identified for each project and that where this option is not proposed strong technical arguments are enumerated. (Discounted cashflow and calculation of NPV, IRR and benefit/cost ratio should be used for this purpose).
- That the optimum funding mix is selected for each project.
- That the final beneficiary can afford to repay any borrowings which it may be required to provide and remain financially viable (ratio analysis of the financial projections – Profit & Loss Account, Balance Sheet and Cashflow Statements - over the expected useful economic life of the proposed asset should be used for this purpose).
- That a national approach is adopted to economic evaluations. Where necessary information which doesn't currently exist to enable full economic cost/benefit analysis to be undertaken, missing information should be identified and responsibility for calculation and gathering specifically assigned to an appropriate state authority.
- That responsibility for calculation, issuing and periodical revision of financial/economic indicators should be assigned to the MoF. These indicators should be used for the evaluation of all public capital expenditure and should include the following:
 - Cost of Capital to be used.
 - Central Discount Rate.
 - Projected inflation
 - Projected exchange rate
 - Other financial/economic variables needed for financial projections.

2.6.3 Experience to date with Water Utility Privatisation

The pilot privatization project in Trencin is considered by many of the organizations contacted during the study to be a success. A private International Operator (Lyonnaise des Eaux) now has a majority share of the operational assets of the Operating Company TVS which is understood to be managing and operating the water and wastewater assets successfully in accordance with an operating license between the owners (TVK Trencin) and TVS.

The pilot privatization project in Komarno was not considered successful however and to date no private operator (national or international) has taken a financial interest in the Operating Company KOMVaK.

Comment: From discussions with various Ministries, Municipalities and VAKs there appears to be a lack of knowledge, experience and thus understanding about the fundamental issues concerning possible Public Private Partnerships (PPP) in Slovakia. For example, the key role of PPP bringing capital for the development of the sector, the range of PPP options appropriate to different asset condition situations, the institutional requirements necessary including an independent regulator and owner-operator standard contracts and other important issues do not appear to be generally well understood.

One of the conclusions described late in this report is the need for basic guidance in the opportunities and risks associated with different forms of PPP by using the PPP documentation and other dissemination material currently under preparation for the EC.

2.7 PROTECTING EUROPEAN INVESTMENTS

2.7.1 Introduction

In order to develop recommendations for the protection of the EU investments in the water and wastewater sector in Slovakia, the Consultant team identified specific risks in each of the following areas:

- unsustainability
- financial risks
- regulatory risks
- political risks
- lack of transparency

All the analysis is based on the assumptions summarized below:

- Recommendations must be consistent with stated Government policy
- ISPA funds should be protected and achieve their stated objectives
- There is limited funding available for necessary improvements

2.7.2 Unsustainability

This section considers the long term sustainability of the ISPA projects. The following issues are to be considered:

Ownership

If the ownership of the assets is not clearly defined, there is a risk that the assets could be transferred in the future without adequate safeguards to protect the original objectives of the project.

Split ownership of the same utility could become a source of conflict and lead to non optimum use of ISPA funds. Such a situation could arise if part of an utility (lets say the new equipment of an upgraded WWTP) is own by the beneficiary of ISPA funds, and the rest of the same utility is own by another institution.

Operation and management competence

Inefficiencies due to inexperience in the operation and management of the completed project leads to inefficient operation and accelerated deterioration of assets.

Financial viability owner/operator

If the owner and/or the operator are not financially viable, there is a risk that the project may not be completed or operated satisfactorily. Commercial loans, which are currently used on all of the six projects to fulfill local financial contributions, have the potential to put additional financial pressure on the beneficiary. It is important that ISPA projects are considered within the wider context of the global financial commitments of the beneficiary.

Lack of systemic approach of investments (water supply, sewerage, disposal)

If complementary long term investments in the other parts of the water and wastewater systems (especially underground assets) are not adequately provided, the whole sustainability of the integrated system could be in danger. For instance, this would be the case if a WWTP is designed supposing a parallel development or extension of the wastewater collection, and this one fails to be constructed.

Apparent lack of integrated Government policy

The apparent absence of an integrated approach to managing the transformation of the water and wastewater sector by the Government is leading to uncertainty and lack of confidence with the risk that the transformation may be delayed or poorly implemented with immediate and long term consequences for water management. Furthermore, there is a lack of guidance on homogenous criteria for development and evaluation of future feasibility studies required by ISPA applications.

2.7.3 Financial risks

Uncertainties and high cost of co-financing

If one or more of the originally projected sources of co-financing fails to materialize, the financing viability of the project could be significantly compromised. Also, there is a risk that high costs and other onerous conditions normally associated with commercial loans could affect the financial viability of ISPA projects.

Uncertainty of revenues

If the actual revenues are below those forecasted because of unaffordable tariffs (customers and/or operators), or unwillingness to pay, then the financial sustainability of the project is compromised.

The financial sustainability of the project might be also compromised if an incorrect transfer pricing between operators and owners¹¹ is agreed.

2.7.4 Regulatory risks

In the absence of a strong and independent regulatory body, unfair contract conditions between owner and operator may be imposed by an experienced and powerful international operator.

2.7.5 Political risks

There is a risk that the transformation process be delayed, including the creation of the new regional water companies according to the established June 30th 2002 timetable. Under these circumstances further exceptional transfers of assets to municipalities could be approved by the Government. The long term viability of this option is not evident. Moreover, it could seriously jeopardise the implementation of the Government's national water resources strategy by encouraging the continued disintegration of the former regional companies. This trend, if allowed to continue, would introduce management difficulties and lack of coherence and also obstruct the necessary solidarity between different geographical sub-sectors with different costs for providing water and sewerage service.

2.7.6 Preparing for PPP

Risk of collusion between owner and operator

There is a risk that the owner and the operator of ISPA funded assets could agree on contract conditions (or amendments to the conditions subsequently) which provide unfair benefits to one or both parties but are detrimental to the sustainability of the project as well as customers interests.

Diversification of assets

During the transformation process there is a risk that the assets transferred from the present VAKs to the new joint stock companies via the National Property Fund are reoriented elsewhere.

¹¹ The Consultant is concerned by the available data showing that present costs are not be covered by actual revenues, and in this situation it will not be easy to negotiate a fair pricing transfer between Nitra Municipality (owner of the WWTP) and ZVAK as operator.

2.8 NEED FOR PPP ADVICE

During the discussions with various organizations as part of the field work stage of the study there appeared to be a low level of appreciation and knowledge of general PPP issues. Several organizations expressed an interest in increasing their knowledge and understanding of PPP. Preparation of dissemination material and operational guidelines, checklists and other working tools covering the PPP options available and their use on ISPA Projects are currently under preparation for the EC. The Guidelines will cover the ISPA approach to the various phases of PPP including:

- Options for PPP
- Method of selecting a private partner
- Ownership of assets
- Criteria for selecting a private partner
- Tendering procedures for goods and works during implementation
- Structuring institutional arrangements
- Calculating grant rate of assistance for PPP projects

There is also a need for an increased emphasis on project and contract management, which stems from the fact that Public Private Partnership contracts are more complex and operate for a longer period than traditional contracts. For these reasons, it is essential that systems are put in place to ensure that projects are properly managed and contracts enforced. It may be necessary to set out a procedure for the management of projects involving the appointment of public sector project and contract managers, the setting up of Steering Groups to run projects, the appointment of client advisers, the development of even closer links between the local and national authorities and their advisers and further development of existing project management techniques.

There is a risk that PPP is not fully understood by interested parties and thus there is a risk that the wrong PPP option is adopted or the opportunities for using PPP are not fully exploited on ISPA funded and other priority wastewater projects

2.9 NEED FOR POLICY ADVICE

During the discussions with various organizations as part of the field work stage of the study there appeared to be a need for institutional strengthening to assist the following organizations in developing policy issues:

- Water and Wastewater Regulatory Agency
- New Regional Water Companies (owners of assets)
- New Regional Operating Companies (ex VAKs)
- Ministry of Finance

The affordability of the whole program of investments in the water and sewerage sector - and more specifically both the capacity and the willingness to pay of the customers of these public services - remains the key issue which should be adequately addressed in order to ensure the sustainability of these investments. It is not enough to fix precise goals and deadlines, and to begin more or less ambitious projects using all possible available resources. It is absolutely necessary to verify the concordance between these goals and projects with the real economic context. This context is not only related to the primary investment phase (project and construction) but essentially to the later operation phase, where the adequate management, maintenance and subsequent re-investments of the new utilities are to be ensured.

The affordability analysis should be executed in two different levels. The first is the national level, where the analysis could be based on macro-economic indicators, leading to an assessment on the actual capacity of the national community to afford improvements in the water and sewerage sector through tariff increases. As a general fact and because funds are scarce, the role of central authorities remains essential for defining priorities and ensuring not only equitable development but also the universal access to the public service of water and sewerage. These priorities are to be necessarily included in the frame defined by the first level analysis. Note that availability of capital investments is an issue in the analysis, but not the only one.

The second level concerns specifically individual projects, which are supposed to be included in the above mentioned priorities. In this level the approach is somewhat more classical, and should cover the customers affordability (if costs are to be recovered through tariffs) and willingness to pay, and also an adequate assessment on the burden that the project could cause in the financial equilibrium of local entities as Municipalities or operator companies.

In the Chapter 4 are enumerated several recommendations leading to the practical implementation of this approach. These recommendations include strengthening of the institutional capabilities, and more specifically in the implementation of the transformation process including establishing a regulatory body of the water and sewerage sector.

3 REVIEW OF EACH ISPA PROJECT IN ACCORDANCE WITH TOR

3.1 NITRA

3.1.1 Introduction/ Field visits

Members of the ISPA-PPP Project team together with a representative from the ISPA Implementing Agency visited the Municipality on 26/02/02 and had detailed and productive discussions with the following representatives:

Mr Josef Prokes (Mayor of Nitra)

Mr Dezider Prickler (Head of Urban Planning Division of Nitra Municipality)

Mr Stanislav Segec (Director of ZsVAK Regional Office).

A brief visit was also made to the existing wastewater treatment plant (WWTP)in Nitra. The key points of the discussions of relevance to the ISPA PPP Project are summarized below in accordance with information provided by the Municipality. The Municipality's response to the standard questionnaire is provided in Appendix 2. Further comments provided later in discussions with ZsVAK representatives in Bratislava are provide later.

3.1.2 Financial Memorandum (ISPA/current)

The original application cited the Municipality of Nitra as the final beneficiary. This is now factually correct as the ownership of the WWTP was passed to the Municipality in February 2002. However, at the time of signing of the Financing Memorandum, April 2001, the assets were still in the ownership, management and operation of the Regional Water Company, ZsVAK, and this organization is named in the Financing Memorandum as the Final Beneficiary. There is a need, therefore, to amend the Financing Memorandum to reflect the change in asset ownership.

3.1.3 Ownership of company and assets (including future assets)

This section considers the previous/ current and future ownership arrangements of the fixed water and wastewater assets together with the operation and the overall management of those assets. Comments are provided where appropriate.

Previous ownership:

Assets/Operations/Management: ZsVAK enterprise (founded by MoA)

Current ownership:

Assets: The WWTP and associated land together with some limited part of the sewage network (25km) plus some parts of potable distribution network are now in the ownership of the Municipality (this transfer of asset ownership took place in February 2002 and was executed by the Government).. The remaining assets (comprising the drinking water source, and the major part of the water distribution and sewerage infrastructure) remain in the ownership of ZsVAK.

Operations: The Municipality has recently negotiated with ZsVAK that this one will maintain the responsibility for the operation of the WWTP. Responsibility for operation of the remaining assets

remains also with ZsVAK. Ultimate responsibility for complying with wastewater effluent quality standards is understood to be with the Municipality.

Management: As above. ZsVAK is responsible for all other management activities including the billing and collection of water and wastewater charges from customers.

Future ownership: As above for current

3.1.4 Change of beneficiary

The rationale for a proposed change in the beneficiary in the ISPA Financial Memorandum was defined by the Mayor as follows:

- In order to raise a commercial loan in the absence of a Government funding¹² the ownership of the assets needs to be the Municipality
- ZsVAK has no available funding for improvements to Nitra WWTP (or other water and wastewater upgrading schemes) and in any event do not see the Nitra scheme as a high priority.
- Lack of collection network and adequate treatment for sewage is inhibiting foreign and local investment in Nitra and expansion of the City¹³.
- The Municipality is responsible for quantity and quality of water and wastewater and will be subject to fines for non-compliance.
- Assurance were given at the time of signing that an amendment to the FM changing the beneficiary from ZsVAK to the Municipality for the above reasons would be feasible and was envisaged by all parties. This point has been checked with ZsVAK and the Chief Executive does not have any objections to amending the FM.

3.1.5 Ongoing/ future transformation of Utility

It is understood that there are no plans for transformation of the Utility's assets.

Comment: Ownership and management of the WWTP by the Municipality would make transfer to private investor relatively straightforward in the future. Nitra Municipality has no experience of operating/managing a WWTP. If, despite the current arrangement with ZsVAK, responsibility for the operation of the WWTP is in the future transferred to the Municipality of Nitra, this would isolate the operators eventually transferred from ZsVAK from their previous organisation. In such circumstances, it is conceivable that the Municipality might need to seek operating experience on the upgraded WWTP plant and this could provide an opportunity for a possible private investor/operator role. However it is also probable that such a private operator would only be interested if they are able to obtain the management of several parts of the whole system, or at least several WWTPs. It is not, therefore, clear what benefit, if any, customers will derive from the new repartition of roles / new private centralization scheme.

¹² The Government has agreed to fund the deficit in co-financing arising from the ISPA Management Committee's decision to fund only 50% of eligible costs, and not the 75% sought.

¹³ Ownership, operation and management of other Utilities in Nitra (power and heating) by the Municipality is also an objective of the Mayor.

3.1.6 Description of current/ future ownership structure

As described above. Details provided by the Nitra Municipality and by ZsVAK are provided below.

Reference to the National ISPA Strategy indicates that the ownership of assets by the Municipality is not an unusual arrangement where some 199 out of a total of 334 WWTPs are under the management of municipal authorities.

3.1.7 Private investor participation

Currently none.

Comment: Ownership and operation and management of WWTP assets would facilitate private sector participation in the future, but at the same time investment in remaining assets (e.g. sewerage network) would be less attractive to potential investors.

3.1.8 Profile and experience of management

ZsVAK has long term experience of operation and management of water and wastewater assets since their inauguration in 1977 as one of 5 regional MoA Water and Wastewater Authorities

The Nitra Municipality has no experience of operating or managing a WWTP.

3.1.9 Private investor contract conditions

Not applicable

3.1.10 Other issues/comments

Comment: A preliminary review of the historical financial performance of the City of Nitra would raise some doubts about their ability to manage and finance the ISPA project. The proposed project represents 15% of the current asset base. The city already has long term loans of approx. €3.4mio and it now proposes to increase this by a further € 4 mio to co-finance the ISPA project. The Municipality returned a loss in 2001 of €1.5 mio and had only €0.8 mio cash and bank balances on 01/01/2002. The ISPA project at €12m is considerably bigger than any other project the Municipality has undertaken during the last two years (largest project during this time was construction of residential buildings and infrastructure costing €2.7 mio) and waste water tariffs are currently under-recovering associated costs. Since this preliminary review based on initial information provided by the Municipality, it has been possible to assess the revenue generating capacity of the WWTP and to undertake a more extensive assessment of affordability. It has also been possible to assess the availability of reserves to help fund the proposed investment (for more details, the reader is referred to the report "Follow on Review of Financial Viability of Municipality of Nitra", May 2002). The report concludes that the financing of the WWTP project has no significant negative impact for the Municipality provided that the project follows the parameters indicated in the ISPA Application, specially in what concerns investment and operating costs, construction delays and required tariff increases. It was also assessed that these tariff increases appear to be affordable for the users, according to the actualized revenue data available from the Municipality. However, to cover interest and loan fee payments during the period of construction and also the probable deficits during the initial operating period of the WWTP (as shown in the cash-flow simulations), the Municipality and the Town Council should commit themselves to use financial resources of the Housing Fund. The Municipality has confirmed the availability of these resources, and the ability of the city Authorities to engage amounts of the Housing Fund for financing the WWTP project.

3.2 KOMÁRNO

3.2.1 Introduction/ Field visits

Members of the ISPA-PPP Project team, together with Mr. Michal Marcinák, from the Ministry of Environment's ISPA Implementation Agency, visited the Municipality of Komárno on February 28, 2002. The team held productive discussions with:

- Ing. Štefan Pásztor, Mayor of Komárno
- Mr. Ivan Kuhn, Project Manager, Renesans A.S., technical consultant to the Municipality.

Following the discussions, the team made a brief visit to the existing wastewater treatment plant (WWTP) in Komárno. Key points of the discussions are summarized below and the Municipality's response to the standard questionnaire is provided in Appendix 2. Details of the operating company KomVaK and the "Asset Transfer Flowsheet" are also included in the Appendix 4.

The 100% ownership of assets by CIVITAS/ KOMVaK as shown on the flowsheet was confirmed subsequently with Mr. Ivan Kuhn as referring to the operational assets only (i.e. not the water and wastewater assets).

3.2.2 Current Status of ISPA Application and Financing

Deputy Prime Minister Pavol Hamžic submitted the Komárno Municipality Wastewater Project ISPA application to the Commission of the European Communities (EC) in August 2000. At that time, outstanding project costs were estimated at € 7,830 million, with the Slovak government requesting a 75% ISPA grant of €5.8 million. The remainder of the cost was to be funded with a € 0.6 million (7%) state grant, and an IFI loan of €1.4 million (17%).

ISPA Application Financing

Source	€(millions)	%
ISPA Grant	5.8	75
IFI Sources	1.4	17
State Grant	0.6	7
Total	7.8	100

The application was approved by the EC, with a signed Financing Memorandum returned to the Slovak government on May 14, 2001. The eligible cost identified in the Financing Memorandum was adjusted upwards to €8,043,700, with the rate of Community assistance reduced to 50%, or € 4,021,850. Remaining costs were to be shared between the central government and the Municipality, as outlined below. It was assumed at the time that the Municipality would cover its portion of the cost through a loan from an IFI, via the State Environmental Fund.

ISPA Financing Memorandum

Source	€	%
ISPA Grant	4.021.850	50
State Grant	1.005.460	12.5
Municipality	3.016.390	37.5
Total	8.043.700	100

The Slovak Government approved the Komárno Financing Memorandum on November 28, 2001, but changed the distribution of the national co-financing between the state budget and the final beneficiary, with each contributing 25% of the project cost, as shown below. The increase in the amount of the national grant is said to reflect the importance the Government of Slovakia places on the environmental benefits the project will bring.

Revised Financing Memorandum (December 7, 2001)

Source	€	%
ISPA Grant	4.021.850	50
State Grant	2.010.925	25
Municipality	2.010.925	25
Total	8.043.700	100

While the Municipality of Komárno had hoped to obtain IFI financing through the National Environmental Fund, such funding does not appear to be available. As a result, in early March 2002, the Municipality is understood to be in final negotiations with DEXIA Slovakia to obtain a commercial loan for its portion. The Municipality is using its reserves as collateral to obtain a 15 year loan at an anticipated interest rate of approximately 8.0%. Details of the Commercial Loan Promise are also included in Appendix 4.

3.2.3 Ownership Structures

This section addresses the previous, current, and future ownership arrangements of fixed (i.e. immovable) water and wastewater assets in Komárno, together with the operation and the overall management of those assets including ownership of the necessary operational assets (typically buildings equipment and vehicles).

Previous ownership

From 1977 through to December 31, 1997, all water and waste water assets, operations, and management in Komárno were the responsibility of the West Slovak Waterworks and Sewer Company (ZVaK), a state-owned enterprise/Authority. The assets include extensive (and currently under-exploited) water wells located in the city near the Danube River, potable distribution pipes in Komárno and three surrounding villages, sewer pipes in the same locations, and a WWTP, located in Komárno on the Vah River, shortly upstream of its convergence with the Danube.

By Parliamentary Decree No. 748 of October 8, 1997, ownership of water and wastewater assets in Komárno were transformed as one of two pilot projects in Slovakia from the State to the City of Komárno. The other pilot project related to Trenčín. All the assets were transferred to the Municipality on January 1, 1998.

Effective from January 1, 1999, management and operation of the water and wastewater assets and *ownership* of the Komárno water and wastewater *operational* assets were transferred to CIVITAS, a municipal property management company fully owned by the City of Komárno. CIVITAS established a Water and Waste Water Unit, and held the operational assets through until October 2000. Prior to the transfer as detailed below, CIVITAS was responsible for the management of all assets belonging to the Municipality, including public housing and other buildings. The company

was not required to earn a profit and received substantial subsidies from the Municipality of Komárno.

Current ownership

In order to improve transparency and avoid confusing water-related finances with CIVITAS's other activities, the Municipality of Komárno established a dedicated, stand-alone, joint-stock company (JSC) in early 2000 to manage and operate its water and wastewater assets. On March 30, 2000, the General Assembly of Komárno moved to establish the Komárno Water Works and Sewer System Company, KOMVaK. KOMVaK, a.s. was recorded into the Commercial Register on September 20, 2000 and began full operation on November 1, 2000. The ownership of all of the city's water *operational* assets was transferred from CIVITAS to KOMVaK. Current ownership of the operational assets remains with KOMVaK and KOMVaK remains fully owned by the City of Komárno which retains ownership of the water and wastewater assets.

Future ownership

Ownership of water and waste water assets in Komárno is not expected to change in the near future. The city has held informal talks with a number of International Water and Wastewater Operators and has expressed a desire in selling a 63 percent share of the operational assets to a private company who would hold the majority share of the assets and manage and operate them on behalf of the city. The city hopes to obtain a one-time licensing fee from an International operator, as well as a ten-year advance payment of KOMVaK's annual rent to the Municipality. The Mayor stated that the Municipality would use these proceeds to repay the commercial loan it plans to take to fund its portion of the Komárno WWTP improvement project.

To date, no international operator have been willing to accept the Municipality of Komárno's proposed terms and a formal tender for the transfer of the assets has not occurred. The Mayor indicated that the Municipality is prepared to continue with the current ownership and operating structures indefinitely if necessary.

Previous Operations

Prior to the transfer of the Komárno water assets to the Municipality, ZVaK was responsible for the operation of water and wastewater assets in Komárno. The City of Komárno also contracted with ZvaK for the continued operation of its assets in calendar year 1998. From January 1999 through to October 2000, operations of the Komárno water and waste water assets was undertaken by CIVITAS.

Current Operations

Since November 2000, KOMVaK, a.s. has operated the WWTP and all other water and wastewater assets in Komárno. KOMVaK will operate the infrastructure through contract year during 2002, at a minimum. KOMVaK's staff of 129 were previously employed by CIVITAS from January 1999 to October 2000, and before 1999 were employees of ZVaK.

Responsibility for complying with drinking water quality standards is understood to rest with the Mayor of Komárno, while that for wastewater effluent quality standards rests with KOMVaK.

KOMVaK currently pays fines for non-attainment to the Vah River Basin Company, which was established under the Ministry of Agriculture.

Current Management

KOMVaK, a.s. is responsible for the internal management of the WWTP, as well as all other management activities in Komárno, including the billing and collection of water and wastewater charges from customers.

3.2.4 Change of beneficiary

Not applicable.

3.2.5 Ongoing/ future transformation of Utility

See § 3.2.3.

3.2.6 Description of current/ future ownership structure

All water assets in Komárno are currently owned by the Municipality. KOMVaK is responsible for management and operation of the water and wastewater assets and also own the operational assets. KOMVaK is fully owned by the Municipality of Komárno. As described above, the Municipality is exploring the possible privatization of a majority share of its water operational assets to a private water company.

3.2.7 Private investor participation

There is currently no private investor participation in the ownership or management of KOMVaK. However, as described above, the Mayor has been approached by a number of international private water companies and held exploratory discussions. Under the right conditions, the City of Komárno is interested in transferring majority ownership of KOMVaK and all operating responsibilities and operational assets to a private water company.

3.2.8 New/ envisaged management structure

No changes are currently envisaged in management structure.

3.2.9 Profile and experience of management

As of January 1, 2002, KOMVaK had a staff of 129 employees, including 80 workers, 43 technical and management staff, and six who are disabled. The great majority of current staff were previously employed by ZVaK and have long term experience in the operation and management of Komárno's water and wastewater assets. As shown in the organizational chart included in Appendix 4, KOMVaK is comprised of the following departments: Division of Economy and Business, Division of the director, Production and Technical Division, and Division of Technical Services. Several

senior staff maintain professional relationships with former colleagues at ZVaK, and stated that they can consult with their former colleagues if the need arises.

3.2.10 Private investor contract conditions

The Mayor of Komárno has held informal discussions with a number of private water companies, including Lyonnaise des Eaux, Vivendi, International Water, as well as Czech and Slovak firms. The mayor established strict conditions for the possible sale of a 65 percent stake in KOMVaK. He required an upfront payment of SLK 50,000,000, (1,237,440 €) as well as a ten-year advance payment of KOMVaK's annual rent to the city, which is currently SLK 7.5million (185,600 €) per year. None of the private companies was interested in pursuing a sale under these terms.

3.2.11 Other issues/comments

Water resources

Water abstraction in Komarno is via a good quality underground aquifer from ground wells adjacent to the River Danube, with significant surplus spare capacity (x10).

Comment: This under-used, good quality water source could be further exploited. There is some concern expressed by MoA that this could present a future private owner/operator with a monopoly situation for provision of drinking water to other adjoining areas of the region where there is a shortfall in water resources.

3.3 BANSKA BYSTRICA AND ZVOLEN

3.3.1 Introduction/ Field visits

Members of the Consultant team, together with Ms Antonia Plucinska, from the Ministry of Environment's ISPA Implementation Agency, visited the STVAK Divisional office in Banska Bystrica on February 28, 2002. The team held discussions with the following representatives of STVAK, Banska Bystrica and Zvolen Municipalities and the Ministry of Agriculture:

STVAK

Ing Jan Zimmerman
Dipl Ing. Lubomir Ryša
Dipl Ing Dušan Brecka (economic-commercial director)
Dipl Ing. Miroslav Babcan (PM)
Dipl Ing Jan Babjak
Ing Svätoslav Mravec
Ing Ingrid Snrova (Zvolen PM)

Banska Bystrica Municipality

Ing Jan Kralik (Mayor)

Dipl. Ing. Richard Maša (Head of Mayor's office)

Ing Miroslav Muron

Zvolen Municipality

Vladimir Manka (Mayor)

Min of Agriculture

Ing. Lydia Bekerova

Following the discussions, the Consultant team made a brief visit to the existing wastewater treatment plant (WWTP) in Zvolen. Key points of the discussions are summarized below and the STVAK response to the standard questionnaire is provided in Appendix 2.

3.3.2 Current Status of ISPA Application and Financing

3.3.2.1 Banska Bystrica. The Banska Bystrica Wastewater Project ISPA application was submitted to the EC in August 2000. At that time, outstanding project costs were estimated at €45.30 million with the Slovak government requesting a 63.90 % ISPA grant of €30.0 million. The remainder of the cost was to be funded with a €2.0 million state grant from several sources, and an IFI loan from the EIB of € 8.0 million. The balance of the total investment cost was to be covered by cash flow generated through tariff increases during the project.

ISPA Application Financing

Source	€(millions)	%
ISPA Grant	30.000.000	63.90
IFI Sources	8.000.000	
State Grant	2.000.000	
Balance	5.300.000	
Total	45.300.000	100.00

The application was approved by the EC, with a signed Financing Memorandum returned to the Slovak government on 4th April 2001 with STVAK the stated final Beneficiary. The eligible cost identified in the Financing Memorandum was €36.15 million, with the rate of EC assistance reduced to 50%, or €18.078. Remaining costs were to be shared between the central government and locally, as outlined below. It was assumed at the time that the local costs would be covered through a loan from an IFI, via the State Environmental Fund.

ISPA Financing Memorandum

Source	€	%
ISPA Grant	18.078.147	50
State Grant	9.039.074	25
Others (local)	9.039.074	25
Total	36.156.630	100

The budget was subsequently revised to reflect the increased costs of the project and an Addendum to the Financial Memorandum was submitted subsequently to the EC as follows:

Revised Financing Memorandum

Source	€	%
ISPA Grant	22.734.334	50
State Grant	11.367.166	25
Others (local)	11,367,167	25
Total	45,468,667	100

While STVAK had hoped to obtain IFI financing through the National Environmental Fund, such funding was not forthcoming. It is understood from the meeting that the reason for the failure to secure the EIB loan was that the Government was not prepared to provide a State Guarantee. As a result, STVAK has obtained a commercial loan from VUB Slovakia for the local cost representing 25% of the total. The loan is guaranteed by STVAK's own assets. The Details of the Commercial loan for the Banska Bystrica project are also included in the Binding Loan Promise in Appendix 3.

3.3.2.2 Zvolen. STVAK submitted an application to the EC for ISPA funding on the Zvolen Wastewater Project in July 2001. At that time, outstanding project costs were estimated at €11.67 million, with STVAK requesting a 50% ISPA grant of €5.83 million. The remainder of the cost was to be funded with contributions from STVAK (12.5%) State loan and income generated from increased tariffs

ISPA Application Financing

Source	€(millions)	%
ISPA Grant	5,833,750	50
IFI Sources	N/A	-
Others	5,833,750	50
Total	11,667,500	100

The application is expected to be signed shortly. The eligible cost identified in the Financing Memorandum was reduced to €10,967,050, with the rate of EC assistance maintained to 50%, or €5.48 million. Remaining costs were to be shared between the central government and STVAK, as outlined below. It was assumed at the time that STVAK could cover its portion of the cost through a loan from an IFI, via the State Environmental Fund.

ISPA Financing Memorandum

Source	€	%
ISPA Grant	5.483,525	50
State Grant	2,741,763	25
Final Beneficiary	2,741,763	25
Total	10.967,050	100

While STVAK had hoped to obtain IFI financing through the National Environmental Fund, such funding does not appear to be available. As a result, STVAK have arranged a commercial loan with VUB Slovakia at an anticipated interest rate of approximately 11%.

The Zvolen Municipality is using its reserves as collateral to guarantee half of the commercial loan and STVAK is guaranteeing the other half.

3.3.3 Ownership Structures (Banska Bystrica and Zvolen)

This section addresses the previous, current, and future ownership arrangements of fixed water and wastewater assets in Banska Bystrica and Zvolen, together with the operation and the overall management of those assets including ownership of the necessary operational assets (typically buildings equipment and vehicles).

Previous ownership/ Current ownership

Previous and current ownership of the water and wastewater assets in the Central Slovakian region is the State/STVAK.

Future ownership of assets

On completion of the transformation process, assets ownership will be transferred to the new regional water (Joint Stock) Company. The municipalities of this region will receive shares of the new Company proportionally to their population. Operating assets eg buildings, vehicles and equipment will also be transferred to the new Company who will have responsibility for managing and operating the water and wastewater assets.

Previous Operation/ Current Operations and Management

Previous and current maintenance and operation of the assets is undertaken by STVAK.

3.3.4 Change of Beneficiary

The current final Beneficiary named in the Addendum No 1 to the Financial Memorandum for the Banska Bystrica ISPA Project and in the Financial Memorandum for the Zvolen ISPA project is STVAK. Following transformation, a new organization (name currently undecided), but possibly the “*Central Slovakia Water Management Company*” will be responsible for funding the ISPA project.

3.3.5 Ongoing/ future transformation of Utility

See §3.3.8.

3.3.6 Description of current/ future asset ownership structure

Ownership of the assets will be transferred via the National Property Fund from the State to the Municipalities (through the new regional Joint Stock water and wastewater company) in accordance with Government Resolution on Transformation (No 35 dated January 2001).

3.3.7 Private investor participation

There are no plans envisaged currently to involve the private sector in either the operation of the assets via the new Regional Water and sewerage operating companies or via the Municipalities who will own the assets.

3.3.8 New/ envisaged management structure

A copy of Annex IV of the Zvolen ISPA Application prepared by Carl Bro entitled “Institutional Assessment” and dated July 2001 was attached to the completed questionnaire received from STVAK showing the current and future structure of STVAK following transformation. The Carl Bro 1991 ISPA Application Annex IV on Institutional Assessment states that: *“STVAK is an efficient and cost-effective customer oriented public utility with a responsive organization with motivated and appropriately trained staff and staffing levels, (including contracting out) to reflect market economy conditions and the goals set out in the NEAP and the National ISPA Strategy for the programming period 2000-2006”*

Comment: The Consultant team were given the impression during the meeting that the change of status of STVAK from a government owned water and wastewater enterprise to a Municipality owned Operating Company (with the Municipalities collectively owning the assets) was unexceptional and that the practical circumstances for both Municipalities and Operating Company were unlikely to change significantly from the present situation. The implications for future funding of investments by the Municipalities and the potential for private sector participation in the operating company as well as in funding new assets in the future did not appear to be recognized by the participants. Furthermore the risk that the change of name and status of STVAK on transformation to a new Regional Water Company could require amendment to the signed Financial Memoranda for both Banska Bystrica and Zvolen was not recognized as a fact or a s a potential source of delay in ISPA funding.

The Carl Bro document (in English) was kindly provided by STVAK. The Project team are not aware of any other details of the transformation process currently available.

3.3.9 Profile and experience of management

STVAK is one of 5 Regional Water and Sewerage Authorities set up originally in 1970 as a “national enterprise” to provide water supply, wastewater collection and treatment for domestic and non domestic customers. STVAK’s status was changed in 1989 to a ”state enterprise” (also sometimes called an “Authority”) in accordance with Law 88/1988. STVAK has a total of 1597 staff including a Head Office in Banska Bystrica and seven branch offices. Further details of STVAK taken from the Carl Bro ISPA Application for Zvolen, dated July 2001 as provide during the meeting are provided in Appendix 3.

3.3.10 Private investor contract conditions

Not applicable

3.4 MARTIN AND THE DOLNÝ TURIEC REGION

3.4.1 Introduction/ Field visit(s)

Members of the Consultant team visited Martin on 01st March 2002 to meet with the Final Beneficiary as identified in the ISPA FM. The participants at the meeting included the following:

ISPA IA

Mr. Roman Ivanco : Project Manager for ISPA IA

Beneficiary

Mr Stanislav Bernát : Mayor of Martin
Mr Josef Turcány : Mayor of Turcianske Teplice, official of board of directors
Mr. Lindtner : Official of Boards of Directors
Mr. Milan Kolimár : Director of SEVAK, st.ent.Žilina
Mr. Milan Rybár : Mayor of Sucany, Official of Board of Directors
Mr. Miroslav Celinský : Director of Subsidiary Works of SEVAK, st.ent. Žilina in OZ Martin
Mrs. Ovská : Manager of Section of Production – OZ Martin
Mr.Krupinský : Manager of Economical Section – OZ Martin
Mr. Jaroslav Gardlík : Manager of Technical Section – OZ Martin
Mr. Pavlovcin : Deputy of Project Manager of Project Martin

The key points of the discussions of relevance to the ISPA PPP Project are summarized below in accordance with information provided by the Municipality. The Municipality's response to the standard questionnaire is provided in Appendix 2.

3.4.2 Financial Memorandum (ISPA/current)

The objective of the ISPA Measure is to improve the sewerage system in the town of Martin and seven other smaller towns in the project area. Also to upgrade and improve the biological treatment process of the existing Martin-Vrútky WWTP. The ISPA Application was submitted by Mrs. Mária Kadlecíková (NIC) to the EC Delegation on 06th August 2001. The Financing Memorandum was signed by the EC on 17th December 2001 but has not yet been signed by the Government of the Slovak Republic.

The original application requested an ISPA grant of 60% of the total eligible cost but the Financing Memorandum provided for an amount of 49%.

3.4.3 Ownership of company and assets (including future assets)

Previous ownership

Assets/Operations/Management: SeVaK¹⁴ (North Slovakian Water Supply and Sewerage Enterprise, Žilina)

SeVaK is divided into 7 subsidiary organizations as follows:

OZ 01 Cadca

OZ 02 Dolný Kubín

OZ 03 Liptovský Mikuláš

OZ 04 Martin

OZ 05 Považská Bystrica

OZ 06 Žilina

OZ 07 Ružomberok

Current ownership

The ISPA application Section 10.1 (b) 1., includes the following information.

- The fixed assets for the collection and treatment of wastewater are owned by local governments; the systems themselves are, for the most part, operated by regional water utilities which form part of the central government structure
- Operation and maintenance are the responsibility of the regional water utilities
- The utilities collect revenues generated for wastewater treatment and apply them to cover their own expenses
- Any financial surplus resulting from the operations of the wastewater system are funnelled back to the owners of the utilities, central government, rather than to the owners of the systems, municipalities.

The above situation was clarified by the beneficiary by way of the completed questionnaire attached as Appendix 2, where in fact the ownership of the assets rests with the State.

Future ownership

Resolution of the Government No. 542 from June 13, 2001 describes the proposed establishment of six new share holding companies. Turiec district will belong to one of these companies. Shares in the Co. will be owned by the municipalities included in the area under the relevant Company's territorial area of responsibility.

A Joint Stock company (J/S Co.) under the name of 'Turcianske Vodárne a Kanalizácie a.s.' was established in 1998 (registration no. 32 382 761) with the intention of taking over the assets of the present water supply and sewerage systems in the region and operating them on a commercial basis. This is expected to occur by 01st July 2002 as a result of the Government's transformation process. It is noted that JS Co. would hope to become the asset owner of the present OZ 04 Martin only and not the other 6 subsidiaries. The Mayor of Martin shall be the Chairman of the board.

¹⁴ Severoslovenské Vodárne a Kanalizácie

Comment: At a meeting between the Consultant team and the NIC on 6th March 2002, the latter offered her opinion that the target date of 1st July will be met. Until transformation is finalised the SeVaK would remain as the asset owner and operator of the water and waste water services.

It is the opinion of the team, the NIC appeared to indicate that the final beneficiary should not be Turcianske Vodárne a Kanalizácie a.s. as this may provide the impression of an 'exception' to the stated Government transformation policy. Should this be the case then the FM would need to be amended to rather reflect SeVaK as the final beneficiary.

3.4.4 Change of Beneficiary-rationale

The ISPA application and current FM (as signed by the EC, but not yet by the Government of Slovakia) states that the final Beneficiary shall be Turcianske Vodárne a Kanalizácie a.s. The information received by the Consultant team and that included in the ISPA application would appear to confirm that Turcianske Vodárne a Kanalizácie a.s. would only become the owner of the assets after transformation.

In view of the above, it is likely that the FM will have to be changed

3.4.5 Ongoing/ future transformation of Utility

The transformation process is underway, and is planned on being completed by 30th June 2002. After that, it is anticipated that a Joint Stock Company will be established with the shareholders and asset owners being the Municipalities in the region.

Comment: The ISPA application for Martin implies that Turianske Vodarne a Kanalizacie a.s. would become the eventual owners of the present SeVaK subsidiary OZ Martin. There is no clear mention as to what will occur with the other 6 OZ subsidiaries.

3.4.6 Description of current / future ownership structure

The SeVaK organization consists of different sections:

- Directorate Section
- Technical Section
- Economical Section
- Production Section
- Advisory Section
- Subsidiary Sections (seven, as described under § 3.5.3)

3.4.7 Private Investor Participation

None identified at present

3.4.8 New / envisaged Management Structure

Not clear at this time.

3.4.9 Profile and Experience of Management

Not clear at this time concerning future management

3.4.10 Private Investor Contract Conditions

None to date

3.4.11 Other Issues/comments

At present the beneficiary, as defined in the Financing Memorandum, has no assets and has not operated as a Company.

Based upon discussions between the NIC and the Consultant team on 6th March 2002, it would appear that the final beneficiary should remain as the SeVaK and not Turciansle Vodárne a Kanalizácie a.s , as indicated in the FM. Should this be the case then an amendment will be required to the FM.

3.5 TRENCIN

3.5.1 Introduction/ Field visits

Members of the Consultant team, together with a representative from the ISPA Implementing Agency, visited the Municipality on 28/02/02 and had detailed and productive discussions with the Mayor of Trencin and:

- Ms. Monika Ciznarova, (Technical Manager, TVK)
- Mr. Jan Koritko, (Managing Director of TVK)
- Mr. Jan Kardos, (General Director, Chairman and minority shareholder of TVS)

The key points of the discussions of relevance to the ISPA Project are summarized below in accordance with information provided by the Municipality. The Municipality's response to the standard questionnaire is provided in Appendix 2.

3.5.2 Financial Memorandum (ISPA/current)

The Financial Memorandum names TVK as the Final Beneficiary and this is correct. In addition to this the shortfall in funding for this project which arises from the ISPA Management Committees decision to approve only 50% funding for the project, as opposed to the 75% sought, will be provided by the Government through the State Budget. No amendment to the Financing Memorandum is required to reflect this.

3.5.3 Ownership of company and assets (including future assets)

This section considers the previous/ current and future ownership arrangements of the fixed water and wastewater assets together with the operation and the overall management of those assets. Comments are provided where appropriate.

Previous ownership

Assets/Operations/Management: ZsVAK enterprise (founded by MoA)

Current ownership

Assets: All waste water treatment assets, including networks and sewage system, and all portable drinking water assets, are owned by TVK. This Joint Stock Company was established by the Government in 1997. It is wholly owned by 48 Municipalities in the vicinity of Trencin, where the assets are located. TVK was previously a district of ZsVAK which was transformed as a pilot project for the transformation of the VAKs.

Operations: Operation of all assets is the responsibility of TVS. This is a private company which is owned by French Water Operator (Lyonnaise des Eaux) and two former directors of ZsVAK. TVS operates the assets under a 20 year agreement entered into with TVK. Under this agreement, TVS pays TVK for the operation of the assets but all responsibility for standards rests with TVS. TVS is also responsible for operation and maintenance of assets, invoicing of customers and tariff collection.

Management: TVS is responsible for the internal management of the WWTP.

Future ownership

We are not aware of any plans to change the current ownership.

3.5.4 Change of beneficiary

Not applicable

3.5.5 Ongoing/ future transformation of Utility

It was understood that there are no plans for further transformation of the Utility's assets.

3.5.6 Description of current/ future ownership structure

As described above.

3.5.7 Private investor participation

The operations of ZsVAK in the Trenčín region were privatised in 1998. Service assets and all staff (290) were transferred to TVS. TVS have a twenty year operating agreement with TVK, who own the assets, and an operating license from the Government. In our meeting in Trenčín we understood that this privatisation was conducted by the Ministry of Privatisation by open international tender and that TVS was the winning bidder.

Comment: The issue of the Trenčín privatisation process is considered in §2.2.1.2, 2.2.1.4 and 2.2.1.5.

3.5.8 Profile and experience of management

The staff of TVS previously worked for ZsVAK, which has long term experience of operation and management of water and wastewater assets since their inauguration in 1977 as one of 5 regional MoA Water and Wastewater Authorities. The owners of TVS are the French water operator Lyonnaise des Eaux and two of the previous directors of ZsVAK.

3.5.9 Private investor contract conditions

TVS will operate the proposed ISPA funded WWTP under the terms of the existing operating agreement between TVS and TVK. The General Director and Chairman of TVS gave assurances to the Consultant team that he is fully aware of tariff increases included in the ISPA application, and produced an internal TVS document which outlined future tariff increases which are higher than those sought by TVK for the purposes of funding this investment. Recovery of depreciation of the WWTP by TVK is also covered by this agreement. Responsibility for asset maintenance rests with TVS and is also covered by this agreement. Refer to § 2.2.1.5 for a detailed analysis of the TVK/TVS agreement.

4 CONCLUSIONS AND RECOMMENDATIONS

4.1 INTRODUCTION

In order to obtain a clear presentation, general and policy-related recommendations are presented first (§4.2). Project-specific recommendations are presented later (§4.3).

The presentation of conclusions and recommendations follows the sequence defined in the text (§2.7). Identified risks are recalled and subsequent recommendations are enumerated. Recommendations are indicated in *italics*. Priority recommendations are indicated in ***bold italics***.

4.2 GENERAL AND POLICY RELATED CONCLUSIONS AND RECOMMENDATIONS

Ownership issues

Risk:

If the ownership of the assets is not clearly defined, there is a risk that the assets could be transferred in the future without adequate safeguards to protect the original objectives of the project.

- *Recommendation 1: The Government should follow its own policy and adopt as a consistent vehicle the joint-stock regional company for transfer of asset ownership.*
- *Recommendation 2: A set of standard statutes with extended minority guarantees should be elaborated to make it more difficult to abuse majority in the future municipality owner-companies by means of requiring approval from a particularly high majority of shareholders.*
- ***Priority recommendation 3: An ultimate protection of the assets against undue transfers could be obtained by adding a provision to the proposed new law on water supply, which would:***
 - *require the municipality owned companies to issue only registered shares on name and conditioning any transfer of these shares to be approved in advance by the Regulatory Agency.*
 - *require a priori approval from the Regulatory Agency of the Statutes of the companies as well as of any proposed amendments to these Statutes*
 - *in cases where assets are owned by the municipality as such to require advance approval of any transfer*

Such requirements established by law would according to Slovak law hold against third parties.

Risk:

Split ownership of the same utility could become a source of conflict and lead to non optimum use of ISPA funds. Such a situation could arise if part of an utility (lets say the new equipment of an

upgraded WWTP) is own by the beneficiary of ISPA funds, and the rest of the same utility is own by another institution.

- *Recommendation 4: All future ISPA applications should only be requested for assets which are wholly owned by a single beneficiary, in order to avoid operational/ management conflicts.*

Operation and management competence

Risk:

Inefficiencies due to inexperience in the operation and management of the completed project leads to inefficient operation and accelerated deterioration of assets.

- *Recommendation 5 : Technical Assistance (TA) should be requested by the Government to the EC or other donors for the new regional companies concerning asset management (Master Plan, investment funding, staff training, etc.)*

Financial viability owner/operator

Risk:

If the owner and/or the operator are not financially viable, there is a risk that the project may not be completed or operated satisfactorily. Commercial loans, which are currently used on all of the six projects to fulfill local financial contributions, have the potential to put additional financial pressure on the beneficiary. It is important that ISPA projects are considered within the wider context of the global financial commitments of the beneficiary.

- *Recommendation 6 : The financial viability of the final beneficiary to implement the project is to be cross-checked.*
- *Recommendation 7 : The Government should assist in seeking soft funding (EIB, EBRD, WB, etc) for ISPA projects*
- *Recommendation 8 : Commercial loans should only be considered as a last resort.*

Lack of systemic approach of investments (water supply, sewerage, disposal)

Risk:

There is a risk that complementary long term investments in the other parts of the water and wastewater systems are not adequately provided. This could lead to an under-utilization of the ISPA project.

- *Recommendation 9 : Long term (15-20 year) socially affordable Master Plan prioritizing investments in water and sewerage services should be developed, and financing sources identified.*
- *Priority recommendation 10: Government should ensure that the proposed six publicly owned, regional water companies, created as a result of the transformation process, have all*

necessary resources and are financially viable (in particular, they should have investment capacity for maintenance, rehabilitation, upgrading and extension of their assets).

Apparent lack of integrated Government policy

Risk:

The apparent absence of an integrated approach to managing the transformation of the water and wastewater sector by the Government is leading to uncertainty and lack of confidence with the risk that the transformation may be delayed or poorly implemented with immediate and long term consequences for water management. Furthermore, there is a lack of guidance on homogenous criteria for development and evaluation of future feasibility studies required by ISPA applications.

- *Recommendation 11: The Government should establish, if not done already, a detailed implementation plan for the six transformed regional water companies.*
- *Recommendation 12: The Government should establish appropriate financial, economic and other criteria to be used by consultants and designers in developing future ISPA applications.*

Uncertainties and high cost of co-financing

Risk:

If one or more of the originally projected sources of co-financing fails to materialize, the financing viability of the project could be significantly compromised. Also, there is a risk that high costs and other onerous conditions normally associated with commercial loans could affect the financial viability of ISPA projects.

- *Recommendation 13: The Government should be very active assisting the beneficiary in raising co-financing as cheaply as possible.*

Uncertainty of revenues

Risk:

If the actual revenues are below those forecasted because of unaffordable tariffs (customers and/or operators), or unwillingness to pay, then the financial sustainability of the project is compromised.

- *Recommendation 14 : Undertake a national study to assess affordability, willingness to pay and tariff issues, including elasticity aspects¹⁵*

Risk:

The financial sustainability of the project might be also compromised if an incorrect transfer pricing between operators and owners¹⁶ is agreed.

¹⁵ A consultant preliminary assessment on national affordability issues indicates there is only a narrow margin for increasing average tariffs.

- *Recommendation 15 : A standard form of operating contract should be developed between owner and operator as a part of the tender dossier in order to ensure that a fair price is paid for the use of the assets and other conditions required by the regulator are met .*

Regulatory risks

Risk:

In the absence of a strong and independent regulatory body, unfair contract conditions between owner and operator may be imposed by an experienced and powerful international operator.

- *Recommendation 16 : As a priority, the Government should fully implement an independent regulatory agency accordance with international practice.*
- *Recommendation 17 : Sufficient financial and staff resources and training should be provided by the Government to enable the regulatory agency to carry out its responsibilities fully. The agency should have sufficient powers to regulate the maintenance and performance of the water and wastewater assets. The agency should also be able to provide service in the shape of standard operational guidelines and consumer practices as well market analysis and tariff calculation schemes.*

Political risks

Risk:

There is a risk that the transformation process be delayed, including the creation of the new regional water companies according to the established June 30th 2002 timetable. Under these circumstances further exceptional transfers of assets to municipalities could be approved by the Government. The long term viability of this option is not evident. Moreover, it could seriously jeopardise the implementation of the Government's national water resources strategy by encouraging the continued disintegration of the former regional companies. This trend, if allowed to continue, would introduce management difficulties and lack of coherence and also obstruct the necessary solidarity between different geographical sub-sectors with different costs for providing water and sewerage service.

- *Recommendation 18 : The Government should not allow any further exceptions concerning the transfer of assets to individual or groups of Municipalities¹⁷.*

¹⁶ The Consultant is concerned by the available data showing that present costs are not be covered by actual revenues, and in this situation it will not be easy to negotiate a fair pricing transfer between Nitra Municipality (owner of the WWTP) and ZVAK as operator.

¹⁷ In a meeting with the Consultant team on March 6th, the Deputy Prime Minister (in her capacity as NIC) stated that ownership of the Martin wastewater assets will not be transferred to the Municipalities, in order to avoid further exceptions.

- ***Priority recommendation 19 : The Government should not present further ISPA applications if they concern "exceptions" and/or they are not fully consistent with the objective of the current transformation process which leads to the creation of the six autonomous regional water companies.***

Preparing for PPP - Risk of collusion between owner and operator

Risk:

There is a risk that the owner and the operator of ISPA funded assets could agree on contract conditions (or amendments to the conditions subsequently) which provide unfair benefits to one or both parties but are detrimental to the sustainability of the project as well as customers interests.

- *Recommendation 20 : The Regulatory Agency should award operating licenses in accordance with best practices for open competition on public contracts. In addition, the legislation on Water Supply could set up requirements for key contractual provisions on for example tariff calculation, performance specifications, separation of operative and investment planning functions etc. The regulatory Agency could be given powers to approve these parts of contracts. On such a legislative basis, it would according to Slovak law apparently not be problematic to extend such power to include the right to require adjustments of already existing contracts.*
- *Recommendation 21 : The Regulatory Agency should have powers to undertake regular audits of the owner- operator conditions and other relevant aspects of the Operator's performance in providing water and wastewater services.*

Preparing for PPP - Insufficient selection procedures (contracts and licenses)

- *Recommendation 22 : The existing legislative framework could be extended beyond strict public procurement and concession to ensure that all forms of PPP becomes subject to general European rules for public contracts. This would include requirements on public invitation of interested companies, transparent procedures based on qualification requirements and performance criteria specified in advance and evaluation/negotiation involving at least two companies.*

Preparing for PPP - Diversion of assets

Risk:

During the transformation process there is a risk that the assets transferred from the present VAKs to the new joint stock companies via the National Property Fund are reoriented elsewhere.

- *Recommendation 23 : The Government should supervise the whole transfer process in order to ensure the integrity of the assets transfer from the present VAKs to the six regional water companies.*

Prioritising future ISPA wastewater investments

Risk:

There is a risk that the current strategy for prioritizing wastewater projects for ISPA funding does not fully take account of all the environmental and other issues and may not truly reflect the requirements of the new Water Framework Directive. Also, there is a risk that the current selection process may not adequately address the relative effectiveness of the different candidate projects in meeting the program's goals. The current list of projects has been criticized as being more of a "shopping list" than a short list of priority projects whose comparative merits and effectiveness have been determined, perhaps due in part to time pressure associated with the expiration of annual grants levels. While these projects may be desirable, the apparent lack of rigor in the selection process could lead to the risk that ISPA funds are not used in the most effective manner.

- *Recommendation 24: the current method of prioritizing wastewater projects in the ISPA Strategy should be reviewed and should take full account of the Water Framework Directive particularly in relation to an integrated approach to water management including downstream users.*
- *Recommendation 25: The present review of the six projects suggests the need to re-address the strategy and update the priorities governing the selection process of the projects benefiting of ISPA financing.*

Government Funding for Environmental Projects

As discussed in §2.2.3, the MoA Paper “*Concept of Water Policy till 2005*” clearly states that: “The cost of water management investments will be covered by the **owners** (p27). This “concept” as outlined in the document appears to limit or absolve the Government from the responsibility to provide resources in the future for investing in the water and wastewater sector.

- *Recommendation 26 : Government should confirm its future commitment to and scale of funding of Environmental projects.*

Need for PPP advice

Risk:

There is a risk that PPP is not fully understood by interested parties and thus there is a risk that the wrong PPP option is adopted or the opportunities for using PPP are not fully exploited on ISPA funded and other priority wastewater projects

- *Recommendation 27: A series of PPP workshops and seminars should be held in Bratislava and other regions of Slovakia to invited participants comprising Government, Municipality and operating company representatives and other interested parties to discuss and disseminate the above information. The creation of a specific site (for instance in the frame of an existing Ministry) for training and advice/case-studies of the PPP practices should be considered. The*

activities should cover all aspects of the so-called policy framework, involving the initial steps such as project identification and suitability assessment and continuing with contract specifications, tariff issues as well as contract management and monitoring. Following or concurrent with such training special technical assistance could be provided to look into the precise need for change of legislative and institutional environment. This would also include assistance to produce the necessary initial regulatory impact assessment.

- *Recommendation 28 : The Government should consider the possibility to execute / actualise an assessment on the present situation of the water and wastewater market in Slovakia, including a review of possible PPP partners at both local and international levels. This review should provide an analysis of the current and/or specific conditions awaited by the potential partners, specially in what concerns effective capital contribution and contractual arrangements. Such an assessment would be an useful tool for decision-makers when implementing the sector strategy.*

Need for policy advice

Risk:

There is a risk that inadequate institutional capabilities could delay the implementation of the transformation process including establishing a regulatory body. This could result in projects submitted for ISPA funding which are inappropriate and/or without adequate economic evaluation of the project and the beneficiary's ability to finance and operate the project.

- *Recommendation 29 : Technical Assistance should be provided to assist with Institutional Strengthening to cover the following policy areas:*
 - 1. Water and Wastewater Regulatory body*
 - Best International Regulatory practices adapted to the Slovakian context*
 - Independence from Government or Private Operator influence*
 - Financial and human resources and training*
 - Pricing policy issues*
 - 2. New Regional Water Companies, New Regional Operating Companies and Ministry of Finance*
 - Effective Financial management of major projects*
 - PPP Issues/ opportunities/risks (see section above)*
 - Securing International soft loans*
 - Economic evaluation of capital projects*

4.3 SPECIFIC PROJECT-RELATED RECOMMENDATIONS

4.3.1 Nitra

Risk:

Current VAK structures are due to be transformed, and are scheduled to be replaced by six new regional water companies (expected by end June 2002) and corresponding operating companies at a later time. Therefore there is a risk that the disbursement of ISPA funds may be delayed where the VAKs are the stated beneficiaries in the current version of the final memorandum

- *Recommendation 30 [also valid for BANSKA BYSTRICA and ZVOLEN] : Ask NAO not to use the ISPA funds for the project until final beneficiary is amended in the FM.*

Risk :

If the ownership of the assets is not clearly defined, there is a risk that the assets could be transferred in the future without adequate safeguards to protect the original objectives of the project. Moreover, the envisaged owner and/or the operator should demonstrate to be financially viable, in order to ensure that the project may not be completed or operated satisfactorily.

- *Recommendation 31 : The current version of the financial Memorandum should be amended to show Nitra Municipality as the beneficiary, provided that it also satisfies what is written below.*

24. Priority Recommendation 32 : The Municipality, as owner of the asset, should negotiate contractual conditions with any operator appointed to manage and operate the WWTP ensuring that all financing costs, relevant economic rent and any other associated costs of ownership are to be recovered through the rent to be paid by the operator and that such operator will in turn be able to recover these and all other operating costs through the water tariff. However, during the construction period and the early operation years of the WWTP, at least until the wastewater treatment tariff reaches the level determined in the financial analysis attached to the ISPA application, the Municipality of Nitra should commit itself to take the appropriate planning measures to reserve part of the amounts available via the housing fund (a) to cover the cost of interest and loan fees during the construction period, and (b) to subsidise at least during several years the WWTP's operating costs. If these conditions can not be agreed, the alternative to reduce the pressure on the Municipality's finances should be to increase the State grant for the project, currently at 12.5%, up to 25% as it is the case in other similar projects.

Risk:

Inefficiencies due to inexperience in the operation and management of the completed project leads to inefficient operation and accelerated deterioration of assets.

- *Recommendation 33 : The operation and management of the Nitra WWTP should continue to be the responsibility of the ZVAK or the future transformed regional water company operator.*

4.3.2 Martin

Risk:

As mentioned before, further exceptional transfers of assets to municipalities could seriously jeopardise the implementation of the Government's national water resources strategy by encouraging the continued disintegration of the former regional companies. This trend, if allowed to continue, would introduce management difficulties and lack of coherence and also obstruct the necessary solidarity between different geographical sub-sectors with different costs for providing water and sewerage service. In this context, ISPA funds should be used to reinforce the SeVaK (North Slovakian Water Supply and Sewerage Enterprise, which is also one of the future six new share holding regional companies), and not only one of its subsidiaries as it is the case in the current Martin project. Moreover, the current proposed Final Beneficiary, as defined in the Financing Memorandum (in fact a Joint Stock company established in 1998 with the intention of taking over the assets of the present water supply and sewerage systems in the region presently covered by the subsidiary above mentioned, and operating them on a commercial basis, see §3.4.3) has no assets and has not operated yet as a Company.

- *Recommendation 34 : The Final Beneficiary in the FM should be changed, and this role should be given to the current SeVaK. However, in the perspective of reinforcing the SeVaK as precursor of one of the new regional companies, it should be also convenient first to assess the priority of the Martin project in the more general framework of the SeVaK development.*

4.3.3 Trencin

Risk:

The Trencin case presents several particularities, not only because it is one of the first "exceptions" in the transfer of water and wastewater assets to the municipalities, or because it is by the moment the sole case where there is effective participation of the private sector in the management of these assets, but also because of the followed procedure (detailed in § 2.2.1.2) and the contents of the agreement between TVK and TVS (discussed in § 2.2.1.5). Even if in this agreement (dated 7th October 1999, that is to say one year after the decision on privatisation on August 1998) the possibility of obtaining ISPA financing for the new WWTP is specifically mentioned and included in the financial plan, there is a risk that ISPA contribution is perceived as inducing undue profits to the private partner, and/or that benefits for the local population induced by the ISPA contribution are not evident.

Recommendation 35 : TVK, as Final Beneficiary, should renegotiate the agreement with TVS in order to reduce the current advantages of TVS that may increase to a point where profits could be considered undue (refer to detailed enumeration in § 2.2.1.5). At least a commitment of TVK on this matter should be asked for and made available in the very near future.

APPENDIX 1

List of meetings

APPENDIX 2

Questionnaires

- **NITRA**
- **KOMARNO**
- **BANSKA BYSTRICA**
- **TRENCIN**

APPENDIX 3

Specific additional information for Banska Bystrica and Zvolen

APPENDIX 4

Specific additional information for Komarno

APPENDIX 5

Comparison of terms and conditions of the proposed commercial loans

Table of Commercial Loans for 6 Slovakian ISPA Environmental Projects

Project	Currency	Volume	Loan Term	Interest Rate	Installment Period	Grace Period	Interest Payments	Fees	Security
Komarno (eligible ISPA costs)	SKK	€0.011m	15 years	3-month Bribor+2.5% p.a. Variable	24 semi annual repayments	3 years	Monthly	1%	a)Pledge right for existing real estate. b)Pledge right for receivables ensuring from the agreement with the operator.
Komarno (non-eligible costs)	SKK	€0.794	12 month revolving for a period of 5 years	3-month Bribor+2.3% p.a. Variable	Monthly	None	Monthly	1%	As above
Banska Bystrica	SKK	€1.367m	15 years	3-month Bribor+1.95% p.a. variable	Quarterly or semi-annually.	3 years	Monthly	0.8%	a)lien on fixed assets of StVaK, except for ISPA assets. Bank notes condition of EU to deliver Binding Promise by MoA guaranteeing financial viability of StVaK for the period of ISPA assistance provided by the project. b)guarantee by another good-standing credible subject.
Zvolen	SKK	€0.742	15 years	3-month Bribor+1.95% p.a. variable	Quarterly or semi-annually.	3 years	Monthly	SKK 250k	a)as for Banska Bystrica above b)Credit will be secured by the real estate property of the city of Zolen in the amount of 50% of the credit.
Nitra									
Trencin									
Martin									

Notes:

1. Bribor is the Bratislava inter bank overnight rate (similar to Libor etc.)
2. 3 – month Bribor is currently (14th March 2002) 7.6%, while Euribor (European inter bank overnight rate) is currently 3.38%.
3. If IFI funding had been used, it is reasonable to assume that interest would be calculated based on Euribor, plus a small margin, typically 1.5%.
4. The effective rates for the four loans above and comparison to typical IFI interest rates based on Euribor are shown in the table below:

Loan	Interest	Current Effective Interest Rate	Typical IFI Interest Rate	Bases point difference
Komarno (eligible ISPA costs)	3-month Bribor+2.5% p.a. Variable	10.1%	4.88%	5.22
Komarno (non-eligible costs)	3-month Bribor+2.3% p.a. Variable	9.9%	4.88%	5.02
Banska Bystrica	3-month Bribor+1.95% p.a. variable	9.95%	4.88%	5.07
Zvolen	3-month Bribor+1.95% p.a. variable	9.95%	4.88%	5.07

APPENDIX 6

Bibliography

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1 ISPA Documents-General

- Practical Guide to Phare, ISPA and Sapard, December 2000
- ISPA Manual, July 2001
- ISPA “In a Nutshell”, 2000
- Framework for Funding of Investments in the Field of Environment, 1999

2 ISPA Documents related to Slovak Republic Environmental projects

- Guidelines on management of financial means during the implementation of ISPA program, undated
- Memorandum of Understanding on the Utilisation of the National Fund for ISPA, undated
- Financing Agreement for the Implementation of ISPA projects through Implementation agency, undated
- National ISPA strategy of the Slovak Republic: Environment, October 2000

3 Slovak Republic Documents: Environment/NEAP/Green papers

- Report on Water Management in the Slovak Republic, 2000 (“*The Green Report*”), published by Ministry of Agriculture, November 2000
- Report on Water Management in the Slovak Republic, 2001 (“*The Green Report*”), published by Ministry of Agriculture, November 2001
- The Concept of Water Policy of the SR till 2005, published by Ministry of Agriculture, June 2001
- National Environmental Action Programme (NEAP) II published by Ministry of Environment, 2000
- Environment of the Slovak Republic, published by the Ministry of Environment, 2001

Slovak Republic Government Acts/ Decrees

- Resolution of the Government of the Slovak Republic No 35 of January 17th 2001 about the Report on the Procedure of the Implementation of the transformation of the State Water management and sewerage Companies and Gratuitous Transfer of State Owned Assets to the Ownership of Municipalities
- Resolution of the Government of the Slovak Republic No 217 of March 2001 about the Schedule of \measures for further Transformation of the state water management and Sewerage Companies and Gratuitous Transfer of State Owned Assets to the Ownership of Municipalities
- Resolution of the Government of the Slovak Republic No 542 of June 13th 2001 about the Report of the Evaluation of the Proposals of Municipalities to Establish Municipal Shareholding of Water management and sewerage Companies

4 Individual ISPA Project Documents

a. Trencin

- Financing Memorandum, signed by EC, 5th December 2000
- ISPA Information sheet for Trencin No 2000/SK/16/P/PE/001
- Correspondence and attachments from TVK to Ministry of Environment dated 18th December 2001 relating to JSCs: TVK and TVS privatisation process and enclosures 2,3 and 4 relating to Government Decree 577, Agreement about establishing JSC TVK and Notary Statement, and Agreement about establishing JSC TVS.
- Organisational structure TVK and TVS
- Document (in Slovak) dated 27/2/2002 provided by Municipality of Trencin as requested at Meeting relating to TVS operations.
- Document (in Slovak-undated) provided by Municipality of Trencin as requested at Meeting relating to analysis and projections of TVK and TVS for the period 2000-2017.
- Programmes for works and services for tendering and construction of Trencin WWTP.

b. Komarno

- Financing Memorandum, signed by EC, 14th May 2001.
- ISPA Information sheet for Komarno No 2001/SK/16/P/PE/004
- Loan Promise from PKB Bank dated 11th July 2001
- Completed Questionnaire for Komarno
- Document provided by Municipality of Komarno at Meeting showing flowchart of transformation of operational assets from ZsVAK to CIVITAS/ KOMVaK via Municipality.
- Ditto showing organisational chart for KOMVaK
- Document provided later by Municipality of Komarno as requested at Meeting showing affordability calculations for ISPA project
- Ditto regarding correspondence with DG Regio concerning DG comments (20 No) and clarification (undated)
- Ditto regarding correspondence with DG Regio concerning DG Regio comments raised at meeting with Ministry of Environment on November 10th 2000
- Ditto regarding correspondence with Mr O'Brien in response to DG questions, reference DG Regio/2 D(2000) of 18th October
- Ditto regarding correspondence between the Mayor of Komarno and Mr Seyler, DG Regio, Brussels dated 12th February 2002 regarding changes to the ISPA budget for TA and site supervision
- Ditto letter from Ms Maria Kadlecikova to DG Regio dated December 7th 2001 regarding signing of Financial Memorandum by Slovak Government and changes to the co-financing distribution arrangements.
- Ditto Slovak Government document (in Slovak) relating to Komarno Financial Memorandum dated 28th November 2001.
- Ditto letter from Mayor of Komarno dated 1st March 2002 with attachments requested at meeting.
- Ditto Annual report for 2000 for KOMVaK and attachments for 2001(in Slovak)
- Ditto Annual Report for 2000 for CIVITAS and attachments for 2001 (in Slovak)
- Ditto financial information for Komarno Municipality 1999-2001 (in Slovak)

c. Nitra

- Completed Project Questionnaire together with organogram of Nitra Municipality staffing including (proposed) WWTP employees.
- ISPA Information sheet for Nitra No 2001/SK/16/P/PE/002

d. Martin

- Financing Memorandum, unsigned.
- ISPA Information sheet for Martin No 2001/SK/16/P/PE/007
- Completed Questionnaire for Martin

e. Banska Bystica

- Financial Memorandum, signed by EC and SR dated 4th April 2001, and Amendment No 1 to Financing Memorandum (unsigned)
- ISPA Information sheet for Banska Bystrica No 2001/SK/16/P/PE/003
- Loan Promise from VUB Bank dated 16th July 2001
- Completed Questionnaire for Banska Bystrica and Zvolen.
- Document provided by STVAK at Meeting showing correspondence between STVAK and Ministry of Agriculture dated 30th August 2001 regarding SVAK's proposal for transformation (in Slovak)
- Ditto regarding STVAK financial projections to 2004 and audited attachments dated 31st December for years 1997/1998/1999 and 2000 (in Slovak)
- Ditto brochure on STVAK (in Slovak)

f. Zvolen

- Financing Memorandum, unsigned.
- ISPA Information sheet for Zvolen No 2001/SK/16/P/PE/005
- Loan Promise from VUB Bank dated 15th October 2001
- Completed Questionnaire for Banska Bystrica and Zvolen with attachment comprising Annex IV of ISPA Application for Zvolen WWTP entitled *Institutional Assessment*.
- Schedule entitled *Report on status of Tender Documents* (undated)
- Final report on Zvolen WWTP by Carl Bro dated November 2001

5 Miscellaneous Background material

- Data on water management: New investment costs and operation cost in 2000 by J Neradovicova: population, various parameters and drinking water data
- Letter from Deputy prime minister dated 13th December 2001 regarding current PPP Mission.
- Letter from Ms Maria Kadlecikova to DG regio dated February 5th 2002 regarding status of transformation process and details of TVS/TVK Trencin
- Country Report, Slovakia published by Erstes Bank, 4Q2001
- Statistical data on Slovak Republic, 1996-2000, source unknown
- Section 3, Economic Criteria, European Commission report (abstract), 2001

- ISPA and its support for PPP in CEE and Baltic States, by Roberto Ridolfi. Paper to Conference on Water Industries of CEE and Baltic States, Prague, October 2001
- Directive 91/271/EEC concerning urban waste water treatment
- Directive 1267/1999/EC establishing an instrument for structural policies for Pre-accession