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STATUS OF PROGRAMME IMPLEMENTATION

PROMOTING BEST PRACTICE IN EFFICIENT PUBLIC-PRIVATE PARTNERSHIPS

**POLICY RECOMMENDATIONS ON IMPROVING THE LEGAL BACKGROUND
FOR EFFICIENT PPPs**

Note by the secretariat

INTRODUCTION

1. At its second session (5-7 December 2007), the Committee on Economic Cooperation and Integration mandated, as part of its Programme of Work for 2008, the preparation of a comparative review on the legal background of public-private partnerships (PPPs), with the goal of identifying whether new legislation needs to be adopted to make PPPs more efficient (ECE/CECI/2007/2, annex II, Focus Area: Promoting best practice in efficient public-private partnerships). In addition, the Committee asked for a synopsis of policy recommendations on improving the legal background for efficient PPPs to be prepared and discussed at the annual session of CECI.

2. The Team of Specialists on Public-Private Partnerships included the preparation of the review and the synopsis of policy recommendations in its implementation plan for 2008 and 2009 at its first session (28-29 February 2008). It was agreed that this task would be undertaken in close cooperation with the European Community and other relevant organizations

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(ECE/CECI/PPP/2008/2, Annex I, paragraph 9). A significant number of experts expressed interest in contributing to the finalization of this document by either sending relevant materials and information to the secretariat or reviewing the final draft. The Team of Specialists agreed on a procedure and a timetable of activities for the preparation of these documents (ECE/CECI/PPP/2008/2, Annex II, items A2. and A3.).

3. On the basis of this mandate, the secretariat prepared an outline with the proposed structure of the review and selected issues that should be covered and invited comments from the experts who expressed interest in contributing to this work. In order to collect information necessary for the preparation of the review, the secretariat distributed a questionnaire on issues pertaining both to national legislation on PPPs and practical experience with its application. The purpose of the questionnaire was to try to identify good practices in this area in order to be able to provide recommendations.

4. Responses to the questionnaire or text of relevant legislation were received from experts of 15 countries¹. In some cases, the material submitted gave an insight into the existence of specific legislative provisions governing PPPs but not into the issues related to their practical application. For this reason, therefore, it was possible to draw only preliminary conclusions on the extent and manner to which these provisions were implemented in PPP projects or what the practical implications of other relevant laws and regulations in these countries were.

5. The purpose of this document is to use information provided by national experts to draw some preliminary conclusions on what constitutes good practice in enabling legal frameworks for PPPs and make recommendations for possible improvements. The recommendations focus on selected issues in existing legislation governing public-private partnerships in the UNECE region in order to identify potential gaps and provide direction on possible improvements.

6. The recommendations are structured around these key areas related to PPP legal framework:

- (a) ***legal efficiency***, i.e. increasing the speed with which PPPs can be completed, standardised contracts, performance monitoring, dispute resolution, etc.;
- (b) ***providing fair treatment to investors***, eg guarantees against expropriation without fair compensation; and
- (c) ***regulating effectively to protect the public interest***, including the contribution of PPPs to sustainable development.

7. In its review of concession laws, the European Bank for Reconstruction and Development derived some common elements that constitute best practice in this area². In reference to the best practice, the results of this work as well as the UNCITRAL's Model Legislative Provisions on Privately Financed Infrastructure Projects have been used as a basis for identifying key issues to be reviewed in this document.

¹ These are: Belgium, Bulgaria, Croatia, Czech Republic, France, Greece, Hungary, Israel, Poland, Republic of Moldova, Netherlands, Slovenia, Spain, United Kingdom, and United States of America.

² See EBRD Concession Law Assessment at: <http://www.ebrd.com/country/sector/law/concess/assess/index.htm>.

8. It is frequently suggested that the main factors constraining the availability of privately financed infrastructure cover the following legal and institutional weaknesses:

- (a) inadequate regulation both at a legislative and administrative levels leading to high contracting and bidding costs and poor bankability of projects;
- (b) lack of sound institutional framework adapted to promotion of PPPs;
- (c) lack of effectiveness of contracts and poor enforcement;
- (d) less developed judiciary with inadequate enforcement mechanisms;
- (e) lack of competition and transparency of selection procedures; and
- (f) unpredictability and vagueness on the authority within government to negotiate and approve projects.

9. When it comes to approaches to these issues in the legal environment, it considerably differs among UNECE member States. In some countries, there are no specific PPP laws, but there are laws, usually on public procurement or concession agreements, that are applied to PPPs *mutatis mutandis* (eg United Kingdom). There are countries that have comprehensive PPP laws (eg Greece). There are also countries that have concession laws that give only general provisions with specific legislative requirements set out only in sector-specific laws (eg Croatia). In countries with federal structure, there are often few legal obligations at the federal level and different federal units (states or provinces) often enact their own legislation the level of sophistication of which differs in relation to the breadth of experience with PPPs (eg Belgium). There are examples of countries that have separate laws or provisions governing PPPs in which the public partner is a subnational (regional or local government) entity (eg United States of America).

10. The novel nature of PPP arrangements means that, in their management, the countries either use legislation originally drafted for activities that differ to a considerable extent from PPPs or enact new legislation precisely in order to resolve ambiguities in existing legislation. In the latter case, there is limited experience with the application of new legislation. Because of long-term nature of PPPs it is difficult to make conclusions on the overall effectiveness of legislation if it has so far only been used during the tendering procedure and contracting stage but not during the entire life-cycle of the projects.

11. It is evident that the decision on enacting laws governing PPPs will to a large extent depend on the agility and interest of the executive branch of government. Strong political will is usually what pushes PPPs forward and in many countries this is taken as part of a wider administrative reform. It is a popular policy tool for the governments that seek to undertake finance infrastructure development without the immediate need to increase the tax burden. However, the starting point for the implementation of PPPs in any transition country should be the assessment of relevant needs of the country in question and ensuring that increased efficiency is the main drive for using a PPP structure, rather than being driven by a desire to move expenditure off-budget and debt off-balance sheet.

12. This works in both directions as political will may also be weak because of sometimes negative public perception of PPPs, primarily because they are seen as a form of privatisation which in many transition economies was conducted without the necessary regard to good governance practices in the area. This at least partially explains why some countries enacted laws

that put emphasis on strong public interest safeguards rather than facilitating PPP arrangements. In some countries, there have been no specific laws simply because they had no PPP projects for which these laws were needed.

13. Existence of specific laws governing PPPs is significantly influenced by the nature of the legal system and legal tradition in a country. In the majority of UNECE countries civil law prevails, so laws governing specificities of PPPs are enacted in order to provide the necessary degree of flexibility that PPPs require. Common law tradition, on the other hand, frequently treats PPPs as a form of public procurement which does not require separate legislative arrangements. Countries with prevailing common law system usually undertake PPP projects under the guidance of their general public procurement laws as well as the so-called “soft” laws (rules, guidelines) and case law³.

14. It is also important to note that Member States of the European Union are under obligation to harmonise their legislation with the relevant European Community directives and candidate states and those aspiring to future accession usually choose to do the same to some extent. This means that EC law is relevant for many countries in the UNECE region, either because they are Member States of the European Union and Community Law there is applied in addition to their national legislation or they are not part of the Union but they choose to use elements of the Community Law as a model when drafting their national legislation. Although not all Member States of the European Union have specific laws governing PPPs, they all have to meet the requirement to comply with certain articles of the Treaty Law. These, however, are quite general and relate mostly to non-discrimination provisions and the use of competitive dialogue⁴ in tendering.

I. BASIC LEGAL PROCESSES RELATING TO PPPs

15. The length and complexity of contract preparation and review after signature is an important aspect of legal efficiency. In some countries, contracts are quite simple and oblige a review every few years. In others, contracts are more complex, but there is no specific obligation to make revisions of the agreement, so in practice they can occur at any time. These comparisons are useful in identifying good practice, as well as trade-offs in approach, in different jurisdictions. Another aspect to be highlighted and compared is the length of time it takes from the start of a project to its contract to be executed. The aim is to achieve balance between transparency and efficiency, with increased level of input from the private sector which should improve the quality of decision-making on a project.

³ The main difference between civil and common law is in that common law draws abstract rules from specific cases, whereas in civil law abstract rules (i.e..legislation) are put in place first, which courts apply to make decisions on specific cases. This difference historically comes from common law being developed by [custom](#), beginning before there were any written laws and continuing to be applied by courts after there were written laws, too. The roots of the civil law come from the Roman law of Justinian's [Corpus Juris Civilis](#) (Body of Civil Law).

⁴ Defined in EC Directive 2004/18/EC as "a flexible [procurement] procedure ... which preserves not only competition between economic operators but also the need for the contracting authorities to discuss all aspects of the contract with each candidate." It is specifically intended for use in markets that are “particularly complex” in legal, financial and technical terms. Its outcome is defined as 'final tender' which is submitted after conclusion of the dialogue with candidates and it should contain all elements necessary for the performance of the project.

16. Evidence suggests that good practice at the international level in enabling legal environment for PPPs is as follows:

- (a) Clarity and efficiency of PPP legislation
 - (i) Importance of putting into place a clear legal framework regardless of whether this entails enacting specific PPP law or amending existing concession and public procurement laws;
 - (ii) Providing clear definition of a PPP in the law;
 - (iii) Where necessary, providing interpretative regulation specific to PPPs;
 - (iv) Keeping in mind the importance for the complementariness of different laws pertaining to PPPs, especially in the course of legal reform;
 - (v) Ensuring that the law provides provisions for putting into place a clear remedy system;
 - (vi) Promoting, to the extent possible, the putting into place and application of uniform rules of procedure for all PPP projects;
 - (vii) Setting legal provisions for a clear communication and coordination mechanism within the public sector for all matters pertaining to PPP policy and PPP projects in different sectors and different levels of government;
 - (viii) Ensuring clarity in legal provisions stipulating which sectors or aspects of PPPs are exempted from regular public procurement requirements (e.g. where they are subject to different laws than existing PPP or concession law as well as statutory law); and
 - (ix) Ensuring integration of the PPP programme into the budgetary system.

- (b) Start-up procedures for PPPs
 - (i) Setting out formal requirements for evaluation that should be undertaken before starting a PPP process, for example, by developing a business case demonstrating the type of procurement to be used that offers best value for money;
 - (ii) Accepting, as a matter of principle, only solicited bids;
 - (iii) Making a requirement for all tender notices for pre-selection of bidders to include all information that is necessary for the public entity to correctly assess the bidder's technical, professional and financial capacities to implement the project;
 - (iv) Applying the principle of free competition by encouraging greatest possible participation of bidders capable of meeting the requirements specified in the tender and by using objective selection criteria and with the possibility to challenge selection criteria before bidding with an appeal to an independent tribunal;
 - (v) Putting legal safeguards in place to ensure transparency in selection of bidders through proportionate weighting of both technical and economic factors and applying the principle of transparency in publicizing intention to conclude a work or service contract with a public entity;
 - (vi) Applying the principle of equal treatment in avoiding discrimination on the basis of nationality or any other criteria that can not be objectively justified;

- (vii) Applying the principle of proportionality in contract award procedure in avoiding requirements for technical, professional or financial capabilities that are disproportionate or excessive with respect to the contract in question;
 - (viii) Applying the principle of mutual recognition in accepting the technical specifications, controls, qualifications or certifications of a foreign bidder as long as they are equivalent to those in the country the government of issuing the bid;
 - (ix) Applying the principle of protection of public interest by taking into account the need to minimize the financial burden of the contracting authority, and the needs of the users for improved services;
 - (x) Applying the principle of the protection of the rights of private individuals in providing justification for all decisions of the contracting authority and provide judicial protection for private entities bidding for a contract; and
 - (xi) Applying the principle of protecting the environment and promoting sustainable development by taking into account the need to maintain environmental balance and preserve natural resources when specifying criteria for selection of bidders.
- (c) PPP coordination mechanism
- (i) Putting into place clear legal provisions on the role and mandate of a PPP coordinating mechanism which should have the power to assess the suitability of projects to PPP criteria, participate in implementation and monitoring; and
 - (ii) In countries where there is no centralized decision-making process for PPPs, encouraging sharing of good practice by encouraging subnational entities to set up units that act as PPP clearinghouses, i.e. repositories of information on projects.
- (d) Contractual issues
- (i) Where possible, designing a standardised PPP contract, or, where this is not possible, a list of compulsory provisions that need to be provided in every PPP contract;
 - (ii) In the contractual procedure, clearly identifying the financial, technical, socio-economic and legal reasons for a decision to implement a project through a PPP, listing criteria for selection of a private partner, actions which may be taken by the contracting authority to prepare the award procedure for a contract (e.g. recruitment of advisors, elaboration of preliminary studies and preparation of draft contracts), deciding on the form and indicative schedule for the contract award procedure as well as the indicative budget for the work and services to be provided under the terms of the contract; and
 - (iii) In the contract, the focusing on the results to be achieved and standards to be met by the private partner, rather than the means by which they are achieved.

- (e) Implementation and performance monitoring procedures
 - (i) Specifying performance monitoring criteria and mechanisms in the PPP contract, in particular the conditions of public control over the execution of the contract with regard to performance indicators as well as the frequency of audits;
 - (ii) Conducting regular performance reviews to ensure best value throughout the life cycle of a PPP project and assess applicability of the type of procurement used;
 - (iii) Keeping records of performance reviews of PPP projects in order to create a repository of good practices on the basis of which guidelines and standards for the selection, monitoring and assessment of future PPP projects can be made;
 - (iv) Structuring the payment mechanism so as to be conditional on the private partner attaining stipulated performance criteria; and
 - (v) Laying down in the PPP agreement an objective basis for determining how any adjustments can be made, with possible remedies and dispute-resolution procedures that can be used.

II. PROTECTION OF INVESTORS

17. In order to stimulate the PPP market, in certain cases a single comprehensive law that covers all the necessary elements of regulation for PPPs seems to work well. In other countries, each PPP contract is considered a *sui generis* and consequently standardized rules that would cover all PPP projects would be difficult to apply. Regardless of the approach, it is important to avoid creating a legal environment for investors that is too complex for both investors and public authorities working to ensure that equal rules apply for all PPP arrangements. In addition to their national legislation, countries have obligations in accordance with different international instruments, such as: World Trade Organisation agreements, Bilateral Investment Treaties, free trade agreements, EU anti-subsidiary rules, International Centre for Settlement of Investment Disputes Convention and the OECD Declaration on International Investments.

18. The following good practice in facilitating PPP projects for investors has been identified:

- (a) Fair treatment of bidders
 - (i) Ensuring transparency of the selection process by clearly defining criteria for selection and disallowing for disproportionate weighting of technical factors in the process;
 - (ii) Providing information to potential bidders on the technical and performance requirements, revenue projections and their basis, procedural requirements, criteria for sponsor selection as well as expected arrangements for regulation and risk sharing;
 - (iii) Providing entitlement on the part of unsuccessful bidders to receive full details of why their bid was unsuccessful as well as enabling them to challenge the decision of the public authority in the court of law; and
 - (iv) Ensuring that all bidders have the same access to information on conditions and criteria for selection when preparing their applications.

- (b) Contractual arrangements for risk allocation and mitigation
 - (i) Requiring minimum amounts of insurance relating to areas which impinge directly on public interest (for example, physical damage, third party claims, and employer's liability) and leaving other areas (for example, business interruption, latent defects) to be dealt with at the private partner's discretion;
 - (ii) Creating an empowerment and shared leadership environment in which policymakers and PPP programme managers work together with private sector partners in a relationship that is open and respectful; and
 - (iii) Introducing fewer management levels and fewer centralised support staff on the part of the public authority while giving maximum autonomy to both private and public implementing partners.

- (c) Government's unilateral interference and settlement of disputes
 - (i) Providing the private partner with compensation in case a PPP contract is unilaterally amended, modified or terminated by the contracting authority for reasons of public interest;
 - (ii) Providing dispute settlement arrangements that put on equal footing both the public private partners and enable the former to challenge decisions of the latter;
 - (iii) Providing for full compensation for transferred assets to be paid as a starting point in case of non-performance, but allowing the public sector to deduct its actual losses (for example, rectification costs) attributable to the private partner's default;
 - (iv) Allowing step-in rights to the lender in case of the private partner's default, including the right to substitute with a new contractor;
 - (v) Valuing assets taken back into public hands on a different basis than where the government is at fault (for example, a proportion of historic cost, as opposed to a depreciated replacement value); and
 - (vi) Disallowing expropriation unless public interest is at stake and only providing that full indemnities are paid to the investor as well as allowing the decision of the regulatory agency and the amount of compensation to be challenged in the court of law.

III. PROTECTION OF PUBLIC INTEREST

19. Good practices in enabling legislation suggest that general government policy principles that create a better regulatory environment for PPPs while ensuring the necessary conditions to protect public interest are:

- (a) Public information, consultation and access to justice
 - (i) During the planning stage, providing the highest possible degree of public information and participation in decision-making in proportion to the purpose, nature, subject and scope of the PPP project;
 - (ii) Establishing and regularly updating the record of PPP contracts with all relevant information, with the exception of respecting the confidentiality

- of commercial and industrial information, where such confidentiality is protected by law in order to protect a legitimate economic interest;
- (iii) Interpreting confidentiality of information in a restrictive way, taking into account the public interest served by the disclosure;
 - (iv) Requiring the contracting authority to consult future users of services provided through a PPP during the planning stage of the project as well as to inform them of their rights in the process and procedures which can be used to exercise these rights;
 - (v) Ensuring that consumers are protected by quality requirements and price limits whilst permitting a fair return on investment; and
 - (vi) Allowing users of services provided by the private partner in a PPP project to demand reimbursement for damages.
- (b) Ensuring value for money
- (i) Developing a public sector comparator that allows the public authority to correctly assess the prospective benefits before deciding on a PPP project;
 - (ii) Establishing risk-sharing arrangements in a PPP project that seek to provide long-term protection of taxpayers against future liability and provide real value for money⁵;
 - (iii) Using competitive dialogue where the contracting authority is unable to elaborate technical specifications or legal and financial criteria for a project or where it is unable to identify these criteria at a level or detail required for open or restricted procedures;
 - (iv) Providing access to the accounts of the PPP projects to the regulators to determine appropriate user charges and to verify compliance; and
 - (v) Conducting regular reviews in the form of independent audit and publication of audit results.
- (c) Environmental protection rules
- (i) Making a legal requirement for a PPP contract to take into account the performance objectives in the area of sustainable development among criteria for the award of the contract; and
 - (ii) Establishing the polluter-pays principle with regard to the prevention and remedying of environmental damage caused by the private partner in a PPP.

⁵ It is important here to emphasize the affordability, limited budget allocations, and legally imposed budgetary limits of PPPs regulation. In that sense we draw your attention to the OECD book entitled which says that “in many countries there are limits on the extent to which second-and third-tier government authorities can borrow, with many cases where they cannot borrow at all. There are also countries with fiscal rules that limit government expenditure, deficit or debt. In absence of such a limit, a government entity such as a local authority might have been able to borrow to finance a traditionally procured project and service the debt with its expected future revenue flows. As such, the project and the borrowing it implies might be affordable, even though the legally imposed budgetary limit prohibits borrowing.” (see *Public-Private Partnership in Pursuit of Risk Sharing and value for Money*, OECD, 2008, pp.44ff)

IV. CONCLUSIONS

A. LEGAL EFFICIENCY AND CERTAINTY

20. Experience suggests that the legislative measures that are pertinent to PPPs can take several forms: PPP law, concession law, public procurement and sector-specific legislation or a combination of several of these the application of which is also influenced other general laws affecting the overall business climate (e.g. competition, private contract law, company law, tax law, labour law, employment law, consumer protection law, insolvency law, infrastructure sector laws, property law, foreign investment law, intellectual property law, environmental law, acquisition or appropriation law, fiscal law and dispute resolution and arbitration).

21. A normative and regulatory framework that encourages the participation of private sector in public infrastructure development will seek to provide a clear, flexible and stable legal environment with provisions on a fair treatment of investors. In addition, involvement of the private sector will have a positive effect on coordinating bodies within the public administration and providing clarity as to the objectives to be achieved.

22. Experience collected from the countries that were reviewed indicates the common need for legal certainty in rules that govern PPP arrangements. In order to ensure the most efficient PPPs as well as good governance in their development and implementation, an effective national legislative framework needs to provide both predictability and security for investors as well as to protect public interest and guarantee the right to information, participation in decision-making and access to justice to the project beneficiaries as well as the general public.

23. There is a general agreement that balance is needed, therefore legislation governing PPPs should not be overly prescriptive, but rather set, wherever possible, only general parameters in such as way to enable both public and private sector partners to design and implement these projects in a most efficient manner without adverse affect on public interest.

24. The right balance between general and specific legislation is needed to ensure that PPPs can be undertaken where they offer value for money while making sure that public interest is protected at all stages of project implementation. In all this, the main challenge is to set standards that ensure transparency in regulating the widest possible range of PPPs without 'overregulating' them.

B. ACCOUNTING FOR COUNTRY-SPECIFIC LEGAL ENVIRONMENT

25. When deciding what approach to take, countries seem to learn best from the countries with similar political, economic, legal and governance conditions. There are many examples of contracts being awarded in countries with economies in transition in circumstances where a regulatory regime is underdeveloped or even non-existent. In those cases, individual PPP agreements may constitute regulatory tools.

26. The scope of financial balance clauses in PPP contracts also tends to differ radically between projects in countries with economies in transition, where risks may be much harder to predict, quantify and manage, and developed economies, with their more stable business

environments. In these countries, the concessionaire will usually press for the broadest possible protection against unforeseen risks. Sometimes, it will even be entitled to seek an adjustment for any material adverse event beyond its control (although a mechanism expressed in such generalised terms would generally be considered too vague today).

27. In developed countries of the UNECE region, the private partner is often allowed only very limited protection of this nature (limiting any change of law to discriminatory and specific changes, for example). In the end, the critical factor for the regulatory agency will be the perception of risk in the particular environment in which PPP project is implemented.

28. In both transition and developed economies, evidence suggests that, regardless of legal provisions, innovative solutions frequently have to be found, taking into account the specificities of each project⁶.

29. It can be concluded that countries that chose to enact specific legislation for PPPs frequently demonstrate strong political commitment to undertake PPP projects. Such legislation usually seeks to clearly define the roles and responsibilities of different government agencies and improve the transparency of procurement procedures and investor's rights. The contractual approach, which is most frequently used in common law-countries, generally offers greater flexibility because it allows contractual changes to be made at any stage of the project's life cycle. It also facilitates dissemination of good practice through standardisation of contract clauses that are common for all PPP projects.

30. The division is not straightforward in practical terms since there is a degree of common law influence in civil law jurisdictions, most often through the influence of supranational regulation, including EC Law, which leads to the adoption of certain elements of common law into civil law jurisdictions.

31. In favor of the civil law system one could argue that because there is legislation on devices like public work and procurement this provides for a greater degree of legal certainty from on investors point of view. At the same time, the civil law system guarantees the legal certainty of law by enforcing the investors' rights against alleged violations of the successive governments. The effectiveness of civil law legislation is based on a democratic process (deliberative representative assembly), which cannot be overruled without the repeal of the specific law. In the civil law system there, at least in principle, seems to be less room for discretionary power or misuse of authority and therefore no lack of legal clarity.

32. In spite of apparent differences, it can be argued that both approaches (civil law in framework legislation and common law contractual approach) in the end achieve the same goal: increasing legal certainty for bidders and lenders, and speeding up the procurement procedure.

⁶ "Public-private partnerships in central and eastern Europe: structuring concession agreements" Christopher Clement-Davies, in *Law in Transition* (2007), EBRD.

C. CHALLENGES OF IMPLEMENTATION

33. It is therefore not possible to prescribe the 'one-fits-all' approach to all countries. What legislative measures different countries will adopt will largely depend on the nature of their legal systems, existing legislation, scope of experience in PPPs and a host of political considerations, which include *inter alia* perceptions of private sector involvement in public service delivery, relationships between professional civil service and elected governing bodies and, for example, possible aspirations on joining the European Union.

34. Above all, what matters is how laws are implemented. In some cases interpretative regulations are put in place to ensure that legal requirements that are either too complex or too general are clarified. Good governance in this area is reflected in the degree of action-orientation, which enables the public authorities to identify problems as early as possible and seek to resolve them efficiently as well as clear commitment to public service values in decision-making on most appropriate public procurement procedure.

35. The role of the judiciary should be emphasised not only because it should ensure that laws are respected but because it creates jurisprudence that either further interprets the law or, in countries where specific legislation governing PPPs does not exist, sets precedents that have implication for future PPPs. Even the best framework legislation will remain ineffective if implementation mechanisms are weak or non-existent or if high level of corruption perverts the justice system. Independent judiciary, low level of corruption and regulatory safeguards to prevent abuse of public funds are all important factors that will foster the creation of real partnerships between the private and the public sectors to the mutual benefit of all.

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