



Public Private Partnerships in the Mediterranean with a focus on Cyprus legal implications

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Introduction

Not long ago, privatisation meant that municipal assets, such as a hospital or a waste treatment plant, would be sold to a private company that would own and operate the facilities. Over the past few years the term has become more complicated and now refers to a range of situations starting with full privatisation and ending in a loose kind of co-operation between the public and the private sector.

“Public Private Partnership” (PPP) is a variation of privatization in which elements of a service previously run solely by the public sector are provided through a partnership between the government and one or more private sector companies. Unlike full privatization scheme, in which the new venture is expected to function like any other private business, the government continues to participate in some way. PPPs are not entirely new, they have existed, in one form or another, for quite some time. In 1652, the Water Works Company in Boston was the first private firm in America to provide drinking water to citizens. Since then, governments and private firms have worked together through simple agreements, for example government purchase of products manufactured and produced by the private sector. What is new is the direction in which this co-operation is taken by all levels of government to bring together the public and the private sectors and also the increasing complexity of the ensuing relationships and agreements.

“Private Finance Initiative” (PFI) is another variation of privatization and was initially developed by the UK government to provide financial support for PPPs between the public and private sector. However, under the PFI, contractors pay for the construction costs and then rent the finished project back to the public sector. Basically, PFI is just a different way of borrowing money which allowed the UK government to get new hospitals, schools and prisons without raising taxes. This method, although quiet new in comparison to PPPs, has now been adopted by parts of Canada, France, the Netherlands, Portugal, Ireland, Norway, Finland, Australia, Japan and Singapore.



International interest

There is now great international interest in PPPs. The U.K. Treasury alone has been consulted on this subject by over 50 countries and the government has recently entertained representatives from at least 13 countries, including Australia, Japan, South Korea, China, Germany and Poland.

All over the world there have been numerous discussions and arguments about the advantages and disadvantages of PPP's both generally and specifically for distinct sectors. Several countries, such as Japan, Italy, Ireland and the Netherlands, have already organised ways to deliver such partnerships. Others are in the process of creating a legal framework to enable them to establish PPPs. In South Eastern Europe PPPs are being used to effect a successful transition to democracy and aid the recovery of the economy, though further efforts are needed to promote private sector participation.

Public Private Partnerships projects are already taking place in Europe, the USA and Australia. Countries are adopting this system with enthusiasm. A few examples are: Japan, which has several extensive programmes, Canada, which is working on a PPP road project and Norway, where a rail scheme is under way. In Ireland PPP has now become a central feature of public policy. Of the mainland European countries, only Germany and France have been slow to follow this trend, Germany because the legislation is prohibitive.

Cyprus is one of the countries showing an interest in this type of privatization and the government has already taken steps to form the necessary legislative framework. Every medium in the legislative and executive process has given public private partnerships its seal of approval and the first PPPs have already been formed.

Legal framework

The legal framework within which PPPs function is very important for their effective application and for their very existence. Local governments around the world found that many of the opportunities for embarking on PPPs were constrained by numerous provisions in the relevant national legislation. Such partnerships need legislative, administrative, political and social environments that support the process their development and the achievement of their objectives over time.

In its decision dated May 12th 1999 the Council of Ministers of Cyprus approved the creation of a statutory regulatory framework for the undertaking of PPPs.

The framework approved by the Council of Ministers for use in Cyprus provides for the creation of a Ministerial Committee under the presidency of the Minister of Finance and a Central Service Committee under the presidency of the General Manager of the Planning Bureau. These Committees will be responsible for the systematic introduction of the Design-Build-Finance-Operate method of public private partnerships to Cyprus.



Public Private Partnerships are context-based. Methods used in one community will not necessarily work in the same way, or indeed work at all, in another and the surrounding environment is a very important factor in the feasibility of PPPs. In observing the way in which other states have utilised PPPs a government can draw out ideas and models which may be adapted to suit the community's needs, but it should not transplant the system as a whole without modifying it to serve their own country better.

Acknowledging the complex character of PPPs the Council of Ministers, in its decision dated March 14th 2001, has approved the creation of a Central Unit in the Planning Bureau which will process policy issues in relation to the Design-Build-Finance-Operate method. The Council has also approved the establishment of Guidance Committees of Works in all Ministries and has determined the definition and competence of the Co-ordinator of Works and the Technical Committees.

Enabling framework

The local authority or central government is enabled to make agreements or contracts in respect of its activities, works or services, including their undertaking, provision and operation. It is also empowered to acquire, hold, manage and dispose of any interest in all kinds of property. The disposition of real property may not be part of a PPP as such but it is an integral part of many partnership agreements and, as such, very important to their continued existence.

An Administrative Process has been approved by the Council of Ministers to apply in the assignment of works to the private sector using the Design-Build-Finance-Operate method. The Office of Programming has been designated as the relevant Service that will be concerned with the pre-approval of financial, economic and legal advisers from whom the competent Service will write bids for the preparation of the procurement documents.

Regulation must be designed not just to protect public interests, but must also create the conditions under which private firms can operate effectively and efficiently. Issues like predictability and certainty are very important to private operators and should be provided for in the legal framework.

Regulatory environment

It is imperative that mechanisms are put in place to minimise the likelihood or appearance of corruption, especially in contract procurement and private sector investment. Unpredictable and unfair procurement and investment processes that are vulnerable to corruption will reduce both the political acceptability of PPPs and the interest of many private investors. A regulatory framework is essential to the acceptance of a scheme both by the general public and the private sector.



Examples of anti-corruption measures include:

- Imposing stricter penalties on civil servants who accept bribes
- Penalising the firms that bribed or attempted to bribe a civil servant
- Prohibiting such firms from contracting with the government for a specified period
- Encouraging local and international non-governmental organisations as well as the media to act as “watchdogs”

In the UK performance-related penalties are now built into most contracts in the hope that they will ensure a continuing improvement in standards. US states have also provided for similar penalties in their contracts with private parties.

Cyprus should follow the example of the UK and make sure that there are penalties inserted in contract with private parties that ensure compliance with safety and quality standards.

But the creation of a regulatory framework is not enough to guarantee effective regulation. Transparency at the contract procurement stage and in evaluating the performance of the private party will go a long way towards combating corruption. The traditional “competitive bidding” procedure seems to satisfy this but it can only be used for the simpler agreements such as maintenance and service contracts. The structures of the more complex PPPs, such as joint ventures and Build-Operate-Transfer contracts, make the procedure inefficient. Despite this inherent incompatibility, fear of corruption makes governments reluctant to contemplate alternative procurement procedures.

Any alternative procedure must satisfy the transparency requirement. The use of “behind closed doors” negotiations adopted by the UK has raised the suspicions of civil employees and the general public, thus damaging the standing of PPPs. The very appearance of corruption will dissuade many private investors and injure the credibility of the parties involved.

This is especially important in Cyprus where, due to the small size of the community and the ties between families, it is easier for corruption to take place or to be alleged. Making clear publicly that everything is above board will make it more difficult for aspersions to be cast on the credibility of the scheme or the people involved in it.

Legal framework in compliance with the EU legislation

Under the EU Law, there is no specific system governing PPPs. However, PPPs created for contracts that qualify as “public contracts” under the procurement directives coordinating procedures for the award of public contracts and must comply with the detailed provisions of those directives.

Cyprus joined the EU on 1 May 2004, together with nine other countries. One of the conditions of its accession was transportation of the provisions of the EU procurement directives into the Cyprus Law. This means that all companies that set up in accordance



with the laws of EU Member States and have their registered office, central administration or principal office of business in the territory of the EU (and the European Economic Area and GATT signatories of the Government Procurement Agreement) now have free access to the public procurement market in Cyprus as well as markets in all other accession states.

The EU public procurement directives regulate the procurement of services, supplies and works not only by the public sector but also by utilities, whether they are publicly or privately owned. The main purpose behind the directives is to ensure that public sector contracts above certain threshold are open to fair competition for all contractors, whichever country they are based on. The EU directives are required to be transposed by Member States into domestic legislation, which must provide for appropriate remedies in the event of a breach of the procurement rules. The remedies that must be available under national law include damages and the potential to freeze the procurement process.

On 2 February 2004, two new public procurement directives were adopted replacing the previous directives. The new directives came into force on 1 May 2004 and the Member States (including the new members) must implement them into domestic legislation by 31 January 2006. One of the directives covers public sectors contracts, consolidating the previous three directives covering works, supplies and services. The other new directive deals with the utilities sector.

The two main objectives of the new legislation are to simplify the existing rules and bring them up to date with modern procurement methodology. There are therefore, changes to facilitate electronic procurement, to provide for increased transparency in relation to award criteria and to create a new procedure allowing for competitive dialogue between contracting authorities and tenderers.

For the purposes of harmonisation with the EU procurement Directives, the government of Cyprus enacted the Award of Public Contracts (Supply, Works and Service) Law 2003. The Council of Ministers exercising its Powers under the Law issued the Award of Public Contracts (Supply, Works and Service) (General) Regulations 2004 creating a statutory regulatory framework for the undertaking of PPPs. The new Regulations the Tenders Boards and the Evaluation Committees are the bodies that have the authority to broche and handle matters of the competition leading to the awards of contracts. The Tender Boards decides in matter of competitions for the award of contracts of unlimited value. The Evaluation Committee have the authority to decide in matter of competition for the awards of contracts below certain threshold. Nevertheless, even the awards of those contracts must comply with the EU principles of transparency, equal treatment, proportionality and mutual recognition.

Public procurement legislation has only been introduced into Cyprus legislation in the last two years and therefore, it remains to be seen how effective the remedies will be in practice in Cyprus.



Whilst full implementation of the public procurement legislation may have been achieved by the accession states by 1 May 2004, there are concerns that many of the accession states lack the administrative capacity to ensure that the rules will be evenly applied by the domestic courts. Another concern is that continuing corruption will influence the award of contracts. There have been instances in some countries of the splitting of contracts into smaller parcels with a view to awarding them on the basis that they are below the thresholds.

With the EU procurement regime in force in the accession states, it is likely that it will be increased investment in the fields of infrastructure, transport and energy. This is likely to involve contracting out of many public services. For example, Cyprus have indicated that is looking to upgrade their port facilities and in particular at marina development and cruise line industry opportunities.

Although, implementation of the procurement regime means that Cyprus contractors and suppliers should have greater opportunities of getting work elsewhere, against this Cyprus contractors and suppliers may suffer more competition.

Comparison of PPP suitability in different sectors

As mentioned before, PPPs are very context-based. While one sector may be ideally suited to such a partnership, another may be completely incompatible with it. Comparison between two sectors can be difficult, as there may be no common ground between them. Sectors can be divided into two types: sectors in which segments are traditionally contracted out to private firms, and sectors that are traditionally handled by the state. The past treatment of different sectors affects the way in which the public views privatization.

Reactions to PPPs have differed in intensity from one sector to another, with stronger opposition shown in areas like public health and education that are linked to fundamental human rights. Less opposition is shown to sectors such as waste management and construction that belong to the second type. It is nearly impossible to offer a comparison between the two types of sector, as they require different approaches from both the public and the private operators. Neither is inherently unsuitable to privatisation but more caution is required in some areas, which are more vulnerable to deterioration after the process is finalised.

Health Care

In the field of health care, one of the most sensitive subjects of PPPs, reaction to them has been strong. There are fears that close association with industry could have negative effects for the health bodies involved and ultimately the public interest would suffer. A great number of campaigns against PPP projects involving public health were organised, especially where hospital privatisation was concerned.



The motives of the private health sector to become involved are looked upon with even more suspicion than in other sectors. It increasingly operates under a spotlight and has been repeatedly criticised that its methods and outputs do little to meet public health needs. It has often been pointed out, at the international as well as the national level, that working in 'partnership' with leading public health institutions at all levels is an effective way of countering that negative image.

Another argument put forward against the use of PPPs in public health is that public-private initiatives can redirect national or international health policies and priorities. They can defeat crucial or national efforts already underway. They are also often seen as an investment in promoting conditions that favour branded products and newer more expensive drugs.

In America, although PPPs have been tried and tested in various other industries, the use of this system in the health care field is relatively new. In Los Angeles such partnerships have only been in place for a couple of years and the cause of their introduction was a severe financial crisis faced by the county in 1995. Matters seem to be improving but progress must be cautious so as to safeguard the quality and availability of services to everyone.

In the UK, by contrast, there has been considerable co-operation and partnership between the National Health Service (NHS) and the private sector for quite some time. For example general medical practitioners and dentists are independent contractors. What is being discussed now is the widening of this co-operation. With evidence showing that Private Finance Initiative (PFI) hospital schemes are unnecessarily expensive there are concerns about value for money, inflexibility, risk transfers and service cuts that have not been adequately addressed. There is no resistance to wider use of PPPs as such, but the way in which it will be affected is much debated. PFI may still be in its infancy for hospitals and schools, but already there are problems and obstructions to its development that should be addressed before other schemes are undertaken.

In Canada, where PPPs have been enthusiastically accepted, there has been intense reaction against their use in health care, with many people pointing at the UK as an example of the unsuitability of this sector for such treatment.

Public confidence in health care privatisation took another blow when a loophole in the private ambulance field was discovered in the UK. People involved in the private ambulance sector are allowed to drive casualties to hospital under a blue light without first having to undertake any specialist training. At least one provider of such services was found to have a record of serious convictions relating to dangerous driving. Such people are not required to undertake special driver training, as no regulatory framework exists. The government has said that it is aware of the anomaly in standards and is considering a change in legislation but much damage has already been done.



This type of sector, one that is closely linked to fundamental human rights, is difficult to privatise. There is strong public resistance to the introduction of PPPs in education or health care amid fears of lesser quality and limited availability of the services. Past experience in the UK has shown these fears to be, if not justified, based on reality.

Cyprus has, so far, refrained from using public private partnerships in the field of health care. No matter how flexible and comprehensive the legal framework is, privatization of such a sector should not be undertaken lightly. In a country like Cyprus, where public private partnerships are still a fairly recent development, the likelihood of falling into traps and making fatal mistakes is even greater, due to a lack of experience in public private partnership management. The sensitivity of this field requires more expertise in handling PPPs than Cyprus has at the moment.

When the time is right and there is confidence in the system of public private partnerships the option to privatize health care may be taken up. But there must be exhaustive research done beforehand to ascertain the suitability of any aspect of health care for PPP treatment and ensure that the quality and availability of the service is not compromised. The government should remain cautious in following that path and learn from the mistakes of the countries already involved in the process of privatizing their health care systems.

Construction:

The public more easily accepts the privatization of the second type of sector though there is still some distrust of the process. PPPs are most commonly used in the construction area, whether it be roads or buildings, with the type of agreement modified to fit the situation.

The US has used PPPs in road and other construction as well as using private money successfully to run its prisons and is exploiting the same ideas to turn around its schools. Last year, in what was seen as a groundbreaking arrangement, \$80m from private investors was used to build and equip Niagara Falls High School in New York.

In the UK PPPs are already well established as a way of paying for new roads and prisons. For example, there are now eight new private prisons, with more in the pipeline, and major road schemes like the Thames crossing and the Birmingham relief road are being financed through PFI.

In Cyprus, construction projects are the most popular area for public private partnership treatment, with 158 million Cypriot pounds allocated to roadworks, 20-30 million pounds for an Archaeological Museum, 16 million pounds for schools and 35 million pounds for waste management. Eight projects in all have been identified as suitable for public private partnerships, and Guidance Committees have been set up to examine each one.

The most advanced and ambitious PPP scheme planned in Cyprus is the development of the Larnaca and Paphos Airports using the Build-Operate-Transfer method.



The tender process began in March 2001 and the 3 pre-qualified consortia out of many competitors for the BOT tender were the Alterra Consortium, Hermes Airport and the Cyprus Airports Group. In November 2003, the Alterra Consortium was chosen by the Tender Board as the first preferred bidder and the Hermes Airport as the second preferred bidder. Five recourses against the above administrative decision were filed in total, three of which were filed by Joannou & Paraskevaides Ltd as a representative member of the Cyprus Airports Group and two by the Hermes Airport. The 9 months negotiations between the Cypriot Government and Alterra were unsuccessful and the second preferred bidder, Hermes Airport replaced Alterra at the negotiating table. The negotiations were concluded with the Agreement signed on 8 July 2005.

This is the largest construction contract the Cyprus Government has ever signed, for a total cost of approximately 550 million Euros. The new Larnaka airport will become operational in approximately 3,5 year, subsequent to the conclusion of the Financial Agreement, whilst the airport at Pafos is expected to be ready in approximately 2,5 years.

The Cyprus Tourism Organisation has prepared bid documents for the development of five marinas in Paphos, Limassol, Larnaca and Paralimni using the Build-Operate-Transfer method or similar methods and the relevant legislation has recently been approved by the House of Representatives and in the Council of Ministers. The procurement process is expected to begin shortly.

The same method has been approved for use in the development of the seaport in Larnaca. PriceWaterhouseCoopers has undertaken the drafting of the procurement documents and the procurement process will take place shortly.

The complex nature of PFI contracts and the political obstacles involved in getting large, controversial schemes such as the London Underground PPP off the ground mean that progress in some areas has been slow. There has also been great resistance from Trade Unions as workers fear for their jobs.

Cyprus has not remained unaffected by these problems. Fear of redundancies and cutbacks in wages has driven civil employees to take strong measures against privatisation. The decision to use PPPs for the development of the Paphos and Larnaca Airports has resulted in a forceful reaction by the affected employees culminating in a number of strikes and protests at the airports.

The ongoing need for transparency is highlighted by the reaction of the employees. Although they are at the core of the emotionally charged anti-privatisation argument, they often stand to benefit the most from privatisation. This is because they are impacted the most, and are pivotal to the success of any privatisation contract. And yet the reaction of civil employees to PPPs has been vigorous.



Before any government or local authority contracts with a private company it should work with the company to evaluate how privatisation will affect current civil employees. Any reduction in staff or changes in benefits or job positions should be a part of the contract negotiations and the employees should be made aware of the government's attempts to ease the transition for them.

Public v private interests

The public and private operators must understand and respect each other's goals otherwise the planned PPP is doomed to fail. Partnerships are sustainable only if they are mutually beneficial. They are effective only to the extent that the goals of the major stakeholders are mutually compatible and only if those goals are understood and accepted by all parties. For partnerships to function effectively, the goals of the different parties do not have to be identical, they merely have to be compatible.

In general, private sector companies prefer that the contract serve as the major regulatory mechanism. Local governments would like to have a wider regulatory discretion. This difference is usually settled during negotiations and upon signing the agreement the matter is settled, for better or for worse.

When we talk of partnerships we must be very clear about the objectives of companies. A private company is driven by profit and it will strive to get the most favourable terms to achieve that goal. It should not be forgotten that corporations have a fiduciary legal duty to maximise profit for their shareholders.

If unregulated, this pursuit of financial gain can lead to under-investment in the human and social capital that is necessary for meeting the basic infrastructure needs. Governments must maintain responsibility for ensuring that adequate and affordable infrastructure services are provided for all citizens.

A conflict of interest may arise where the public sector, in the form of a local authority, wishes to tie the partnership to operate within its community so as to attract and retain local businesses. The ultimate aim of the private company to maximize its profit may work against the wishes of the public sector in this case, especially if the location is commercially unattractive, remote or isolated.

As the regulator of the service, the government must ensure that basic social needs are met and that the individuals goals of the other parties are honoured. This requires the public sector to take charge and find the appropriate balance between making a partnership attractive to private firms and protecting the rights and interests of the citizens.

Flexibility, both in the legal framework and in the agreement itself, is very important for both the public and the private partners as the contracts usually last for an extended period of time. During the life of the contract the nature of the services and the methods of delivery may change. Other changes may also take place and it inevitably it will be necessary to



respond to unforeseen circumstances. Clear procedures for dealing with such events will reduce the chance that they will have a negative impact on the partnership or the project itself.

Conclusion

Public Private Partnerships constitute one of the most promising forms of public-private collaboration, but even their proponents point out that they are not a cure-all. Private involvement does not provide an automatic solution to all the problems faced by the government. What a PPP may do is help state-owned businesses provide better services for their customers while allowing the government to retain responsibility for public interest issues.

The government of Cyprus must be very careful when choosing public private partnership projects and in deciding on the partners to handle them. Many countries have made mistakes when applying this system of privatization and we should learn from them and try to avoid those same mistakes from the very beginning.

Before reaching the decision to privatise, the government or local authority should examine the sector and project in question to see if a PPP is the right way to go. Some sectors are not suitable for PPP or require extensive preliminary work.

When a government or local authority does decide to privatise, it is crucial to do so in the correct way. Transparency and co-operation with the other stakeholders are key elements. The procurement must take place in a competitive environment where bidders that are financially stable, experienced and have the ability to deliver the required services should be naturally at the forefront. The terms and conditions of the agreement are vital to the effectiveness of the project and should be examined carefully.

The Institute of Public Policy Research in the UK released its long-awaited report on PPPs in June 2001. The report said questioned whether PFI projects were really good value for money in health and education, as opposed to the roads and prisons sectors.

Instead, the report argues for a pragmatic rather than a dogmatic approach to the use of the private sector in providing public services - and argues that several flagship privatisations by the British Government, including the London Underground and the National Air Traffic Services, have been mishandled.

The lessons to be learned from the IPPR's report are useful for Cyprus. To use a cliché, "some things should not be rushed". As Cyprus is only just beginning to implement ppp measures, care must be taken that the proper foundations are set. If a sector is not ready for privatisation it should be left alone. If a sector seems suitable then the best possible solution should be found without rushing into a PPP. Only then will the public begin to take PPPs seriously and consider them as a legitimate option.