

LEGAL ASSESSMENT OF PBMC IMPLEMENTATION AT THE MUNICIPAL LEVEL IN SERBIA

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Summary: Performance based maintenance contracting cannot operate in an unsuitable legislative and regulatory environment that has to accommodate principally the lengthy contract durations, the corresponding forward budgetary commitments and the need to levy contractual penalties for poor or non-performance. The paper provides a step-by-step commentary on the implementation of procurement legislation in correlation with communal services, with special attention to assessment whether performance based maintenance contracts can be procured under the national legislative framework.

Key words: performance based maintenance, legal assessment, procurement, contract

1. INTRODUCTION

The traditional way of contracting out road maintenance is based on the amount of work being measured and paid for on agreed rates for different work items. The agency as a client normally specifies techniques, technologies, materials and quantities of materials to be used, together with the time period during which the maintenance works should be executed.

Performance Based Maintenance (PBM) contracting is a specific form of a public-private partnership, whereby the private contractor (but also a public one in some cases) is paid over a multi-annual period to meet a road condition standard defined in the Performance Based Maintenance Contract (PBMC). The contractor is paid a “unitary charge” on a regular basis for the full duration of the contract, regardless of whether rehabilitation, maintenance and/or other road activities take place.

Performance Based Contracts (PBCs) are defining a final product and it is up to the contractor how to achieve this. Therefore, work selection, design and delivery are all his responsibility. Hence, the choice and application of technology and the pursuit of innovative materials, processes and management are all up to the contractor. This allocates higher risk to the contractor compared to traditional contract arrangements, but at the same time opens up opportunities to increase his margins where improved efficiencies and effectiveness of design, process, technology or management are able to reduce the cost of achieving the specified performance standards.

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Road agencies have moved towards PBMC approach because it offers several advantages over more traditional approaches:

- cost savings in managing and maintaining road assets;
- greater expenditure certainty for road agencies;
- ability to manage road network with fewer agency staff;
- better customer satisfaction with road service and conditions;
- stable multi-annual financing of maintenance.

From the road user point of view there are two main benefits:

- users know exactly the road conditions they can expect and demand, and
- are satisfied to see the exact result of the fees they are paying.

There are also some key features of a PBMC for contractors:

- with a guaranteed flow of work and income over a number of years a contractor finds it worthwhile to invest in equipment, staff development and new methods;
- he is also able to submit competitive bids without an extra margin to cover the risk that future budgets will fail to provide for fulfilment of the contract;
- knowing that he will be required to maintain the whole road length every year, a contractor has a strong incentive to use the most efficient methods and do as good job as he can in order to minimize his future expenditure.

Introduction of PBMC in the road business is usually a challenging task since, as with most new concepts, PBMC will probably be criticized and scrutinized at the beginning by those who are used to the old ways of “classical” road maintenance contracts and the concept of contractors engaged through “work orders”, and being paid against quantities executed during road maintenance operations.

There is general perception that efficient organization and implementation of road maintenance through PBMCs reduces the operating costs, thus increasing profitability of involved companies (i.e. contractors). It is also believed that through PBMCs maintenance companies increase their profitability up to 10-12% (or even more), which is more in line with expected yields on nominal and shareholders’ capital.

2. LEGAL ENVIRONMENT

PBM contracting cannot operate in an unsuitable legislative and regulatory environment. There must be an appropriate legal and budgetary framework in place to accommodate the requirements of PBM contracting - principally the lengthy contract durations, the corresponding forward budgetary commitments and the need to levy contractual penalties for poor or non-performance. In addition, it is sometimes the case that existing legislation places direct duties on bodies such as local authorities which must be amended or removed before PBM contracting can be put in place.

Furthermore, sound public procurement policies and practices are among the essential elements of good governance. Good practices reduce costs and produce timely results; poor practices lead to waste and delays.

The paper provides a step-by-step commentary on the practical application of the laws guiding public procurement in the Republic of Serbia (RS) in correlation with the procurement of communal services. Special attention will be given to assessment whether

PBMCs can, and under what circumstances, be procured under the national legislative framework, and legal and institutional impediments shall be highlighted.

The opening remark concludes that the Law on Public Procurement (LPP) [3] sets good practices, but exceptional waiver as well, which in the case of maintenance is used more as a rule than exception. Delays in passing and adopting several documents especially those in respect to the list of entities to which the provisions of the LPP shall not apply (i.e. with exclusive rights when procuring and rendering services) gave rise to a case to case regulation, in which no pattern could have been distinguished.

3. RELEVANT LEGISLATION

Detailed analysis of the Serbian legal framework related to the introduction of PBMCs has been conducted in order to identify possible hindrances and to eventually propose any required changes/amendments to the present legislation. The analysis has been performed as a part of the PBMC implementation study for the City of Kragujevac [9].

The following list presents relevant and applicable national legislation related to introduction of the PBMC into maintenance practice:

- Law on Budgetary System [1];
- Law on Communal Services [2];
- Law on Public Procurement [3];
- Decree on the Criteria for Determining the Nature of Expenditures, Terms and Conditions of Obtaining Permission for Concluding Specific Agreements which, by Nature of Expenditure, Demand Payment over Several Years [4];
- Decision on Determination and Mode of Entrusting Communal Services [5];
- Decision on Determination of Communal Services Financed from the City Budget, and for which Contracts are Awarded Based on the Law on Public Procurement [6];
- Decision on Determining the Utility Sector and Utility Operations that can be Exclusively Performed by the Public Utility Companies in the City of Kragujevac [7];
- Decision on Communal Services on the Territory of the City of Kragujevac [8].

3.1. Law on Public Procurement

The LPP [3] enshrines the principle that all contracting authorities in terms of the LPP, such as statutory authorities, autonomous provinces, local government authorities, as well as all legal entities established with the purpose of public and general interest, and not operating on commercial activity basis, must apply LPP principles provided that more than 50% of the financing is from the proceeds of any of the contracting authority budget as defined by the LPP, and that such entity is being supervised by a board where the majority of the members are elected by the contracting authority.

The LPP does not apply to procurement from entities with the qualifications of contracting authorities in accordance to LPP and who have been assigned with exclusive rights to perform a certain type of activity to be procured (Article 7). An exclusive right, with the meaning assigned to it by the LPP, is defined as such right on the basis of which only a

certain entity can perform a particular activity within a certain area, entrusted by or derived from the specific law, special regulations or individual decisions or contract or agreement, adopted or concluded by the RS, territorial autonomy or local government (Article 3, bullet point No. 24).

Furthermore, the provisions of the LPP do not apply to contracts which the contracting authority concludes with another legal entity supervised by the contracting authority and if more than 80% of that entity activities are performed as entrusted activities, and if there is no private capital share in such entity influencing the decision-making processes or prevent decision-making.

The RS Government and the Public Procurement Administration intended to publicly disclose a list of contracting authorities to which the LPP does not apply, but such publication has been delayed. In absence of such regulatory framework on exclusive rights it is noted that individual decisions are passed throughout the country, and contract agreements concluded to substitute such list. This is also the case with the City of Kragujevac passing the Decision on Determining the Utility Sector and Utility Operations that can be Exclusively Performed by the Public Utility Companies in the City of Kragujevac [7]. This decision shall remain in force and valid until and unless the official list of contracting authorities is disclosed.

3.2. Law on Communal Services

On the other hand, the Law on Communal Services (LCS) [2] is decisive when it comes to awarding contracts for communal services.

Communal services within the meaning assigned to it by the LCS are the activities of providing municipal/communal services of importance to the fulfilment of basic needs of physical and legal entities for which the local government is obliged to create conditions for the provision of the appropriate quality, quantity, availability and continuity, as well as supervising their execution.

Communal services are, inter alia: maintenance of streets and roads, maintenance of streets and roads in towns and other settlements, works which ensure smooth and safe traffic and preserve and enhance the value of roads, streets, squares, terraces, etc.

The local self-government, in accordance with the LCS, provides organizational, financial and other requirements for construction, maintenance and operation of communal facilities, and regulates and provides for communal services and their development systems. This can be achieved through:

- Establishment of a public company: If for the performance of communal services a public company has been established, and such company is the holder of public right, it shall, inter alia, be obliged to provide permanent and unobstructed municipal services to users under the prescribed conditions and in the prescribed manner, but is not authorized to “further” assign such rights to another entity who is entitled to perform services. This, in other words, means that the public company could not later “alienate” the right to provide communal services and transfer it to another entity. This rule has exceptions provided that, in the present case, the LCS explicitly allows the transfer of rights in relation to the determination of communal services and interpretation of the charter of that public company;

- Assigning or entrusting communal services by virtue of the exclusivity: Assigning or entrusting communal services is a time-bound contract of relations in connection with the performance of communal services or certain tasks in the framework of communal services between the local self-government and the provider of communal services. Assigning or entrusting shall be based on the decision of the assembly of local self-government in accordance with the methods of providing communal services and the contracts of assignment. The procedure of entrusting the performance of communal services funded from the budgets of local governments is subject to the LPP;
- Through public procurement: The LPP applies to the procedure of determination the provider of communal services if such services are financed from proceeds made available through the budget of the local self-government, in this case the City of Kragujevac. This would imply that any activity providing maintenance of roads and streets, financed from the local budget shall be subject to the LPP, if not being entrusted (as described in the bullet point above).

Furthermore, the City of Kragujevac has passed three decisions [5, 6, 7] on the determination of communal services financed from the City budget for which contracts are awarded pursuant to the LPP. On the basis of these decisions the following services, which are financed from the City budget shall be awarded with the application of procedures and rules of the LPP:

- restoring public areas to a technically correct condition (pavements and sidewalks);
- repairs of streets;
- repairs of sidewalks;
- periodic maintenance of asphalt pavements;
- periodic maintenance of block pavements;
- maintenance of public lighting;
- maintenance of green surfaces in residential areas and parks;
- maintenance of green surfaces around watercourses;
- maintenance of public hygiene in settlements.

3.3. Law on Budgetary System

One of the main constraints of procurement is the mandatory requirement that any commitments by direct or indirect budget beneficiaries must correspond to appropriations which have been designated for this purpose in the budget year following the Law on Budgetary System (LBS) [1]. Notwithstanding the above paragraph, obligations may be assumed under the contracts which, due to the nature of expenditure require payment through several years, provided that before launching the procurement procedure funds have been reserved for payments due in that financial year. However, it is also necessary to obtain written consent of the Ministry of Finance (MoF), or local authority responsible for finances, for obligations that will become due and be included in the financial plan for the following two years. By virtue of this exception, the Government adopted the Decree on the Criteria for Determining the Nature of Expenditures, Terms and Conditions of Obtaining Permission for Concluding Specific Agreements which, by Nature of

Expenditure, Demand Payment over Several Years [4]. This Decree limits such time period to three years, provided the contracts are concluded to procure goods and services under the budget group No. 42. No detailed definition was available to determine as what services and goods fall under this category. For these multi-annual contracts to be endorsed by the MoF, it is necessary to submit an application, using the relevant template, and containing information sheet on the planned procurement.

4. PROCUREMENT THROUGH INTERNATIONAL FINANCING INSTITUTIONS

The LPP does not apply to procurement under international treaties, loans, contracts, etc., including loan agreements with International Financing Institutions (IFIs). This is the case for the RS and most of the countries receiving financial support from IFIs. This means that LPP does not apply to procurement of goods, services and works implemented by virtue of an international agreement taking precedence over the national legislation in accordance to the Constitution (in order that a contract of public law receives an international qualification it has to be ratified or enacted in the host country, and the procurement rules and guidelines of such financing organization, donor or international organization are mandatory to be used during implementation). Logically, constraints imposed by the LBS regarding availability of budget resources also do not apply to international agreements.

5. AMMENDMENTS TO LEGISLATION

There is no need to propose amendments to the current regulatory framework in order to allow exclusion of the LPP in case of financing by IFIs. If loan agreements are signed, the relevant bidding documents and conditions of contract therein agreed shall be applicable. However, in terms of national legislation, introduction of PBMC is a radical transformation, and would ideally require some legislative and procedural changes to allow multi-annual contracts to be written with assured annual payments for achievement of performance targets. At present each year's budget is subject to availability of funds and decisions about relative priorities. The full benefits of multi-annual PBMCs cannot be realized with such a system. It is recommended that legal or procedural means be found to give contractors a much greater degree of certainty about the revenue they can expect from a multi-annual contract. For example, the MoF might adopt and announce an internal policy to honour multi-annual fixed-payment contracts up to a defined ceiling in each sector, or in the roads sector alone, irrespective of future budgetary restrictions. Another option in order to give full effect to the results of PBMC would be to develop such amendments to allow conclusion of multi-annual contracts for a period beyond the current limit of three years. In addition, to enhance competitiveness and effectiveness of the maintenance services in general for application of PBMC any waiver of the LPP should be discouraged. This could be done by limitation of communal services to a list of services which can be entrusted.

6. CONCLUSION

Current national legislation, while invoking broadly accepted principles of fairness and transparency, introduces some exceptions which in the case of the subject matter even after careful review allow for ambiguity and uncertainty.

Whilst on one hand all the cited and applicable laws and bylaws promote the transparency and competitiveness during procurement of communal services, all the exceptions allow double standards. This is specifically related to delay in listing the contracting authorities to which the LPP does not apply and substituting the missing list with individual decisions. This would mean, if the communal services are financed from the budget of the local self-government, i.e. the City of Kragujevac, it would mandatory impose the application of the LPP. On the other hand, even when financed from the budget, the LPP does not apply if the communal services are rendered by a public company established for this purposes (i.e. Public Utility Company), or the services have been entrusted by virtue of exclusivity. No genuine competitiveness can be identified since only limited communal services are procured in a manner and by application of the LPP.

On the other hand multi-annual contracts are limited to three years maximum and it is unclear if the PBMCs can be successfully implemented and the goals achieved within this limited period in terms of “value for money“ and “input against outputs“, without implementing proposed changes in national legislation.

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PРАВНА ПРОЦЕНА ПРИМЕНЕ PBM УГОВОРА НА ЛОКАЛНОМ НИВОУ У СРБИЈИ

Rezime: Ugovori za održavanje zasnovani na učinku ne mogu da se realizuju u neodgovarajućem zakonskom i regulatornom okruženju koji treba da omogući uglavnom dugotrajne ugovore, osiguranje odgovarajućih budućih budžetskih obaveza i potrebu nametanja ugovornih kazni za loše izvršenje ili neizvršenje obaveza. Ovaj rad daje detaljne komentare o primeni regulative o nabavkama koja se odnosi na komunalne usluge, sa posebnim osvrtom na procenu da li se ugovori o održavanju zasnovani na učinku mogu realizovati u skladu sa nacionalnim zakonodavnim okvirom.

Ključne reči: održavanje zasnovano na učinku, pravna procena, nabavka, ugovor