

**Conditions of Acceptability of Water Sector Projects
for the Operational Programme Environment in the
Programming Period 2007 - 2013**

August 6, 2007

SUMMARY

The purpose of the document "Conditions of Acceptability of Water Sector Projects for the Operational Programme Environment in the Programming Period 2007 - 2013" (hereinafter "Conditions of Acceptability") is complex setting of rules for accepting water sector projects within the framework of which there will be supported, from the European Union sources, infrastructure operated on the basis of operational contracts by operational companies with participation of the private sector. The document represents the key supporting material for negotiation concerning the priority axis 1 "Improvement of water infrastructure and reduction of flood risk" of the Operational Programme Environment. The document sets up the rules of the acceptability of the water sector projects among others by the way of eliminating incorrect using of EU funds so that these resources could be utilized only for intended purposes and the apparent or hidden incompatible state aid is prevented.

The Conditions of Acceptability work out the main principles for solving this issue approved by the Government (Government Resolution No. 619 of June 4, 2007), defined in the Mandate of the Vice-premier and the Minister of Environment for negotiations with the European Commission concerning the issue of operational contracts regarding projects in the field of water/sewage systems for public use in the framework of the Operational Programme Environment for the programming period 2007 - 2013.

The document is divided into, in total, four sections. The first section (A) focuses on the field of the existing operational relationships, the second section (B) concentrates on the field of new operational contracts, the third section (C) deals with the criteria making carrying out of a tender procedure¹ necessary, and the last section (D) solves the issue of quality of the provided services and tools supporting effectiveness.

Within the framework of **Section A**, the conditions of acceptability of the existing operational relationships aim to meet three basic requirements:

- 1) Elimination of provision of an undue profit on the side of the operator;
- 2) Ensuring of the period of duration of the contractual relationships compatible with the competition legislation of the European Community;
- 3) Application of tools ensuring higher effectiveness and quality of water services.

Implementation of all the three requirements applies to all operational contracts belonging into part 1, section A, i.e., contractual relationships concluded with operators with decisive participation of the private sector. Ensuring of the third requirement applies, under meeting of certain conditions, to contracts concluded with operators with decisive participation of the public sector - part 2, section A.

The proposed measure for prevention of creation of an undue profit on the side of the operator is acceptance of the model of price ceiling for calculation of the water and sewage charges (tariffs) with simultaneous regulation of the profit rate. At the same time, this measure supports also higher effectiveness of the operator.

Ensuring of the period of duration of the contractual relationships compatible with the competition legislation of the European Community was based on the following assumptions:

¹Tender procedure as a common expression for both the procedures according to Act No. 137/2006 Coll., on public procurement and according to the Act No. 139/2006 Coll., on concession contracts and concession procedure.

- 1) Application of the competition legislation of the European Community (rules of economic competition) to operational relationships only within the framework of the period of duration of the contractual relationship after accession of the Czech Republic to the EU;
- 2) Respecting the principle of proportionality so that the duration of the contract allows the operator to recover the costs of his investment;
- 3) Conclusion of these contracts before accession of the Czech Republic to the EU with the conditions and obligations accepted in accordance with then legal environment without the necessity to "comply" with the competition legislation of the European Community at that time;
- 4) Risk of legal actions in the case of disagreement of the operator with reducing the duration of the contractual relationship, and, thus, barring of acceptance of the project in practice.

On the basis of these assumptions, it was necessary to look for a compromise solution, and to "not apply" the competition legislation with such intensity as in the case of new operational contracts concluded in the time when the European legislation has been valid. The time point, to which durations of contractual relationships would relate, was chosen taking this into account.

The whole section A is statistically supplemented by categories of contractual relationships in relation to terms of their termination.

Section B focuses on new operational contracts, wherein the key support for this field is represented by binding legislation for public tenders and concessions. The section works out conditions concerning the duration of a contract, use of the main and partial evaluation criteria. A model operational contract will be made available on web pages of the Managing Authority of the Operational Programme Environment.

Section C sets criteria (for example, separability of infrastructure) in the case of meeting of which there will be necessary to carry out a tender procedure for operating new infrastructure procured using the EU funds in accordance with procedures stated in section B. In this case, it will not be necessary to amend, or "compete", an operational contract concerning the existing infrastructure (not financed from the EU funds) according to requirements stated in sections A and B, respectively.

Section D is a complementary section to both the section A and B, because both the existing and the new contracts must include tools supporting effectiveness, defined in section D. Section D is indirectly linked to the document "Catalogue of Performance Parameters" which will be made available on web pages of the Managing Authority of the Operational Programme Environment.

A. EXISTING OPERATIONAL CONTRACTS

The current arrangements of operations in the Czech Republic in relation to yet unsolved agglomeration² can be summarized in the following table³:

Model of operation	Number of operat. relations	% of operational relations	Number of P.E.	% of P.E.	Investment costs (mil. EUR)⁴	% Investment costs
Not under operation	8	2 %	22 748	0 %	28, 2	2 %
Municipality operates by itself	19	4 %	62 863	1 %	17,6	1 %
100 % owner controlled model	27	5 %	204 092	2 %	22,6	1 %
“Mixed” model	140	27 %	1 736 096	18 %	284,4	20 %
Separate model	243	47 %	6 803 997	71 %	973,2	68 %
Data not available	77	15 %	781 298	8 %	114,2	8 %
Total	514	100 %	9 611 094	100 %	1 440,1	100 %

Not under operation – this category is characteristic for smaller agglomerations composed of individual municipalities; it covers cases when WWTP is either in the design stage or under construction, eventually under trial operation, however this infrastructure has not been subject to regular operation so far.

Municipality operates an infrastructure by itself, eventually some services ensure external organizations, however responsibility for operation and collecting of tariffs is on the municipality.

100 % owner controlled model – organization responsible for operation was constituted and is 100 % owned by the municipality. The infrastructure is operated based on operational contracts or other forms of authorizations (agreement, decree, directive etc.).

The “mixed” model of operation⁵ – the owner and operator of the infrastructure is one and the same entity.

² Resolution of the Government of the Czech Republic of December 6, 2006, No. 1391 on updating of the strategy for financing the Council Directive No. 91/271/EEC concerning urban waste-water treatment.

³ Data are taken from the document "Analysis of the possibility of financing of water sector projects from the European funds in view of the relationship owner - operator" (hereinafter "Analysis of the possibility of financing") drawn up for the Ministry for Regional Development and published on the address www.strukturalni-fondy.cz. From the total number of 531 conurbations, data were collected concerning 454 ones, i.e. ca 85 %.

⁴ Investment cost converted to EUR by the rate 28, 03 CZK/EUR.

Separate model of operation – means cases when operational contracts are concluded with operational companies with proprietary participation of other entities than only owner of infrastructure.

Conditions of acceptability presented within this document relate to the separate model of operation with proprietary participation of private entities i.e. arrangements that have been subject to the interest of the European Commission so far.

A.1. Separate model of operation

Definition: Separate model of operation means cases when operational contracts are concluded with operational companies with proprietary participation of private entities, who ensure operation through their means. These companies have labour forces, their own machines and equipment, buildings and land, concessions, licences and know how necessary for ensuring the operation according to the valid legislation.

This set of measures relates to operational contracts within the framework of which operation of infrastructure co-financed from the EU funds is assumed.

1. Dominant influence of private property

Definition: An operational company is a controlled entity, and the controlling entity is a private entity/entities (Section 66a of the Commercial Code⁶).

Category I - Contracts with the term of expiration by the end of 2020

In relation to yet unsolved agglomerations this category can be roughly divided into the following groups defined by the term of expiration of the contractual relationships⁷:

Contracts with the term of expiration by the end of 2013

Total number of contracts: ca 18

Total investment costs: ca 760 million CZK - ca 27, 1 mil. EUR

Percentage of operational contracts - separate model: ca 8 %

Contracts with the term of expiration in the period 2014 - 2015

Total number of contracts: ca 10

Total investment costs: ca 540 million CZK - ca 19, 3 mil. EUR

Percentage of operational contracts - separate model: ca 4.5 %

Contracts with the term of expiration in the period 2016 - 2020

Total number of contracts: ca 48

Total investment costs: ca 2 800 million CZK - ca 99, 9 mil. EUR

⁵ The so-called “mixed” model of operation with the participation of private capital, where the owner and operator of the infrastructure is one and the same entity, i.e. the applicant for grant support, will be assessed in line with generally binding procedures for the assessment of state aid, following the standard approach applied to the assessment of applicants of this type in the implementation of EU programmes.

⁶ Act No. 513/1991 Coll., Commercial Code, as amended (hereinafter “Commercial Code”). Definition of control according to Section 66 a paragraph 3 of the Commercial Code is based on the wording of so-called Second Company Law Directive No. 77/91/EC of December 13, 1976.

⁷ Data concerning the individual categories are derived from the “Analysis of the possibility of financing”. In total, data were obtained on 212 contracts within the framework of the separate model, what is 80 - 85 % of all contracts within the framework of this model of operation. The separate model of operation represents ca 43 % from the point of view of the total number of operation relationships, ca 66 % from the point of view of the necessary investment costs.

Percentage of operational contracts - separate model: ca 21.5 %

In total for category I

Total number of contracts: ca 76

Percentage of operational contracts – within the separate model: ca 34 %

Total investment costs: ca 4 100 million CZK - ca 146, 3 mil. EUR

Percentage of investment costs in relation to costs for meeting 91/271/EEC: ca 10.2 %

The contracts must either include the following mechanisms as of the date of putting of the infrastructure financed by the EU into operation, at the latest:⁸

- a. Requirements on quality of water services, performance parameters supporting effectiveness, sanctioning mechanisms and monitoring tools corresponding to this: see section D;
- b. Calculation of water and sewage charges (tariffs) according to the following rules:
 - Use of the method of price ceiling (fixed price, included in the contract) with simultaneous respecting of requirements of substantial regulation of prices according to the Act on Prices⁹, the Decree Implementing the Act on Prices, and the Price Decision on Regulation of Prices, with respecting of socially acceptable price of water for the inhabitants; fixing of water and sewage charges will be carried out in periodic cycles lasting at least 5 years; during the period of fixation of water and sewage charges, indexing of prices will be carried out according to the recommended publicly available indexes set in the contract;
 - The basis for the above-mentioned calculation of water and sewage charges, given in an operational contract, will be a financial model (similar to the model required as a part of concession projects)¹⁰, which will include and develop all items (including rent) decisive for this calculation; a financial model drawn up for the period up to the expected termination of an operational contract will be an obligatory annex to the operational contract;
 - Water and sewage charges may be otherwise increased only in the case of growth in cost items, the prices of which the operator cannot influence within the scope of his activities by his operational efficiency (for example, fees for water extraction or requirement of the owner for increase of rent);
 - The operator will bear the risk of collecting of debts, i.e., the water and sewage charges cannot be increased in the case of reduction of collecting of water and sewage charges caused by their non-payment by the consumers;
 - The amount of the calculation profit¹¹ included in the financial model (hereinafter “continuously defined calculation profit”) will be fixed on a year-by-year basis to maximum values ensuring return on invested capital, both in relation to the

⁸ Checking of the existing and new operational contracts, including the relating documents, will be ensured by the Intermediate Body in accordance with the Manual of Working Procedures of the Operational Programme Environment.

⁹ Act No. 526/1990 Coll. on prices, as amended (hereinafter "Act on Prices").

¹⁰ Determined and developed by Implementing decree No. 217/2006 Coll., implementing the Concession Act.

¹¹ "Calculation profit" follows from the Methodical Instruction of the Ministry of Agriculture "Rules for setting of water and sewage charges concerning Section 36 paragraph 5 and 7 of the Act No. 274/2001 Coll.

documented capital investments by the operator in the past and in relation to justified needs for further capital investments up to the end of the operational contract;

- Together with the fixed calculation profit, the financial model will set also a fixed regimen of income from rent, whereby these rent payments will be set so as to substantially contribute to the reconstruction and reasonable development of the infrastructure by the owner in accordance with the Act No. 274/2001 Coll. on water and sewage systems for public use and on amendment of certain acts, as amended (hereinafter "Act on Water and Sewage Systems"); it will not be possible to reduce the rent payments in comparison with the data in the financial model during the duration of the contract, however, there will be set an exact mechanism for a possible price adjustment of the water and sewage charges resulting from an increase in the rent payments (beyond the values contained in the financial model) in order that the impact of this change is financially neutral for the operator;
- In the case that the calculation profit in subsequent years of the contract is above the level of the continuously defined calculation profit (measured as a percentage of the turnover of the operator relating to his own performance of the main activities), the difference between the actually obtained calculation profit and the continuously defined calculation profit will be divided in the same proportion between the operator and the owner of the infrastructure.

or, at the latest before starting of operating the infrastructure financed from the EU, there must be selected a new operator on the basis of regular tender (contracting/concession) procedure - see section B.

Verification of setting of items in the financial model including the "fixed" water and sewage charges will be carried out by an independent third entity contracted by the Managing Authority (Ministry of the Environment). Report on this audit will be available to the Intermediate Body (State Environmental Fund) during the final evaluation of the project. The Intermediate Body can, in the case of non-compliance with this duty, require return of the EU subsidy.

In accordance with the conditions set for provision of grant support for the specific project (and partially also in relation to Article 57 of the Regulation 1083/2006)¹², the Managing Authority will provide for checking of compliance with the above-mentioned requirements after ending of the project till the end of duration of the operational contract in regular intervals, in order to ensure that the above-mentioned conditions are met and that an unreasonable advantage on the side of the operator does not take place.

The tender procedure for a new operator must be launched sufficiently before termination of validity of the existing contract for the reason of ensuring smooth continuity. The relevant owner of the infrastructure will inform the Managing Authority on declaration of the tender procedure. The final beneficiary will be required to allow the presence of another person (from the State Environment Fund or Ministry of Environment) at the meetings of the evaluation committee, in line with Article 75 para. 4 of the Public Procurement Act as an "observer".

¹² Council Regulation (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999.

All the above-mentioned conditions will be set in the conditions in the Granting Decision, wherein non-compliance with them will result in withdrawal of a part or the whole subsidy.

A condition for inclusion of contracts concluded after April 30, 2004, into this category is their conclusion on the basis of carrying out of a regular tender procedure according to the European Community legislation. If this was not the case, the contract automatically belongs into Category IV.¹³

This category does not apply to contracts concluded in accordance with procedures described in section B of this document.

Category II - Contracts with the final term of expiration after 2020

In relation to yet unsolved agglomerations, this category can be roughly divided into the following groups defined by the term of expiration of the contractual relationships:

Contracts with the term of expiration in the period 2021 - 2025

Total number of contracts: ca 8

Total investment costs: ca 970 million CZK - ca 34, 6 mil. EUR

Percentage of operational contracts - separate model: ca 3.5 %

Contracts with the term of expiration in the period 2026 - 2030

Total number of contracts: ca 13

Total investment costs: ca 15 200 million CZK - ca 542, 4 mil. EUR (ca 2 600 million CZK - ca 92, 8 mil. EUR without inclusion of the Prague agglomeration)

Percentage of operational contracts - separate model: ca 5.8 %

Contracts with the term of expiration in 2031 and later

Total number of contracts: ca 9

Total investment costs: ca 420 million CZK - ca 15 mil. EUR

Percentage of operational contracts - separate model: ca 4 %

In total for category II

Total number of contracts: ca 30

Percentage of operational contracts – within the separate model: ca 14 %

Total investment costs: ca 16 590 million CZK - ca 592 mil. EUR (from this, 12 590 million CZK - ca 449, 2 mil. EUR the Prague conurbation)

Percentage of investment costs in relation to costs for meeting 91/271/EEC: ca 41.1 % (10 %)

The contracts must either include the following mechanisms as of the date of putting of the infrastructure financed from the EU funds into operation, at the latest:

- a. Either the duration of the contracts will be reduced in order that the contractual relationship will be terminated by the end of 2020, at the latest or the operator must provide a substantial investment into the relevant infrastructure commensurate with the length of the contract and respecting the principle of proportionality for concessions. The

¹³ The number of operational contracts in relation to unsolved conurbations, concluded after accession of the Czech Republic to the EU (after May 1, 2004) is estimated to be 10 % of all the contracts within the framework of the separate model.

size of the investment will be determined based on the financial model and will be fixed in the contract by the date of the Granting Decision at the latest;

- b. Requirements on quality of water services, performance parameters supporting effectiveness, sanctioning mechanisms and monitoring tools corresponding to this: see section D;
- c. Calculation of water and sewage charges (tariffs) - see Category I:

or, at the latest before starting of operating the infrastructure financed from the EU funds, there must be selected a new operator on the basis of regular tender procedure - see section B.

Verification of setting of items in the financial model including the "fixed price" water and sewage charges and investments (if any) will be carried out by an independent third entity contracted by the Managing Authority. Report on this audit will be available to the Intermediate Body during the final evaluation of the project. The Intermediate Body can, in the case of non-compliance with this duty, require return of the EU subsidy.

In accordance with the conditions set for provision of grant support for the specific project (and partially also in relation to Article 57 of the Regulation 1083/2006), the Managing Authority will provide for checking of compliance with the above-mentioned requirements after ending of the project till the end of duration of the operational contract in regular intervals, in order to ensure that the above-mentioned conditions are met and that an unreasonable advantage on the side of the operator does not take place.

The tender procedure for a new operator must be launched sufficiently before termination of validity of the existing contract for the reason of ensuring smooth continuity. The relevant owner of the infrastructure will inform the Managing Authority on declaration of the tender procedure. The final beneficiary will be required to allow the presence of another person (from the State Environment Fund or Ministry of Environment) at the meetings of the evaluation committee, in line with Article 75 para. 4 of the Public Procurement Act as an "observer".

All the above-mentioned conditions will be set in the conditions in the Decision on Granting a Subsidy, wherein non-compliance with them will result in withdrawal of a part or the whole subsidy.

A condition for inclusion of contracts concluded after April 30, 2004, into this category is their conclusion on the basis of carrying out of a regular tender procedure according to the European Community legislation. If this was not the case, the contract automatically belongs into Category IV.

In the cases when possible reducing of duration of these contracts resulted in risks of disproportionate economic burden on the side of the owner of the infrastructure, and, thus, in risk of non-implementation of the relevant project, there will be aimed, in exceptional cases, at achieving a compromise solution in the case of these contracts, together with the European Commission. A consequence of strict application of the requirement on reducing of duration of these contracts could be not only economic burden on the side of the owner of the

infrastructure, but also economic burden of the inhabitants through higher water and sewage charges exceeding the limits of social acceptability.

In the cases when the operator provided a substantial investment into the infrastructure within the framework of the original contract, this contract will be evaluated individually (using the financial model), with the possibility to retain the duration of the contract commensurate with the need to achieve a return on the investment. However, the rules concerning economic competition and eliminating of incompatible state aid have to be respected.

Category III - Contracts for indefinite period of time

In total for category III

Total number of contracts: ca 12

Percentage of operational contracts - separate model: ca 5.4 %

Total investment costs: ca 320 million CZK - ca 11, 4 mil. EUR

Percentage of investment costs in relation to costs for meeting 91/271/EEC: ca 0.8 %

- The duration of the contracts will have to be reduced in the way that before starting of operating the infrastructure financed from the EU funds, at the latest, there is selected a new operator - see section B.
- In those cases, where as part of the original contract the operator provided a substantial investment in infrastructure, the contract will be assessed individually (making use of the financial model) and considered within the frame of category I with the duration of the contract established so as to provide for a return on such investment. However, the rules concerning economic competition and eliminating of incompatible state aid have to be respected.

Category IV - Contracts concluded or extended with private operators after April 30, 2004, without regular tender procedure according to the European Community legislation

- The projects will be accepted on the condition of declaration of a regular tender procedure for a new operator before starting of operating the infrastructure financed from the EU funds, at the latest.

2. Dominant influence of public property

Definition: An operational company is a controlled entity, and the controlling entity is a public entity/entities (Section 66a of the Commercial Code).

A condition for inclusion of the operational contract into this section is ensuring that the public entity in line with the provision of the Commercial Code shall undertake only such decision of assembly (e.g. approval of long term business plans of the company), that shall ensure reasonable profit only in an amount necessary for renewal and development of infrastructure and for necessary financial reserves and funds of operation companies. It shall then not be generated profit for the purpose of payments of dividends or other form of profits for the owner of the operational company, whereby public entity as a entity controlling the operation company shall realize only those profits (e.g. payment of rent) that would be in line with the generally binding legislation.

If not ensured so, the operational contracts shall be treated in Category I of these conditions.

Total number of contracts: ca 105

Percentage of operational contracts – within the separate model: ca 47 %

Total investment costs: ca 5 500 million CZK - ca 196, 3 mil. EUR

Percentage of investment costs in relation to costs for meeting 91/271/EEC: ca 13.6 %

The data presented in this table are taken from (or inferred from) the study “Analysis of options for the financing of water sector projects from European funds in respect of the relationship between owner and operator”, based on data for entities with majority public sector ownership. These data therefore do not correspond precisely with the definition above.

The contracts must include the following mechanisms as of the date of putting of the infrastructure financed from the EU funds into operation, at the latest:

- a. Requirements on quality of water services, performance parameters supporting effectiveness, sanctioning mechanisms and monitoring tools corresponding to this: see section D;
- b. Calculation of water and sewage charges as for Category I.

Verification of setting of items in the financial model including the "fixed" water and sewage charges will be carried out by an independent third entity contracted by the Managing Authority. Report on this audit will be available to the Intermediate Body during the final evaluation of the project. The Intermediate Body can, in the case of non-compliance with this duty, require return of the EU subsidy.

In the cases when the owner of the infrastructure did not dispose of exclusive property rights (Section 18 para. 1(j) of the Act on Public Procurement)¹⁴ or the owner in relation to the operator did not meet the conditions of an associate entity (Section 17 point h) of the Act on Public Procurement), and, simultaneously, the operational contracts were concluded or extended after April 30, 2004, the corresponding projects will be accepted on the condition of declaration of a regular tender procedure for a new operator before starting of operating the infrastructure financed from the EU funds, at the latest. The tender procedure need not be carried out if it is ensured, before starting of operating the infrastructure, at the latest, 100% ownership, i.e., exclusive property rights, of the public sector concerning the operator of the infrastructure (then, the operational contract is not subject to the conditions of acceptability), or if the conditions of an associate entity are met within the same term. In the case of meeting the criterion according to section C, these requirements apply analogically.

Till the end of duration of the operational contract, there must not be carried out sale of any part of the operated property owned by a public owner into the hands of the private sector, which would increase the percentage of the share of the private sector in the operator of the infrastructure. Also there must be no change in the controlling entity.

In accordance with Article 57 of the Regulation 1083/2006, the Managing Authority will provide for checking of compliance with the above-mentioned requirements after ending of the project till the end of duration of the operational contract in regular intervals, in order to ensure that the above-mentioned conditions are met.

¹⁴ Act No. 137/2006 Coll., on public procurement, as amended (Act on Public Procurement).

B. NEW OPERATIONAL CONTRACTS

1. Selection of a new operator

Selection of a new operator should be based on the valid national legislation, especially the Act No. 139/2006 Coll. on concession contracts and concession procedure¹⁵ and the Act No. 137/2006 Coll. on public procurement, as amended, which transpose, into the Czech legal system, the basic principles contained in the EC Treaty and the European directives regulating the field of public procurement, namely the Directive of the European Parliament and of the Council 2004/18/EC of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts, and the Directive of the European Parliament and of the Council 2004/17/EC on coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors.

Concessions for services are not basically regulated in the EC legislation by a similar act, but they are essentially based *de iure* only on the basic principles contained in the EC Treaty. In contrast with the European legislation, which does not regulate the concessions for services anyhow, the Concession Act regulates the conditions of concluding and implementing both concession contracts concerning buildings, and concession contracts concerning services, i.e., it exceeds the EC regulation.

Auxiliary criteria for determination of procedures according to the valid legislation are given below:

1.1. Concession contract according to the Act No. 139/2006 Coll.

- It is commissioned by a public entity (for example, a municipality carrying out so-called relevant activity, which receives an EU subsidy);
- Responsibility and risks connected with the actual operation of the water infrastructure are, to a large extent, transferred to the operator;
- The operator bears the risk connected with collection of the user fees (water and sewage charges) - i.e., profit of the operator is directly dependent on the level of use of the operated infrastructure, or the amount of the collected water and sewage charges, wherein there exists a real risk that the operator will suffer loss, or, optionally, that it will not get back its original investment into the infrastructure, or another starting "fee";
- The operator has the possibility to actively influence the level of its profit, and there depends on its business activity whether it prevents possible losses (thus, the operator can - for example by means of quality of the provided services - really influence the number of customers, or, optionally, the amount of water and sewage charges, etc.);
- In the case of drop in income from the water and sewage charges, it is not counted on compensation from the awarding entity (not even via increase of price of the "regulated water and sewage charges");
- The operational contract is a fixed-term contract with duration of at least 5 years;
- The consumers pay the user fees (water and sewage charges) directly to the operator.

¹⁵ Act No. 139/2006 Coll., on concession contracts and concession procedure (Concession Act).

1.2. Public procurement according to the Act No. 137/2006 Coll.

- It is commissioned by a public awarding entity (for example, a municipality carrying out so-called relevant activity, which receives an EU subsidy, or a municipality carrying out so-called relevant activity, if this concerns an above-limit public procurement);
- The awarding entity (owner) is fully responsible for fulfilment of all duties connected with operating of water or sewage systems, ensuing from the Act on Water and Sewage Systems, or, optionally, Act on Waters - thus, the awarding entity bears all costs connected, for example, with the maintenance needs, liquidation of accidents, change of requirement on quality of the provided services, payment of fines in the case of non-compliance with the legal requirements etc. Solving of originally unexpected situations will be secured on the basis of the contract, for example, by means of extra payments to the supplier for solving the unusual situation; it will depend on the awarding entity whether it will reflect such situations in the amount of the user fees (water and sewage charges);
- The supplier bears only usual business risks connected with providing the required performance, it does not carry out investments which need not be necessarily connected with the subject-matter of the public procurement (for example, the starting "fee" for the possibility to be the supplier);
- The awarding entity acts as the entity responsible for providing the services in relation to the end users;
- The fees (water and sewage charges) are usually collected from the customers by the awarding entity. It provides direct (fixed) financial consideration to the operator for operation of the networks. This consideration does not depend on the level of use of the networks.

1.3. So-called "quasi-concession" - above-limit public procurement according to Section 156 of the Act No. 137/2006 Coll.

- It is commissioned by a public awarding entity (for example, a municipality carrying out so-called relevant activity, which receives an EU subsidy, or a municipality carrying out so-called relevant activity, if this concerns an above-limit public procurement);
- At least a part of the responsibility and risks connected with the actual operation of the water infrastructure is transferred to the operator (for example, responsibility for maintenance of the proper technical condition, ensuring of repairs and solving accident situations, or, optionally, the duty to pay fines if the operator does not properly meet the duties, wherein the caused increased costs are not compensated to the operator from the awarding entity);
- However, the income of the operator is not essentially dependent on the level of use of the networks, i.e., the possible loss caused, for example, by decrease of the number of users, or reduction of consumption, may be compensated to the operator in certain way;
- The operator did not carry out a significant starting investment, return of which was not clear from the beginning (thus, the operator does not risk loss of this starting investment in the case that the business is unsuccessful);
- The operational contract is a fixed-term contract with duration of at least 5 years;
- The consumers may pay the user fees (water / sewage charges) directly to the operator.

As follows from the above-mentioned facts, it is likely that the most usual procedure for selection of the operator will be the procedure according to the Concession Act. Thus, the following sub-chapters deal, in particular, with the procedure according to this Act.

2. Duration of contracts and financial participation of the operator

In the case that the operator does not financially participate in investment into the water and sewage infrastructure, procured using subsidy from the EU funds, the duration of the concluded contract will be set by the owner in a way that its duration will be 10 years, at most. In the case of direct investment participation of the operator, a longer duration of the contract will be set respecting the principle of proportionality i.e. the duration of the contract must be set so that it does not limit open competition beyond what is required to ensure that the investment is paid off and there is a reasonable return on invested capital, whilst maintaining a risk inherent in exploitation by the operator¹⁶.

Direct investment participation may be implemented only in the case that there will not take place co-ownership of the built water and sewage infrastructure by the operator.

- The required level of participation and its link to the duration of the contract will follow from the concession project (Section 21 and subsequent sections of the Concession Act). In the case that the awarding entity chooses procedure in the form of a concession dialogue, these expected values may be specified more precisely via feedback from the applicants for the concession.

3. Evaluation criteria

The main criterion for selection of the operator during evaluation of economic advantageousness of the offers will be the offered price of water and sewage charges (tariff), created in accordance with the principles of price regulation, amount of operating costs or payment for the given service (Section 11 paragraph 2 of the Concession Act and Section 78 paragraph 4 of the Act on Public Procurement).

In the case of procedure according to the Concession Act, the partial evaluation criteria within the framework of the basic evaluation criterion "economic advantageousness of the offer" should reflect the previous steps in the process of preparation of the concession procedure, especially results of the concession project. In particular, it is necessary to know:

- Needs of the awarding entity and the chosen method of their meeting (for example, whether it is desirable to include, into the concession, the element of investment into the infrastructure by the concessionaire);
- The chosen distribution of risks between the awarding entity and the concessionaire (for example, whether the concessionaire should bear the risk of demand for water services or not);

¹⁶ COMMISSION INTERPRETATIVE COMMUNICATION ON CONCESSIONS UNDER COMMUNITY LAW (2000/C 121/02).

- The method for constructing the price of water and sewage charges, including the mechanisms of contractual sanctions, which ensues, as such, from the previous two items.

These questions are solved by the concession project and proposal of the concession contract, based thereon.

In the case of evaluation of the economic advantageousness of the offers according to the Concession Act, it is possible to use the following procedure for evaluation of the offered price of water and sewage charges, as the basic partial evaluation criterion:

- The awarding entity determines the method for constructing the price of water and sewage charges, generally in the concession project, and in detail in the proposal of the concession contract;
- The awarding entity draws up a financial model, reflecting the method for constructing the price of water and sewage charges into unambiguous mathematical formulae, and, simultaneously, it ensures the way of calculation of the expected income of the concessionaire during the duration of the concession contract;
- The awarding entity determines the assumed values of input data into the financial model which cannot be influenced by the concessionaire, such as, for example, rent and price of taken over water;
- The applicants enter their inputs (offer items) into the structure of the financial model, and the financial model adapted in this way will de facto represent their price offers;
- The awarding entity evaluates the submitted financial models using a pre-defined method.

Concerning evaluation of contractual consideration to the concessionaire, there exist, essentially, three variants of the procedure:

- Variant (a): The awarding entity determines a year of the financial model which is a "typical" one (for example, after conclusion of a big investment project) and the level of water and sewage charges in this year is the decisive criterion;
- Variant (b): The decisive criterion is the discounted sum of water and sewage charges during the whole duration of the concession contract;
- Variant (c): The decisive criterion is the discounted sum of water and sewage charges during the whole duration of the concession contract, divided by the discounted sum of the volume of the invoiced drinking water and discharged wastewater.

Essentially, variants (b) and (c) seem to be more suitable, because they take into account the whole period of duration of the concession relationship.

The auxiliary partial evaluation criteria (i.e., criteria having lower importance) could be the following ones:

- Own values of parameters of critical performance parameters, including values of parameters in the field of services for the customers;
- The amount of contractual fines for failure to achieve the performance parameters;
- The amount of insurance protection of the operator concerning the corresponding kind of insurance and insured risks;

- Environmental criteria exceeding the framework of conditions of the permission.

4. Provisions ensuring quality of water services, including tools supporting effectiveness

Measures for ensuring quality of water services, and tools supporting effectiveness, will form part of each new operational contract as a matter of course - for details please see section D.

The applicant is recommended to use the model operational contract which in the near future will be available on the web pages of the Managing Authority of the Operational Programme Environment.

C. CRITERIA FOR ASSESSING THE NECESSITY OF A TENDER PROCEDURE FOR OPERATING INFRASTRUCTURE CO-FINANCED FROM THE EU FUNDS¹⁷

In the case that creation of a service of a new or additional kind with significant increase of quality takes place from the EU funds via building of infrastructure of water and sewage systems, the operator of the infrastructure financed from the EU funds will be selected in a regular tender procedure, respecting valid national legislation in this field.

Determination whether it will be necessary to declare a tender procedure for operating infrastructure financed from the EU funds will be primarily based on valid national public procurement legislation.

Requirement of declaration of a tender procedure for the new infrastructure financed from the EU funds must be understood as the minimal requirement following from the law. However, it does not influence the right of the owner to carry out selection of the operator for the new infrastructure voluntarily in a given concrete case, without meeting any criterion making carrying out of the tender procedure necessary, if this is not contrary to the valid legislation and the existing operational contract, without it being possibly amended by an agreement. In this case, it will not be necessary to amend, or “compete”, an operational contract concerning the existing infrastructure (not financed from the EU funds) according to requirements stated in sections A and B, respectively.

Auxiliary criteria, on the basis of which it is possible to determine whether the operation of the infrastructure of water and sewage systems financed from the EU funds within the framework of the existing water project needs starting of a new tender procedure or not, are defined below. Meeting of any of the criteria will make necessary carrying out of the tender procedure for operating the infrastructure financed from the EU.

In this connection, it is necessary to take into account that the awarding entity (or the owner, respectively) need not proceed in accordance with the Concession Act in the case that the expected income of the operator following from the possible new concession (according to Section 2 of the implementing decree No. 217/2006 Coll., implementing the Concession Act, sum of the expected income of the operator from implementation of the subject-matter of the operational contract in the individual years during the time of expected validity of the operational contract) is less than 20 million CZK without the value added tax (Section 5 paragraph 2 of the Concession Act).

1. Criterion of separability

The first criterion is whether the new water infrastructure is objectively separable from the existing water infrastructure both from the material and the functional points of view. It means that operation of this new infrastructure would represent a service of a new or additional kind (for example, operation of a new sewage system in comparison with operation of a water supply system only) which would enable the new operator to collect payments of water and sewage charges. In this case, it will be necessary to declare the new tender procedure.

¹⁷ It is expected that tender procedures applied according to this definition will apply to 20 - 30 % of costs from the total volume of funds necessary for achieving compliance with the Directive 91/271/EEC.

2. Criterion of expected income of the operator, or, optionally, extent of additional services

The second criterion is impact on the expected income of the existing operator, or, optionally, increase of the extent of the additional services by more than 20 % in comparison with the original values in the contract.

Increase of the expected income of the concessionaire, or, respectively, operator (see above) by more than 20 % means that the concessionaire, or, respectively, operator must ask the awarding entity (or, respectively, the owner) for new approval of the concession, or, respectively, operational contract (Section 23 of the Concession Act). This is an analogy with the additional services, through which the concept can be commonly applied to public procurement in the way that increase of the sum or price of the existing public procurement by 20 % (according to the Czech legislation) represents a new public procurement, for which a new tender procedure has to be declared. Thus, if operation of both the new and the existing water infrastructure did not have any impact on the expected income of the existing operator, or it decreased this expected income (for the reason that costs of the operator were increased, without increase of the water and sewage charges) or if increase of the additional services by more than 20 % in comparison with the original values in the contract did not take place, it is less probable that such operation would represent a new concession, or, optionally, additional service. However, improvement of the expected income of the existing operator by 20 %, or, optionally, increase of the extent of the additional services by more than 20 % in comparison with the original values in the contract, will mean higher probability that the case is a new concession, or, optionally, public procurement, for which a new tender procedure needs to be declared (Section 23 paragraph 4 of the Concession Act, in relation to Section 23 paragraph 7 of the Act on Public Procurement).

The basic procedures in the tender procedure for the operator of the infrastructure are defined in section B.

Provisions ensuring quality of water services, and tools supporting effectiveness, will form part of each new operational contract as a matter of course - for details please see section D.

D. QUALITY OF WATER SERVICES, TOOLS SUPPORTING EFFECTIVENESS

This section is complementary to sections A and B, because both existing and new contracts must include elements supporting improved efficiency. These include:

1. Quality of water services

Quality of water services, which must be achieved by the operator, including quality laid down by the relevant legal regulations, and, optionally, also decisions of public authorities, concerning the concrete contractual relationship according to the operational contract, will be preferentially included in annexes to the operational contract.

2. Performance parameters of the quality of water services

For the purpose of checking of compliance with the relevant standards of required quality of water services by the operator, the operational contracts will also define the indicators of

performance of water services provided by the operator. These so-called performance parameters will take into account the legal indicators and indicators ensuing from decisions of public authorities, concerning the concrete relationship according to the operational contract, and, further, they will define requirements of the owner exceeding the framework of this legal regulation. The performance parameters will function as a test whether the operator has achieved, in certain time period, certain standard of required quality of water services. If this was not the case, the operator will be at risk of penalisation (see "Sanctions in operational contracts" below), to the extent corresponding to seriousness of failure to comply with the standards of required quality of water services.

The applicant will have at its disposal a methodical tool for guidance - so-called Catalogue of Performance Parameters published on the web pages of the Managing Authority of the Operational Programme Environment. Further, it is possible to use relevant publications of the International Water Association (IWA).

3. Monitoring of performance parameters of quality of water services

The monitoring system of performance parameters of quality of water services will consist in commitment of the operator (1) to continuously inform the owner on ensuring of performance of the services and on possible breaching of commitments within the framework of providing of water services, (2) to draw up, and to submit to the owner, in regular intervals, a report on ensuring of performance of the services and on possible breaching of commitments within the framework of providing of water services for the previous calendar months, and (3) to draw up operational records required by the law, acting for the owner (if this commitment of the operator ensues from the relevant operational contract).

This monitoring system must be in accordance with rather developed legal regulation in the field of monitoring of providing water services.

During monitoring of effectiveness of operating of water and sewage systems for public use, there will be used also the technical audit of water and sewage systems, laid down by the law.

4. Sanctions in operational contracts

In addition to reference to sanctions defined in the relevant legal regulations, the operational contracts will define both sanctions of compensation type (in relation to damages or costs of the owner) and sanctions of motivation type (for the purpose of proper providing of water services by the operator). The sanction system will if possible be set in such a way as not penalise the operator repeatedly for the same reason.

The system of contractual sanctions ("payment mechanisms") will be differentiated, in particular, according to the extent of consequences caused to the owner, or, optionally, customer, and according to seriousness of the fault of the operator.

This system set by the owner will form part of the documents for selection of the operator of the new infrastructure, and, on the basis of the selected strategy of the owner, it can become one of the evaluation criteria of the selection.