

General Framework for Liberalization and Regulation of Public Utilities – the Case of the Republic of Slovenia

Aleš Ferčič*

Legal framework for liberalization and regulation of public utilities in the Republic of Slovenia is in principle comparable to similar legal frameworks in other European Union Member States. In the field of public-private partnerships (PPPs), Slovenian legal framework is well developed, however, institutional support at the state level needs to be improved and more pro-active approach of the Government would be highly welcome.

1. Introduction

The Republic of Slovenia⁵⁵ became an independent country on 25 June 1991. Simultaneously, it began to transform its political and economic systems and sub-systems. Not surprisingly, the Slovenian public sector also underwent this process.

The initial impetus for public sector transformation can be mostly attributed to internal factors. A new constitutional order brought many substantial organizational and procedural changes, which directly or indirectly affected the Slovenian public sector and triggered its transformation⁵⁶. Further impetus came from outside due to increased participation in the international community. The most important factor however was the country's orientation towards the then European Community (EC)⁵⁷. Its influence has been present even before the Republic of Slovenia became a Member State in 2004 and a member of the Euro-zone in 2007. Obligations accepted during the association process and even more so after accession play(ed) a significant role in shaping the Slovenian public sector or at least of its 'economic part'⁵⁸, which traditionally includes public utilities.

Before I proceed to discuss public utilities in the Republic of Slovenia, I would explain some related concepts, namely, public sector, public undertakings and public services. Public sector of the Republic of Slovenia is consisted of: public organs or administration at the state and local level, public funds, public institutes, (independent) agencies established by the state or/and by one or more municipalities, Health Insurance Institute of Slovenia (mandatory service), Pension and Disability Insurance Institute of Slovenia (mandatory service), public economic institutes, and public undertakings and other legal persons under the state or/and municipalities control. Public undertaking has two meanings in the Slovenian legislation. The Services of General Economic Interest Act defines public undertaking by using narrow formalistic approach, since it is defined as a company established and governed by the state or/and one or more municipalities for the provision of services of general economic interest. On the other hand, the Transparency of Financial Relations and Maintenance of Separate Accounts for Different Activities Act defines it by using wide functional approach (as used in the Directive 2006/111/ES). Public services in the Republic of Slovenian are non-economic or economic activities subject to public services obligations. Here, the

* Dr. Aleš Ferčič is an associate professor at the Faculty of Law of the University of Maribor and Head of the Institute for Public Law at the University of Maribor. He holds the following courses: Constitutional and Administrative Law and European Union Legal System: Selected Topics; Administrative Law; and European Economic Law. His specialty is Public Economic Law. ales.fercic@um.si

⁵⁵ The Republic of Slovenia is a parliamentary republic. Its public administration is organized at the state and local level. The local public administration is composed of 212 municipalities whose typical competences are local spatial planning and development, and provision of local public services including water and wastewater service). Some state's macroeconomic data: GDP(2015): 18,693 EUR per capita; volume growth of GDP (2015): 2.2 %; GDP per capita in PPS[EU-28 = 100](2015): 83; actual individual consumption per capita in PPS[EU-28 = 100](2015): 75; public debt (2015): 83.1 % of GDP; share of domestic production in total supply of goods and services (2013): 69.7 % (total value of domestic production: goods 33.2 %, services 66.8 %); average price change for total use(2013): 96.4 %; average price change for final household consumption(2013): 100.4 % (see: the Slovenian Statistical Office web-page).

⁵⁶ Without any ambition to discuss new constitutional order and the aforementioned significant changes in this article, let me just point out a shift from the administrative economy to the social market economy.

⁵⁷ And after the Lisbon Treaty from its 'successor', i.e. the European Union.

⁵⁸ Because of the principle of institutional autonomy this influence was more or less indirect.

main emphasis is on the economic public services, which correspond to services of general economic interest in the sense of article 106(2) of the Treaty on Functioning of the European Union.

Liberalization in the network infrastructure sectors

Liberalization in network infrastructure sectors, such as energy, communications, postal services and transport sectors, has been unrolled according to the European Union (EU) legal framework⁵⁹ consisting of sector specific rules (and of general competition rules)⁶⁰. Yet this in spite of the sector specific approach, used because of considerable differences between the aforementioned sectors⁶¹, one can perceive more or less the same pattern of liberalization process in those sectors.

First, legal barriers for market-entry, (mainly) created by exclusive and special rights, were removed⁶². But this alone would not suffice for the transformation of previously closed and uncompetitive markets to (more) competitive markets, since companies that would like to enter this market, i.e. new-comers, would not be able to effectively offer services because of the lack of (own) network infrastructure, having a characteristics of essential facility, which was in hands of ex-monopolists, i.e. incumbents. Therefore, the second logical step was a pro-competitive regulation, through which actual and not merely formal

conditions for the establishing of desired market competition intended to be created. By this kind of ex-ante economic regulation precisely the problem of infrastructure should be solved, which is characterised by a combination of a natural monopoly and economic irreversibility of (fixed) costs. This was done in such a way that the obligation of the incumbent, which owned the infrastructure, was defined such that it had to provide interested companies with access to it, and at an appropriate price. Moreover, this price was/is not set by the incumbent, but by the so-called national sector regulator⁶³, which was established as an independent regulatory agency specifically in order to define price and to perform other ex ante regulation in certain⁶⁴ economic sectors under the liberalization process. Since the simultaneous presence of the former vertically-integrated monopolist on the markets, both above and below the network infrastructure operation market proved to be problematic in a daily practice⁶⁵, this eventually led to its disintegration or by using different kinds of separation⁶⁶ of the network operation from other business activities.

As a result, in the aforementioned sectors competition gradually sprang up but not of the same kind and not of the same intensity. Namely, in the central or pure public utilities markets, i.e. network infrastructure operation markets, one can mainly find competition for the market⁶⁷, while in the upstream and downstream markets dominates

⁵⁹ Considering the nature of this article, I do not discuss the European Union legal framework in detail here; however, for practical reasons I would like to point out the following:

- the European Union law has a constitutional character within the Slovenian legal system;
- the European Union has an exclusive competence in the establishing of the competition rules necessary for the functioning of the internal market;
- the so-called sector specific rules define far-reaching obligations for Member States, however, this is not to say, that all-sectors general competition or economic rules do not play any role but rather opposite;
- the European Commission shall ensure, inter alia, the application of competition rules and shall, where appropriate, address appropriate directives or decisions to Member States.

⁶⁰ Considering the European Commission's practice in last ten years, it is obvious that the general competition rules, such as articles 101, 102 and 107 TFEU, are often used for the purpose of (full) liberalization.

⁶¹ One size simply does not fit all.

⁶² Such a 'de-monopolization' is a pro-competitive deregulation. Since a deregulation can be oriented towards more or less competition; I use the adjective 'pro-competition'.

⁶³ In the Republic of Slovenia there are more than just one sector regulator.

⁶⁴ Such as energy sector (around 3 % of GDP2015), communications sector (around 4 % of GDP2015), postal services sector (around 0.5 % of GDP2011) and transport sector.

⁶⁵ Because of the real chance of the abuse of power, which stems from ownership and management of the network infrastructure, on the upstream or downstream markets.

⁶⁶ There are several kinds of separation having different nature or intensity. The first grade of separation is accounting separation, which demands separate accounting for each activity. The second grade of separation is functional separation, which demands separate business units or departments (within the same legal person) for each activity. The third grade of separation is legal separation, which demands separate legal persons for each activity. Finally, the fourth grade of separation is ownership separation, which demands separate ownership for each activity, that is to say, there cannot be a business group carrying out the operation of network infrastructure (essential facility) and which would at the same time carrying out one or more activities at the upstream or downstream market(s).

⁶⁷ Where the network infrastructure is predominantly operated by public undertakings, e.g.:

- ELES, d.o.o., electricity transmission system operator,
- SODO, d.o.o., electricity distribution system operator,
- Plinovodi, d.o.o., natural gas transmission system operator,
- Pošta Slovenije, d.o.o., universal postal services operator,
- Telekom Slovenije, d.d., communications system operator,
- Slovenske železnice – Infrastruktura, d.o.o., rail system operator.

competition within the market⁶⁸.

However, that is certainly not to say, the competition sprang up in the aforementioned sectors only. After all, in the new paradigm of social market economy as introduced at the beginning of the nineties a private property protection, free business incentive and market competition became a general rule⁶⁹. Yet, also this rule is not without exceptions or limits, mainly due to the public interest considerations⁷⁰. In the social market economy, economic aims shall not a priori prevail over non-economic aims⁷¹.

This approach is important to take into consideration in all economic sectors, particularly in those providing essential services. I would also like to point out the water sector, not only because it is a typical network infrastructure sector but also because of the new constitutional provision which explicitly recognized the self-standing right to drinking water and it reserved provision of the household water supply for public sector⁷².

The Slovenian water sector was not liberalized according to the aforementioned liberalization pattern, yet some market competition, although modest, sprang up, but private participation is relatively weak⁷³. In principle, the Slovenian water sector is dominated by vertically integra-

ted public bodies, predominantly by local and regional public undertakings⁷⁴. Even though I do not want to make any prejudice, since at the moment there is still no act for implementation of the new article 70a of the Constitution and, logically, no case law in this regard, it is relatively safe to say that at least in the mid- and long-term period⁷⁵ the new constitutional provision has a potential to affect the water sector structure and competition⁷⁶. As far as I understand the new constitutional provision, it excludes private participation in two ways; it demands public ownership over water resources as well as public provision of water supply services. With other words, the Constitution itself now prohibits two kinds of the genuine or material privatization, i.e. privatization of public asset (water resources) and of public task (provision of water supply service)⁷⁷. Yet, this seems to be in line with the EU law since it is neutral in relation to national decisions governing the ownership regime for water undertakings⁷⁸, and also – at least *de iure*⁷⁹ – in relation to the self-provision of public tasks in the water sector⁸⁰. On the other hand, however, I have scruples about the (supposed)⁸¹ intent to transform the household water supply from economic to non-economic activity⁸².

Let me here also point out that the new constitutional provision is directed at water resources and household water

⁶⁸ A market competition is not protected by the European Union rules only, but also by the genuine domestic rules, including competition rules, whose scope of application is not limited to cases where the trade between Member States may be affected.

⁶⁹ At the moment, I am not aware of any specific liberalization agenda, since the competition approach is already dominant. But at the same time, I would like to point out that there is a privatization agenda according to which more or less all public utilities companies directly or indirectly owned by the Republic of Slovenia are classified as strategic investment which should in principle stay in the state's hands (see <http://www.sdh.si/en-us>). For practical reasons, let me point out the article 345 TFEU according to which the Treaties shall in no way prejudice the rules in Member States governing the system of property ownership.

⁷⁰ In principle, supranational (and national) competition rules define relative prohibition of restrictions of competition. See for example articles 101(3), 106(2) and 107(2-3) TFEU.

⁷¹ In case of their collision, a careful primacy-assessment must be carried out on case-by-case basis.

⁷² Article 70a of the Constitution:

(1) Everyone has the right to drinking water. (2) Water resources shall be a public good managed by the state. (3) As a priority and in a sustainable manner, water resources shall be used to supply the population with drinking water and water for household use and in this respect shall not be a market commodity. (4) The supply of the population with drinking water and water for household use shall be ensured by the state directly through self-governing local communities and on a not-for-profit basis.

⁷³ Here, I limit myself to household water supply services and to waste water or sewage services.

⁷⁴ In 2014, the structure of the Slovenian Water Sector was as follows: self-provision: 26%; local public undertakings: 26%; regional public undertakings: 58%; (private) concessions: 4%.

⁷⁵ I expect that the existing concessions granted to private undertakings will remain in force.

⁷⁶ At any rate in the field of household water supply services while this is less likely in case of waste water or sewage services.

⁷⁷ Privatization in a wide sense is a transfer of something, e.g. of a task, right or asset, from a public to private sphere. In theory, there are different classifications of privatization, however, in this article I use very common classification, i.e., the so-called formal privatization in case a legal person of public law is converted into legal person of private law, and the so-called genuine or material privatization in case a specific (public) task is transferred to private person where the transferred task remains under the public control, e.g. public services concession, or where this is not the case; or in case a specific (public) asset is transferred to private person (e.g. sale of shares).

⁷⁸ See article 345 TFEU.

⁷⁹ In addition, one should also consider possibility of *de facto* impact of state aid and other general competition rules.

⁸⁰ See Communication from the Commission on the European Citizens' Initiative 'Water and sanitation are human right! Water is a public good, not a commodity!', COM(2014) 177 final, 19. 3. 2014.

⁸¹ This assumption relies on the informal discussion with a member of a working group which has prepared the theoretical background for the new constitutional provision.

⁸² The application of the competition rules does not depend on whether the entity is set up to generate profits. Non-profit entities can also offer goods and services on a market. See Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, OJ C 262, 19. 7. 2016, p. 1.

supply 'only', therefore it at least formally (*de iure*) allows private participation and market competition in other segments of the water sector, e.g. the disposal of sewage or waste water. In the daily practice, however, although the core activities such as water supply and wastewater treatment are legally considered as two different activities, in most cases the same undertaking provides both activities in a given geographical area.

Public-Private Partnerships (PPPs) in Network Infrastructure Sectors

PPPs can be found in all aforementioned network infrastructure sectors, yet, until now, projects above 1 million EUR are mainly concentrated in the field of energy⁸³ and water⁸⁴, which are mainly concentrated at the sub-national level (i.e. regional or local/municipality level). I assume that in these two fields even new public private partnerships will be established in the near future considering the trend towards smart grids in the field of energy and also considering the need to modernize as well as to expand the canalization and sewage or sanitation plants⁸⁵. Moreover, I assume at least some new PPPs in Slovenia will be established in the field of (tele)communications; namely, because of thoughtless spatial planning which led to very dispersed settling with low user-density, there are a lots of (rural) areas where private investors alone will certainly not be willing to invest in the so-called high- and ultra-speed broadband networks. Moreover, at the moment it is also not certain how the so-called second rail track will be built, while PPP is one of several options.

The Republic of Slovenia enacted its Public-Private Partnership Act as late as 2006⁸⁶. The act regulates the purpose and principles of private investment in public projects and/or of public co-financing of private projects that are in the public interest (hereinafter: PPP)⁸⁷, the methods of encouraging PPP and the institutions concerned with its encouragement and development, the conditions, procedure for creation and the forms and methods

of operating PPPs, the special features of works and service concessions and of public-private equity partnerships, the transformation of public companies, the system of law that applies to resolving disputes arising from PPPs and the jurisdiction of the courts and arbitration services to decide on disputes arising from such relationships⁸⁸. Unfortunately, considering the length of this article, only certain issues can be discussed here.

The purpose of the Act is twofold. It intends to foster and protect the public interest and it intends to enable and promote private investment in the construction, maintenance and/or operation of structures and facilities of PPP and other projects that are in the public interest, to ensure the economically sound and efficient performance of commercial and other public services or other activities, which are provided in a method and under conditions that apply to commercial public services. It also relates to other activities whose performance is in the public interest, aims to facilitate the rational use, operation or exploitation of natural assets, constructed public good or other things in public ownership, and other investment of private or private and public funds in the construction of structures and facilities that are partly or entirely in the public interest, or in an activity provided in the public interest⁸⁹.

The Act defines methods of promoting PPPs. In order to promote PPP, the public partner must, *inter alia*, assess whether it can be carried out as a PPP; namely, it shall assess the grounds of project feasibility and comparison of options or other projects. This assessment is obligatory, except in the case of projects provided by a regulation. In my opinion, in this regard some improvements are still possible. There are cases where in reality no business risk was transferred to private persons who even do not make any investments and yet exclusive or special rights were granted⁹⁰. Again, at the state level more should be done not in terms of support only, even in form of consultations, but also in terms of control. Another tool to promote 'healthy' projects is that decisions determining the

⁸³ More precisely, natural gas distribution network.

⁸⁴ More precisely, water distribution network, canalization and sewage or sanitation plants.

⁸⁵ Here is already considered a potential impact of the new constitutional provision, which would probably decrease public private partnerships regarding the water distribution network. The latter will, however, need great investments considering the fact that one-fourth of the Slovenian water network was installed before the year 1920. See *Water and Wastewater Services in the Danube Region: Slovenia Country Note*, IMF, 2015, p. 6.

⁸⁶ As it seems the act will be modified in the near future by the Act on the award of concession contracts and public-private partnerships which intends to implement the Directive 2014/23/EU of the European parliament and of the Council of 26 February 2014 on the award of concession contracts, OJ L 94, 28. 3. 2014, p. 1. In addition to the aforementioned 'central' act in the field of public private partnerships, also some other horizontal and sector specific acts apply.

⁸⁷ More precisely, according to the article 2 of the Public-Private Partnership Act, public-private partnership is a relationship involving private investment in public projects and/or public co-financing of private projects that are in the public interest, and such relationship is formed between public and private partners in connection with the construction, maintenance and operation of public infrastructure or other projects that are in the public interest, and in connection with the associated provision of commercial and other public services or activities provided in a way and under the conditions applicable to commercial public services, or of other activities where their provision is in the public interest, or other investment of private or private and public funds in the construction of structures and facilities that are in part or entirely in the public interest, or in activities where their provision is in the public interest.

⁸⁸ See article 1 of the Public-Private Partnership Act.

⁸⁹ See articles 6 and 7 of the Public-Private Partnership Act.

⁹⁰ See *Poročilo o sklenjenih oblikah javno-zasebnega partnerstva v Republiki Sloveniji* (2009).

public interest in establishing PPP and on implementing projects in one of the forms of PPP shall be taken by the Government or by the representative body of a self-governing local community. Other public partners may take decisions determining the public interest in establishing PPP and on implementing projects in one of the forms of PPP only on the basis of the agreement of the founder or of authorization provided by law. PPP contracts shall be adopted by other public partners after obtaining the consent of the founder⁹¹. Yet, also in this regard I sometimes miss more awareness that PPP is not a miracle solution which always works, no matter how it is planned and executed. The truth is, PPP is neutral since it could be either success or failure, depending on its performance from the first to last day of the project. Although for now I am not aware of any project in the Republic of Slovenia that would fail, I would like explicitly to point out that we shall not assess the sphere of private and public⁹² partners only, but also the sphere of customers/users.

The Act empowers the Ministry of finances to form a special organizational unit within its structure to develop, monitor and cooperate in implementing PPPs in Slovenia, to draw up manuals for operating PPPs, to formulate expert proposals for amendments to regulations and the adoption of other measures that might help improve practices and eliminate problems in this area, and to perform other tasks provided by this Act. In addition, for the purpose of studying policy and providing consultation in the area of PPP a Council of the Slovenian Government for PPP shall be created, which shall be headed by the minister competent for finance, while other members of the Council shall be independent experts in the economic, legal and other areas of PPP⁹³. Yet, in my opinion, this institutional support needs to be reconsidered and reformed in order to become more proactive. What is more, I believe that the major shortcoming in the discussed field is weak national-level or central support and capacity to plan nation-wide projects. Nevertheless, as the practice shows, PPPs at the local level are in principle very successful in terms of planning and executing projects, even when relatively large-scale.

Last but certainly not least, the Slovenian Public-Private Partnership Act recognizes two forms of PPP⁹⁴. Namely, the contractual and institutional (equity) PPPs. In the network infrastructure sectors the latter can be found very rarely. That is to say, a great majority of all PPPs in the Republic of Slovenia are established in the form of contractual arrangement.

Conclusion

Legal framework for liberalization and regulation of public utilities in the Republic of Slovenia (particularly in the economic sectors such as energy, communications, postal services and transport) is in principle comparable to this kind of legal frameworks in other EU Member States.

Namely, in the new paradigm of social market economy as introduced at the beginning of the nineties a private property protection, free business incentive and market competition became a general rule. Yet, this is not to say there are no exceptions, which are probably most obvious in the water sector. Nevertheless, a private participation and market competition are in principle more or less present in all network infrastructure sectors, but of course not of the same intensity and not of the same kind. As I already said, in the central or pure public utilities markets, i.e. network infrastructure operation markets, one can mainly find competition for the market, while in the upstream and downstream markets dominates competition within the market⁹⁵.

In the field of PPPs one can notice relatively well developed legal framework, however, institutional support at the level of state needs to be improved and more pro-active approach of the Government would be highly welcome. In fact, the biggest weakness lies in the institutional design and capacity to plan nation-wide projects. This is in particular obvious when state projects are compared with local projects. Namely, local projects have been relatively large in investment terms, and it is fair to say that numerous local authorities have shown capacity to plan and execute large-scale projects which is certainly encouraging.

References

1. European Commission, Communication from the Commission on the European Citizens' Initiative 'Water and sanitation are human right! Water is a public good, not a commodity!', COM(2014) 177 final, 19. 3. 2014.
2. European Commission, Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, OJ C 262, 19. 7. 2016, p. 1.
3. International Monetary Fund, Water and Wastewater Services in the Danube Region: Slovenia Country Note, IMF, 2015.
4. Directive 2014/23/EU of the European parliament and of the Council of 26 February 2014 on the award of concession contracts, OJ L 94, 28. 3. 2014.

⁹¹ See articles 8 – 11 of the Public Procurement Act.

⁹² In a strict sense (public authority or body as such).

⁹³ See articles 20 – 22 of the Public-Private Partnership Act.

⁹⁴ See articles 26 – 30 and articles 96 – 134 of the Public-Private Partnership Act.

⁹⁵ Again, the water sector has rather different characteristics.