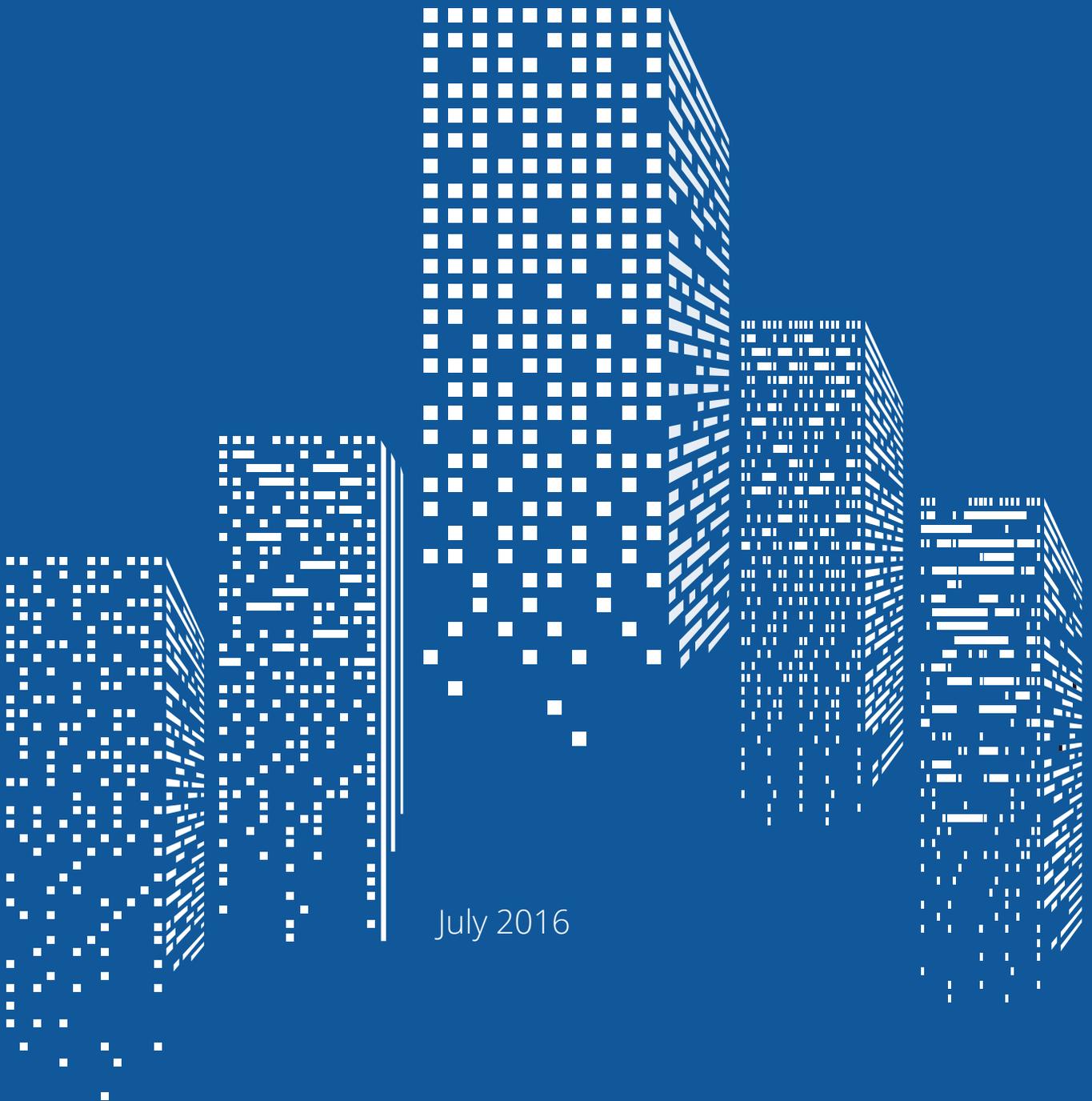




Business  
**OMBUDSMAN**  
Council

# SYSTEMIC REPORT

**REDUCING THE RISK OF CORRUPTION  
AND ATTRACTING INVESTMENT  
TO THE CONSTRUCTION INDUSTRY**



July 2016



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## PREAMBLE

This report was prepared by the Deputy Business Ombudsman Tetiana Korotka with BOC Investigator Olena Kutsay contributing to the section on the state architecture and construction supervision, under the direction of Business Ombudsman Algirdas Šemeta. The report could not have been written without the support of the entire team of BOC investigators.

We would like to thank the local and international experts for their very helpful comments, observations and participation in the process of researching for this report: Larry Hearn, Daniel Aspleaf, Natalia Forsiuk, Dmytro Lutsenko, Volodymyr Vorobey, Serhiy Ovcharenko, Olena Shuliak, Natalia Kocherhina, Oleh Matiush, Oleksandr Shatkovskiy, Iryna Novikova, Svitlana Teush, Vitaliy Hrusevych, Oleksandra Malomuzh, Olena Svitlychna, Volodymyr Borysenko, Ksenia Liapina, and Inna Samchynska.

Thanks to the cooperation of leading business associations in Ukraine—the Confederation of Developers, the Ukrainian Real Estate Club, the American Chamber of Commerce, the European Business Association, the Federation of Employers, the Ukrainian Union of Industrialists and Entrepreneurs, the Ukrainian Chamber of Commerce and Industry, the Association of Public Oversight in Construction and Urban Development, and a number of others, the Business Ombudsman Council was able to come up with many useful recommendations.

In the course of writing this report, we held consultations with the Ministry of Regional Development, Construction and Residential and Community Services, the Ministry of Infrastructure, the Ministry of Economic Development and Trade, the State Regulatory Service, the State Architecture and Construction Inspection, and the Kyiv Municipal State Administration.

We would like to note, however, that the recommendations presented by the BOC may not coincide with the opinions of individual experts or the official positions of government agencies with whom consultations were held during the preparation of this report.

## LIST OF ABBREVIATIONS

<b>BOC</b>	Business Ombudsman Council
<b>CMU</b>	Cabinet of Ministers of Ukraine
<b>CEB</b>	Central Executive Body
<b>DTP</b>	Detailed Territorial Plan
<b>EU</b>	European Union
<b>KMSA</b>	Kyiv Municipal State Administration
<b>LEB</b>	Local Executive Body
<b>MinEcon</b>	Ministry of Economic Development and Trade
<b>MinInf</b>	Ministry of Infrastructure
<b>MinReg</b>	Ministry of Regional Development, Construction and Residential and Community Services / Ministry of Regional Development
<b>MinJust</b>	Ministry of Justice
<b>SACI</b>	State Architecture and Construction Inspection
<b>SCN</b>	State Construction Norm
<b>SSTU C</b>	State Standard of Ukraine in Construction
<b>SRDF</b>	State Regional Development Fund
<b>VR</b>	Verkhovna Rada, Ukraine's legislature

## EXECUTIVE SUMMARY

The construction industry and ancillary spheres, and related business processes, have traditionally been an area that government agencies have paid close attention to. This specific attention has generally been due to the inevitable emergence of issues related to the use of land, the architectural integrity of local environments, the technical safety of buildings being erected, and high financial risks. However, overregulation, red tape and costs related to getting the necessary permits to carry out a construction project have both restricted commercial activity and led to widespread corrupt practices. And this, in turn, has hampered investment into the domestic economy.

Moreover, global anti-ratings of the construction sector have typically evaluated it as the industry with possibly the highest risks of corruption and graft on the part of government agencies<sup>1</sup>. The Business Ombudsman Council has received many complaints from businesses about the behavior of government offices at every phase of construction. The list of typical issues that arise includes:

- abuses related to the allocation of land and delays in the issuing of urban development plans;
- risks of corrupt violations of the law at the point where projects need to be hooked up to existing infrastructure and later on during the actual construction phase;
- unjustified refusals to register announcements and notices of the start of preparatory or construction works;
- delays in getting the right to carry out construction works on sites whose liability class is average.

Still, the problems related to corruption have another aspect as well, that is, when the corruption is initiated on the part of the business entity. Often bribes are offered to shorten the process of mandatory procedures or to reduce direct business costs. It is clear that opportunities for corruption arise there where the rules for providing services are not sufficiently regulated.

<sup>1</sup> [http://www.transparency.org/news/feature/preventing\\_corruption\\_on\\_construction\\_projects](http://www.transparency.org/news/feature/preventing_corruption_on_construction_projects)

The report opens with an analysis of **problems directly related to all phases of construction**.

One of the most common problems is **lack of access to information on urban development plans, architectural issues, and territorial planning**. Without current information about urban planning, the monopolists who provide the service are able to take advantage of developers, the way decisions are made by local government agencies is very opaque, and there is now a moratorium on allocating land for construction.

To resolve these issues, the BOC recommends that the Ministry of Regional Development, as the key CEB responsible for regional development policy, work with oblast administrations to determine the state of urban development documentation in specific towns and the need to develop it in order to resolve the question of adding specific expenditures to the list of those what might be covered by the State Regional Development Fund in the next budget cycle. To clearly regulate open access information vs restricted information, the BOC recommends amending the Law of Ukraine “On the Regulation of Urban Development Activities.”

The next issue is the need for **equity contributions**, which are nominally intended to improve the infrastructure of the region where the property is being developed, but are today leading to serious obstacles due to corruption. This increases the cost of building and of getting hooked up to utility networks, and hampers local development. Moreover, the requirement of an equity contribution has been listed by the Government of Ukraine and experts as a major hurdle to improving Ukraine’s rank in the World Bank’s Doing Business Index.

The BOC proposes that the Ministry of Regional Development collaborate with local government agencies, related associations, professional business societies, and experts to identify and

draft amendments to the Law of Ukraine “On Regulating Urban Development Activity” in terms of canceling the equity contribution for developers or improving the current procedure by, for instance, authorizing the Cabinet of Ministers to establish a universal procedure and payment for contributing the equity, to ensure that this contribution is used for the stated purpose, and to mandate local government agencies to regularly publish information about the size of accumulated contributions and the ways in which they are being utilized.

The Association Agreement with the EU commits Ukraine to adapting domestic legislation to European laws with the purpose of further signing a Agreements on Conformity Assessment and Acceptance of Industrial Goods (ACAA), which will largely affect **state building standards**. The problem has been exacerbated by the expectation that the Cabinet Decree of May 10, 1993 “On Standardization and Certification” will lose force on January 1, 2018, and it contains the list of types of construction products needing mandatory certification.

To ensure that the law is substantially modernized and brought in line with EU legislation, the BOC recommends that MinReg draft a legal act approving the technical regulation of building materials in full compliance with EU Regulation #305/2011, passed by the European Parliament and Council on March 9, 2011, to establish harmonized conditions for placing building materials on the market, and repealing the Council’s Directive #89/106/EEC, in compliance with Ukraine’s commitments to the Association Agreement.

**Land relations** are one of those areas of public administration that involve considerable corruption risks when it comes to allocating land, approving project documentation, and registering lots and ownership rights. In the absence of detailed urban development plans and zoning plans in most population centers, investors have no opportunity to confirm in

publicly accessible sources which parcels of state or community land are free of buildings and can be used to greenfield building projects. The fact that the right to use a parcel of land on a lease basis does not automatically get transferred when ownership changes also causes considerable difficulties in doing business. The BOC recommends that MinReg amend Ukraine's laws governing land, to directly obligate local government agencies to replace their land leasing contracts with the new owners of a property following a simplified, transparent procedure.

In addition, the Ministry of Justice needs to provide an inventory of all state and consolidated cadastres and the direct exchange of information among them, through automated systems using hyperlinks. This includes the State Land Cadastre, the State Register of Immovable Property Rights and Encumbrances, YDRPOU (Unified state register of enterprises and organizations of Ukraine), the State Register of Civil Status, Taxpayer Registers, and so on.

Another aspect that remains inadequately regulated is [getting an official postal address](#), both for new buildings and reconstructed properties. The street or postal address is, in fact, the only link between a building and its location and is the basis for formulating other documents that establish ownership for an investor. In addition, terminology connected to postal addresses for buildings is not consistent in laws, which use such terms as "postal address," "address of a construction site," "building or postal address of a construction object," "location (address) of a plot of land," and "address of immovable property."

The BOC recommends regulating all issues around the assignment of a postal address to buildings at the national level by amending the Laws of Ukraine "On Local Government," "On Local State Administrations," "On the Regulation

of Urban Development Activities," "On the Basis for Urban Development," "On Architectural Activity," and "On Advertising" to all refer to the assignment of an address to a construction project site and to be used to regulate the construction process, the commissioning of a facility, and the registration of rights to immovable property. Finally, the procedure for having a postal address issued needs to be improved. The BOC proposes establishing the procedure for assigning a postal address at the level of the Cabinet of Ministers and confirming the general list of documents that the developer must submit to have a postal address assigned.

#### **Abuses in the oversight and supervision of architecture and construction**

are complicated in nature and this is one area that both business and the Business Ombudsman Council are continually focused on.

First in this set of issues is the question of [licensing activities related to carrying out construction works](#). Unjustified refusals by the State Architecture and Construction Inspection to extend licenses in perpetuity are in direct violation of the Law of Ukraine "On Licensing Various Commercial Activities." The BOC recommends that Cabinet Resolution #1396 dated December 5, 2007 "On Licensing Commercial Activities related to Establishing Architectural Structures" be brought in line with the requirements of the Law of Ukraine "On Licensing Various Commercial Activities" by removing contradictions related to the terms of licenses and the basis for reissuing them. In addition to this, the BOC recommends that SACI adhere to the requirements of Para. 6 of Art. 21 of the Law of Ukraine "On Licensing Various Commercial Activities," which recognizes those limited-term licenses to carry out commercial activities related to Category IV and V complexity construction projects that were in effect on the day that the Law came into force as in perpetuity.

The failure to register permit documents within established timeframes is yet another issue that the BOC has received many complaints about. This has been a problem for far too long and in order to resolve it, Law of Ukraine #320-VIII “On Amending Certain Legislative Acts Regarding the Decentralization of Powers in Architecture and Construction Oversight and Improve Urban Development Laws,” dated April 9, 2015, established the exclusive reasons for returning a declaration by amending Arts. 35-36 of the Law of Ukraine “On Regulating Urban Development Activities.” Still, there is a widespread practice of issuing developers “rejection slips” stating that the necessary permit cannot be issued because of minor errors in the way the application was filled out or because the information provided is not in conformity with the “extensive list of construction works provided under current law.” Sometimes SACI keeps issuing new observations regarding the packet of documents submitted by the developer.

BOC recommendations aimed at resolving problems by amending urban development legislation are in the current draft Law of Ukraine #4733-1 “On Amending Certain Legislative Acts to Improve Urban Development Activities” dated June 3, 2016. Among others, they provide for dropping the need for declarations at the start of construction, using the principle of notifications instead, and removing the option of refusing to register such notices. The option of bringing disciplinary action against SACI employees for unwarranted delays in the issuing of permits should also be established.

SACI abuses in architectural and construction oversight also have a negative impact on the timeliness of construction works, increasing costs and pushing developers to look for “alternate means” of resolving such issues with SACI officials. The BOC recommends that, prior to the adoption of draft Law of Ukraine #2418a “On mending the Law of Ukraine ‘On the main basis for state supervision (oversight) of commercial activities’ in terms of liberalizing the state supervision (oversight) system in the area of commercial activities” dated July 21, 2015, SACI extend the Inspection Plan for state market oversight published on its website to include a register of warnings it has issued and the reasons for fines; to draft and publish a Plan of Scheduled Inspections of developers licensed to carry out Category IV and V construction works on the SACI site; and to work with MinReg to develop a mechanism of appeals against abuses at the local level.

Last, but not least, are problems with designating construction projects according to specific categories of complexity and using the “declarative principle” to issue construction permits because of the failure to clearly distinguish these categories. Where the declarative principle is applied, that is, when determining whether a construction belongs to Category III or Category IV, a major corruption component comes into play. BOC recommendations include instituting the e-office concept for submitting documents to SACI for permits to carry out construction works, and instituting the principle of tacit consent for projects that are of a minimal complexity, in the form of an electronic notice that cannot

be rejected by the oversight agency and automatically bestows the right to carry on. Also, with the establishment of unified, open, ownership registers for immovable property and a register of construction permits, SACI should be able to independently confirm information without demanding additional actions from developers.

The final key area that gives rise to corruption is lack of **transparency and public oversight**.

This relates primarily to public procurements connected to construction. One important aspect of improving procurement legislation is adapting it to EU norms. The BOC recommends that the Ministry of Economic Development

and Trade draft amendments to the Law of Ukraine “On Public Procurements” to (i) add to the basic terminology of the law the concept of a consortium to allow for the joint submission of proposals for bidding by several participants without having to establish a separate legal entity; (ii) reduce the mandatory minimum weight of the criterion “low price” from 70%; (iii) plan the further adaptation of public procurement legislation to EU law to allow for the use of such criteria as “life-cycle cost,” the impact of a company’s reputation on its potential participation in procurements, and the specifics of procurements when setting up concession agreements.

## 1 PROBLEMS AT STAGES OF CONSTRUCTION

### A) Access to information on urban development, architecture and territorial planning

The BOC has already published a report<sup>2</sup> on this issue in the context of getting facilities hooked up to utility networks: today, business in Ukraine often has to pay for both designing and building the necessary facilities to hook up to monopolist infrastructure. Aside from abuses on the part of monopolist service providers, such problems are also connected to the plain lack of capacities to handle certain kinds of facilities, which is itself

the result of lack of urban planning, opaque decision-making at the local government level, and a general lack of coordination among various participants in this process.

Still, there is another side to this issue that is directly connected to corruption risks in the construction industry.

#### What is the problem?

Art. 24 of the Law of Ukraine “On Regulating Urban Development Activity” came into effect in 2015 and regulates the transfer of land parcels for urban development projects. Where there are no zoning plans or detailed area maps,

this law prohibits the transfer or granting of parcels of state or community land to physical or legal entities as owners or tenants for urban development purposes.

#### Urban development plans

Urban development plans need to be in place first and to be the basis for any decision about the allocation of land resources that are the material and financial base for a local government. Such documentation should include:

- a General Plan of the population center: a town development plan that establishes the primary goals of development, planning, building, and other use of the territory of the population center;
- a Detailed Area Plan: a town development document that establishes the way planning

has been organized and the development of the territory;

- urban development documentation : approved texts and graphic materials that regulate the planning, building and other utilization of the territory;
- urban development conditions and building restrictions on specific land parcels: a document that contains comprehensive planning and architectural conditions for design and construction in terms of the height and density of buildings on a given parcel of land, the distance of buildings and

<sup>2</sup> BOC Systemic Report on Natural Monopolies vs Competitive Business: How to improve relations: [https://boi.org.ua/media/uploads/sysrep\\_monopolies\\_eng\\_final.pdf](https://boi.org.ua/media/uploads/sysrep_monopolies_eng_final.pdf)

structures from the any easements, the boundaries of the land parcel, along with any improvements and greenery, and other requirements as to buildings established by law and local development documentation;

- zoning plan: an urban development document that establishes the conditions and restrictions on the utilization of a territory for urban development purposes within the boundaries of specific zones;
- project documentation: approved texts and graphic materials that establish urban planning, space planning, architectural, structural, technical, and technological aspects of a project, as well as a cost estimate of the planned construction;
- regional territorial planning charts: planning documentation that is drawn up as the General Plan for the development of the territory of Ukraine is developed and establishes the basic decisions for developing, planning, building, and utilization of administrative units and their individual parts.

Even where certain documentation materials are available, urban development plans require updating under a number of circumstances<sup>3</sup>:

- circumstances require changing the scale and nature of the development of the population center;

- the type of functional utilization of specific areas is changed;
- environmental and engineering issues need to be resolved;
- the need arises to establish national or regional facilities or facilities that meet the public interest;
- the need to carry out investment programs and projects.

Unfortunately, in many cities and towns in Ukraine, urban development documentation that was drawn up in line with current legislation is either missing entirely or requires substantial updating. Among others, 24% of the General Plans of oblast-level cities need updating, as do 45.3% of county-level towns, and 66.5%<sup>4</sup> of villages and hamlets. A series of draft laws has already been drawn up to repeal or postpone bans on the transfer or granting of land parcels for construction purposes. However, this does not resolve the issue of the lack or outdatedness of urban development plans. What's more, this kind of practice is unproductive as it directly or indirectly offers incentives to be dilatory in coming up with the necessary documentation. And without such documentation, community development can tend to become chaotic. For those territories that do not have the necessary urban planning information, the risks of abuse, corruption and unjustified demands on the part of government agencies are very high.

<sup>3</sup> Decisions to change urban development documents should be based on the results of monitoring carried out in accordance with the Procedure for Urban Development Monitoring, as approved by MinReg Decree #170 dated September 1, 2011.

<sup>4</sup> <http://www.minregion.gov.ua/press/news/gennadiy-zubko-minregion-dopomozhe-mistseviy-vladi-virishiti-problemu-z-generalnimi-planami/>

## Sources of funding for territorial planning works<sup>5</sup>

According to BOC information, this unsatisfactory situation in urban planning and development is at least nominally the result of insufficient funding for the preparation and maintenance of such records. As a result, it leads to other problems. Local executive bodies do not allocate money in their budgets for documentation, while developers violate urban development legislation by building as they see fit—the perfect situation for corruption risks. State agencies propose properties for companies to develop without reference to territorial development plans, while developers “settle issues” and draw up territorial development plans after the fact—with their newly-minted facility, as is, already in place.

Funding for territorial planning in oblasts, counties, population centers, districts, and blocks, along with urban development monitoring, and setting up and running an urban planning cadastre are all done at the expense of the related local budget or other sources that are not prohibited by law. Under Ukrainian law, in addition to the state and local budgets, the LEB or local government can draw funding to develop zoning plans and detailed territorial plans [from other sources](#) not prohibited by law, provided that the relevant local government agency acts in the capacity of the developer.

But it's important to understand exactly what is meant by [funding from other sources](#) in this context. Art. 17 of the Law of Ukraine “On the Principles for Preventing and Countering Corruption” states that “Government bodies and local government bodies are prohibited from accepting free services or assets from physical or legal persons, except in those instances provided for in law or by current international agreements with Ukraine.”

Art. 13 of the Budget Code states that extrabudgetary funds may not be set up by government bodies, local government bodies or other budget institutions. A local council may decide to set up a special fund as part of the local budget and direct the revenues of budget institutions that are outside their general fund to such special budget funds. Thus, targeted purposes, such as developing a detailed territorial plan, may be funded at the request of market participants under this particular article.

Recently, a State Regional Development Fund (SRDF) was established as part of Ukraine's state budget. The money in the Fund is being directed towards regional development investment programs and projects aimed at developing the regions, and setting up industrial infrastructure and innovation parks that meet the development priorities established in the State Regional Development Strategy and matching development strategies in the regions.<sup>6</sup>

The establishment of this Fund has made it possible to begin funding the drafting of regional development strategies and specific measures to carry them out. All programs and projects that are funded by the SRDF are expected to be at least 10% co-funded by local budgets.

The Law of Ukraine “On the 2016 State Budget of Ukraine” has allocated the SRDF UAH 3 billion. Unfortunately, so far, the oblasts have not removed objections raised at meetings of the Interagency Commission regarding the compliance of their regional development investment programs and projects with the law in order to release SRDF funding worth UAH 456.15mn. Meanwhile, regions that have been approved have not yet requested another UAH 8.3mn in funding that was earmarked for their projects. Moreover, the Commission still has to review projects from three oblasts: Mykolayiv, Kherson and Cherkasy. The funding set aside for these regions is UAH 228.22mn<sup>7</sup>.

<sup>5</sup> Some of the information in this section is based on materials found at [www.ukrcsb.com.ua](http://www.ukrcsb.com.ua)

<sup>6</sup> Art. 24-1, Budget Code of Ukraine

<sup>7</sup> <http://dfr.minregion.gov.ua/uryad-zatverdiv-perelik-investitsiy-nih-program-i-proektiv-regionalnogo-rozvitku-scho-dozvolyat-pokraschiti-sotsialno-ekonomichnu-situatsiyu-na-mistsyah->

## Access to information on urban development documentation

According to law, the materials in a town's General Plan or detailed territorial plan may not include information whose access is restricted or have overall access restricted. Proper access to urban development plans, including General Plans, is regulated primarily by the Laws of Ukraine "On Access to Public Information," "On Regulating Urban Development Activities," "On Local Governance in Ukraine," and "On the Basis for Urban Development."

Despite what the law says, to ensure the full-fledged publicness of existing urban development documentation, open data needs to be distinguished from restricted information

within urban development plans. This will make it possible to provide public access to planning decisions that interest the public and business circles without damaging national security interests.

In the Council's opinion, the problem with drawing up urban development documentation can be resolved using both local budget funds and assistance from Kyiv. One of the possible sources of this assistance is the State Regional Development Fund, which meets the priorities set out in the State Regional Development Strategy to 2020 and related development strategies in the oblasts.<sup>8</sup>

### BOC Recommendations:

As the central executive body responsible for regional policy, the Ministry of Regional Development, Construction and Residential and Community Services should:

- work with oblast administrations to establish the status and need for revising urban development documentation in specific cities in order to further resolve the issue of including appropriate expenditures in the list

of those eligible to be funded by the SRDF in the next budget cycle;

- work with interested agencies to draft changes to legislation that will clearly regulate what constitutes unclassified or open access information and what is restricted information, and then push local government agencies to publish their urban development plans on their websites.

<sup>8</sup> <http://zakon4.rada.gov.ua/laws/show/385-2014-%D0%BF#n11>

## B) Equity contributions to local infrastructure development

Art. 40 of the Law of Ukraine “On Urban Development Activities” states that the developer of a commercial property must make a monetary contribution to the local budget on behalf of the LEB, which will go to the development of infrastructure in the town. Moreover, the law prohibits making this payment in kind, that is, as goods or services. The law also contains an extensive list of exceptions for developers who do not have

to make this contribution, and establishes a cap on this payment at 10% of the total value of the construction estimate for non-residential projects and 4% for residential ones. The concept behind this contribution was to generate financial resources to develop social, communications and transport infrastructure in the given territory, to increase transparency in bringing utility services to facilities, and to reduce the financial burden on developers.

### What is the problem?

- The nature of this kind of payment, regardless of its size, is that it is simply an additional, not-so-hidden tax. What's more, it is not related to measures needed for the project construction to function. It simply increases the costs of construction and hook-ups, as the contribution is calculated individually for each developer, ranging from 0% to the maximum for the particular category of developer; the size of this share contribution, up to 10% of the overall value of an industrial project, is huge; and the only mechanism for challenging the level of the contribution is the courts or “informal negotiations” with local officials.
- Interestingly, this particular payment is not on the list of local taxes and fees approved by the Tax Code of Ukraine. One thing Art. 40 does set as a condition in cases where the developer needs to lay utility lines beyond the actual construction site in order to be hooked up, is that the value of this extra work is subtracted from the contribution. Still, this in no way eliminates the corrupt nature of such a payment. And there is no mechanism for calculating the value of adding to engineering networks against the payment of the contribution, no procedure for documenting the offset against the contribution payment, and so on.
- Revenues from these share contributions are not recorded, nor are they accounted for separately, which means that it's impossible to know whether the funds received have been used as intended.
- The value of utility infrastructure installed by the developer is often more than the share contribution, and the difference is not compensated to the developer. There is not even any mechanism for paying such compensation.
- The cost of power networks and equipment purchased and installed by the developer is not included in the calculation of the contribution payment and has to be transferred without compensation to the balance of the power utility company.
- Unless a developer pays this share contribution, no postal address will be issued for the site and the ownership of the facility will not be registered.
- In the case of a building reconstruction, a share contribution also has to be paid. Even though the power supply is often reduced during reconstruction and new networks are not installed, the developer still has to pay this share.

Although experts from business circles support the idea of establishing transparent, predictable fees related to all stages of construction, they are concerned that repealing this contribution will only lead to greater corruption:

- as they lose some of the revenues to their budgets, local government agencies will no longer be interested in the building of new facilities and developing their community's infrastructure;
- Draft Law of Ukraine #3610<sup>9</sup> has been registered in the Verkhovna Rada that proposes repealing the share contribution and simultaneously prohibiting the inclusion in the technical specifications the need for the developer to install utility lines or

structures outside the actual construction site. Should this draft law be adopted without a properly regulated procedure for installing networks to the developer's site, there is a serious risk that a large number of problematic construction sites will simply have their power cut off;

- current legislation clearly establishes the cap on the share contribution and prohibits any requirements for other official payments from the developer. If the share contribution is dropped without prohibiting the drawing of funds in other forms, this could offer a pretext for setting up new mechanisms for drawing money in unregulated amounts and propositions to "resolve these issues" in other ways.

## Decentralizing budgets and new opportunities to fund territorial development measures

In discussing this issue with the BOC, local officials were concerned that dropping the share contribution would mean that the territory would lose the opportunity to build social infrastructure, expand its roadway infrastructure and so on. However, with the process of decentralization, including budget decentralization, changes to budget and tax laws are fundamentally changing the quality of fiscal security of local communities:

- The land tax is now a local tax.
- Commercial and non-residential properties are now taxed for the first time.
- 182 cities now have the right to borrow externally, where previously only 16 were able to do so.<sup>10</sup>
- The principle of tacit consent has been introduced with local borrowing, and the provision of local guarantees. Servicing local debt is now classified as a protected expenditures.

<sup>9</sup> This concept was supported by the BOC in the context of issues related to natural monopolies.

<sup>10</sup> According to the Ukrainian Association of Municipalities.

As can be seen in the table, the financing of local budgets has improved considerably since 2014<sup>11</sup>.

### Revenues to consolidated, state and local budgets, 2012-2015

Years Revenues	2012	2013	2014	2015	2015 vs 2014	
					Absolute growth, UAH bn	Pace of growth, %
Consolidated Budget, UAH bn, incl:	445.5	442.8	455.9	652.0	196.1	43.0
<i>General fund</i>	369.7	375.0	388.9	602.7	213.8	55.0
<i>Special fund</i>	75.8	67.8	67.0	49.3	- 17.7	- 26.4
State Budget (less inter-budget transfers), UAH bn, incl:	344.7	337.6	354.8	531.5	176.7	49.8
<i>share of revenues in Consolidated Budget, %</i>	77.4	76.2	77.8	81.50	x	x
<i>General fund</i>	288.5	290.1	308.7	501.1	192.40	62.3
<i>Special fund</i>	56.2	47.5	46.1	30.4	- 15.7	- 34.1
Local budgets (less inter-budget transfers), UAH bn, incl:	100.8	105.2	101.1	120.5	19.4	19.2
<i>share of revenues in Consolidated Budget, %</i>	22.6	23.8	22.2	18.5	x	x
<i>General fund</i>	81.2	84.9	80.2	101.6	21.4	26.7
<i>Special fund</i>	19.6	20.3	20.9	18.9	- 2.0	- 9.6

### BOC Recommendations:

In cooperation with local government officials, various associations, representatives of professional business associations<sup>12</sup>, and experts, MinReg should draft amendments to the Law of Ukraine "On Regulating Urban Development Activities" to abolish the share contribution imposed on developers or

improve the current approach, for instance by authorizing the Cabinet to establish a uniform procedure for calculating the contribution and to require the LEBs to publish information for public consumption on a regular basis regarding the volume of contributions received and the purposes to which they are being applied.

<sup>11</sup> According to the Institute of Budgetary and Socio-Economic Studies. [http://www.ibser.org.ua/UserFiles/File/Monitoring%20Quarter%202015/KV\\_IV\\_2015\\_Monitoring\\_ukr.pdf](http://www.ibser.org.ua/UserFiles/File/Monitoring%20Quarter%202015/KV_IV_2015_Monitoring_ukr.pdf)

<sup>12</sup> Such as the Ukrainian Association of Municipalities, the Association of Local Governments, and so on.

## C) Safe construction norms and standards

State construction norms constitute a nearly 17% of all normative documents in construction. Sector experts say that this particular activity is more-or-less regulated, with reviews and updates to state construction norms scheduled regularly.

However, the issue of standardizing in construction requires greater attention from the Government of Ukraine, as it directly affects

both manufacturers and importers of building materials in terms of declaring the technical features of the products, it affects the value of works, the use of energy-efficient technologies, the use of contemporary materials, the reliability of roads, railways, airports, lines of communication, and oil pipelines, industrial enterprises, the agro-industrial complex residential and public buildings, and so on.

### What is the problem?

The need for serious effort in this area is driven by two key factors:

**Firstly**, the CMU Decree “On Standardization and Certification” dated May 10, 1993, becomes void on January 1, 2018,<sup>13</sup>—and the list of products requiring certification under the CMU system with it. Building materials are one of the biggest categories on this list.

**Secondly**, the Association Agreement with the EU commits Ukraine to adapting national legislation to EU standards in preparation for the further signing of a Agreements on Conformity

Assessment and Acceptance of Industrial Goods (ACAA) ). This includes EC Regulation #305/2011 approved by the European Parliament and Council on March 9, 2011, which establishes harmonization conditions for placing building materials on the market and cancels EC Directive #89/106/EEC. The implementation plan for this regulatory act was approved by Cabinet Resolution #162 “On approving the plans developed by the Ministry of Regional Development, Construction, and Residential and Community Services to implement certain EU legislative acts,” dated March 4, 2015.

### BOC Recommendations:

In compliance with Ukraine’s commitments under the Association Agreement with EU, MinReg should draft a regulatory act to confirm the technical regulations for building

materials in complete compliance with EC Regulation #305/2011,<sup>14</sup> which establishes harmonization conditions for placing building materials on the market.

<sup>13</sup> <http://zakon5.rada.gov.ua/laws/show/46-93>

<sup>14</sup> Regulation (EU) No 305/2011

## D) Land issues linked to construction

The Business Ombudsman Council is well-informed on problems related to land ownership and use in Ukraine and the need for serious reform in this area. Given the many consultations with qualified professionals and detailed recommendations prepared by international organizations on this vast issue, the BOC has focused only on the specific land

issues related to construction for the purposes of this report.

Land issues are one of those areas of public administration that involve considerable corruption risks when it comes to allocating it, approving project documentation, and registering lots and ownership rights.

### What is the problem?

- The right to use a parcel of land on a lease basis does not automatically get transferred when ownership of the property changes. The new owner has to effectively go through the entire procedure of allocating the land for use and signing a new leasing agreement, which takes nearly six months under the most optimistic circumstances. This means that new owners effectively cannot use their own property, such as to carry out reconstruction.
- Investors have no means to check in publicly available sources which state and community land is free of buildings and can be used to carry out construction projects.
- Land ownership is divided into private, state and community ownership in Ukraine. The distribution between state and community land parcels has not been completed yet, which means that it is generally difficult to identify the owner of a piece of land. This leads to considerable delays in preparing documentation for a parcel.

### BOC Recommendations:

#### Short-term measures

MinReg and MinJust should propose amendments to Ukraine's land legislation to directly obligate LEBs to re-sign leasing agreements for land parcels with new owners of the properties following a simplified, transparent procedure.

#### Long-term measures

Working with other agencies, MinJust should inventory all state and consolidated registers or cadastres and ensure direct exchange of information among them through automated systems using hyperlinks. This includes the State Land Cadastre, the State Register of Immovable Property Rights and Encumbrances, YDRPOU, the State Register of Civil Status, Taxpayer Registers, and so on.

## E) Problems with getting a postal address (Doing Business)

### What is the problem?

The issue of getting an official postal address, both for new buildings and for reconstructed properties, remains unregulated in law. A street or postal address is effectively the only link between a building and its location, and is the basis for formulating other documents establishing ownership for an investor.

In addition, there is legal chaos with terminology related to the address of a building site. For instance, the Rules for Providing Postal Services approved by Cabinet Resolution #270 dated March 5, 2009, "postal address" means the address of the sender and receiver designated on the actual mail and the form for a postal order in a specially designated place. Meanwhile, the Law of Ukraine "On Regulating Urban Development Activities" uses the term "address of a construction site," while the Law of Ukraine "On Financial-Crediting Mechanisms

and Managing Property during the Construction of Housing and Operations with Real Estate" uses the term "building or postal address of a construction object." The Land Code of Ukraine refers to the "location (address) of a plot of land." Sub-legislative regulations related to state registration of property rights and rights to immovable property and their encumbrances use the term "address of the immovable property."

The issuing of a postal address is based on instructions issued by the given district council in the City of Kyiv or a government agency locally. When it comes to "reconstructed" facilities, the document issuing an address needs to be found in archives that are not properly organized and sometimes lack the necessary information altogether.

### Getting a postal address in Kyiv

According to Point 4.1 of the Provision on the Register of Addresses in the City of Kyiv was approved by the City Council Resolution #337/9394 dated May 22, 2013, assigning a postal address to property involves the issuing of instructional documents by the Department of Urban Planning and Architecture or by city district state administrations. These addresses are then entered into the Register of Addresses.

This provision requires a building address to be issued before construction is complete and the facility is commissioned. What's more, the Department needs to receive a series of

documents, including the project documentation for the building that has been approved in the established procedure, and a notice that the share contribution for the development of social, communications and transport infrastructure has been paid.

According to Point 4.18, a completed building is commissioned based on a positive report from the Urban Planning Cadastre Service of the Department of Urban Planning and Architecture. This report is then submitted to the district state administration (RDA), which is supposed to issue an instruction issuing a postal address

for the building within five working days. Within two working days, the RDA sends a copy of this instruction to the Cadastre Service so that the address can be added to the Register of Addresses.

A notice of the assignment of a postal address to an immovable property is then issued by the Register of Addresses within two working days and sent to the applicant through the appropriate permit center of the relevant RDA of Kyiv, as well as to the Information Center state enterprise of the Ministry of Justice, to the Kyiv Municipal Administration of the state postal service, UkrPoshta, to the community enterprise

called the Kyiv Municipal Bureau of Technical Inventory and Registration of Ownership of Immovable Property.

In practice, however, these timeframes are rarely upheld. There is even one case where it took years for an address to be issued to a newly-constructed building. The effect of corruption can be clearly seen in this. Developers often also have trouble when streets are renamed and addresses for several properties need to be updated. This also leads to confusion and delays in issuing the necessary documents confirming ownership.

## BOC Recommendations:

MinReg should amend key legislation to:

- clearly distribute powers among different agencies regarding the assignment of postal addresses to buildings and properties, in Sec. 1 “Organizational and legal basis for local government” in the Law of Ukraine “On Local Governance” and Part 1 “The competencies of local state administrations” in the Law of Ukraine “On Local State Administrations;”
- establish procedures for assigning a postal address in the Law of Ukraine “On Postal Communication” by: (i) designating the Cabinet of Ministers as the authorized body to establish a Procedure for Assigning Addresses with a complete list of documents necessary, reasons for possible refusal, and

other key issues; and (ii) establishing that the term “postal address” may only be used in the context of legislation on postal services.

- clarify the assignment of a location of a construction site in the Laws of Ukraine “On Local Governance,” “On Local State Administrations,” “On the Regulation of Urban Development Activities,” “On the Basis for Urban Development,” “On Architectural Activity,” and “On Advertising” to all refer to the assignment of an address to a construction project site and be used to regulate the construction process and the commissioning of a facility, and the registration of ownership of immovable property.

## 2 ABUSES IN THE OVERSIGHT AND SUPERVISION OF ARCHITECTURE AND CONSTRUCTION

### A) Licensing for construction work

#### What is the problem?

The State Architecture and Construction Inspectorate refuses to extend licenses in perpetuity without providing justification, which is in direct violation of the Law of Ukraine “On Licensing Various Commercial Activities.” This law states that Category IV and V complexity construction is to be licensed on the basis of features outlined in the Law of Ukraine “On Architectural Activity.”

However, Art. 17 of the law also states that the procedure for licensing activities related to the erection of architectural objects is established by the Cabinet of Ministers, which issued Resolution #1396 “On licensing commercial activities related to the erection of architectural objects” dated December 5, 2007, for that

purpose. It turns out that this resolution does not fully conform to the Law of Ukraine “On Licensing Various Commercial Activities,” where the expiry dates of licenses and the grounds for extending them are established.

Sec. 6 of Art. 21, “Transitional Provisions” in the Law of Ukraine “On Licensing Various Commercial Activities” states that limited-term licenses to carry out commercial activities related to architectural objects that were in effect at the time that this law came into effect are now automatically considered in perpetuity. Moreover, Para 4, Sec. 6 states that having such a license reissued is the right of the licensee, but is not mandatory.

#### BOC Recommendations:

The State Architecture and Construction Inspection should:

- bring CMU Resolution #1396 “On licensing commercial activities related to the erection of architectural objects” dated December 5, 2007, in line with the provisions of the Law of Ukraine “On Licensing Various Commercial Activities” by removing contradictions regarding the expiry terms of licenses and the basis for re-issuing them;

- carry out the provisions of Sec. 6, Art. 21 of the Law of Ukraine “On Licensing Various Commercial Activities” in recognizing term-limited licenses to undertake constructions of Category IV and V complexity objects that were in effect on the date this Law came into effect as now in perpetuity.

## B) Delays in registering permits and licenses<sup>15</sup>

### What is the problem?

The Business Ombudsman Council receives many complaints from developers about SACI offices not upholding the official timeframes for registering permit documents of all kinds: notice of start of construction works, notice of start of preliminary work, and permits to undertake construction works.

This has been going on for too long and in order to resolve it, the Law of Ukraine #320-VIII "On Amending Certain Legislative Acts of Ukraine to Decentralize Competencies in the Oversight of Architecture and Construction and Improve Urban Development Legislation" dated April 9, 2015, designated the only grounds for returning notices by amending Arts. 35 and 36 of the Law

of Ukraine "On Regulating Urban Development Activities."

Still, such notices really are technical documents and filling one out requires specialized knowledge. One widespread practice at SACI is giving developers "rejection slips," saying that they will not be issued the permit because of minor errors in filling out the declaration or because the stated information is not in compliance with the "extensive list of construction works permitted by current law." Sometimes, SACI will keep sending back declarations with new observations each time the developer submits a revised packet of documents.

### BOC Recommendations:

- MinReg should propose amendments to the Law of Ukraine "On regulating Urban Development Activity" and several other legislative acts to replace the procedures for registering notices of construction starts and the commissioning of buildings of average and significant liability class on construction starts and the commissioning of buildings with permits to carry out such construction works and certificates accordingly.
- SACI should set up information and consultation centers at every one of its branch offices to provide assistance to developers. This is a key element in eliminating the risks of rejection when registering notices with minor "technical" errors on the part of the developer.
- SACI management should set up systematic internal oversight and penalize those employees who unreasonably hold up the issuing of permits to developers, as required by current law.

<sup>15</sup> Some of BOC's recommendations have been included in the draft Law of Ukraine #4733 "On amending certain legislative acts of Ukraine to improve urban development activities" dated June 3, 2016.

## C) Abuses in the exercise of architecture and construction oversight

### What is the problem?

SACI is authorized to inspect construction sites and developers to ensure that they uphold the law on urban development activities, building codes, standards, and rules. SACI officials carry out both scheduled and unscheduled inspections, the result of which can result in warnings to eliminate violations of urban development law or the cancellation of permits that are not in line with current law. An unscheduled inspection can be instigated by a complaint from any physical or legal person about violations of urban development rules on the part of the builder. Sometimes SACI officials have taken advantage of their rights and powers to even bring a construction project to a complete halt without justification.

These kinds of SACI abuses affect the schedules of construction projects, increasing costs and forcing developers to look for “other avenues” to resolve their problems with SACI officials. Of course, project managers can submit counterarguments and observations regarding the inspection results, which become an integral part of the document, but this does not seem to influence the conclusion of the inspection and its consequences for the developer. The only resort for a developer to have SACI warnings repealed is to turn to the administrative court.

### BOC Recommendations:

#### SACI should:

- Extend its Inspection Plan, which is published on its official site,<sup>16</sup> with a section that lists the warnings issued to developers during inspections, the reasons for any fines charged, and the results of developers’ eliminating violations, without waiting for the adoption of draft Law of Ukraine #2418a “On amending the Law of Ukraine ‘On the basic principles of state supervision and oversight of commercial activities’ to liberalize the system of state supervision and oversight of commercial activities” dated July 21, 2015.

This draft law provides for setting up an integrated, automated state supervision and oversight system that will include inspection schedules for all government agencies and the results of any measures taken;

- draw up and publish its schedule of planned inspections of developers who are licensed to carry out Category IV and V complexity construction works on the SACI site;
- together with MinReg, develop an appeal mechanism against local architecture and construction oversight actions.

<sup>16</sup> <http://www.dabi.gov.ua/phocadownload/072016/rinknagl3kv.pdf>

## D) Categorizing projects by complexity and using the declarative principle to get permits

### What is the problem?

Adopted in 2011, the Law of Ukraine “On Urban Development Activities” was intended, first of all, to simplify obtaining building permits and commissioning previously erected buildings. One key innovation in this law was a change in the principle for beginning construction work to a declarative form, that is, without the need to get a permit to begin construction on structures that are not in the complex and hazardous class. The developer only needs to notify the State Architecture and Construction Inspection about starting construction work, and SACI is supposed to register the notice within 10 days. The main principle in operation is supposed to be tacit consent, which gives the developer the right to begin building on the 11th day if the permit or a denial is not issued within the stated term.

In practice, however, no “declarative” principle is being applied. SACI returns notices of start of preliminary works or construction works for “minor” reasons. The BOC has seen cases when such unjustified delays have dragged out the registration of notices for 6-8 months. Where the declarative principle is used, that is, when determining whether a construction belongs to Category III or Category IV, a major corruption component comes into play. What’s more, the negative practice related to corruption can be initiated by an unscrupulous developer who plans to “legalize” the project, or by pressure from SACI officials.

The BOC carefully studied the Government’s draft Law of Ukraine #4733-1 regarding the start of construction works based on electronic notices and has concluded that, should this initiative be passed, individuals and smaller

builders will have the right to begin construction the day after they submit notice and SACI will be in no position to pressure them.

What’s more, this draft law proposes dropping the concept of category of complexity and replacing it with hazard classes: low, medium and high. Developers of projects in the medium and high hazard classes, currently called Category III and IV, will be granted permits for construction works on identical principles. The BOC considers that these innovations make sense but the procedure itself needs to be thoroughly discussed within the professional community to reduce corruption risks once it is instituted. A critical issue is to separate supervisory and oversight functions related to architecture and construction, which should not be handled by the same agency because this, too, leads to corruption.

In addition, current legislation requires developers to prepare notarized copies of project documentation, which can sometimes run into several volumes. BOC experts say that this requirement is a hangover from soviet times and requires too many additional technical and material resources. Given the advances in information technology, project documentation can easily be submitted to SACI in electronic form. Another example is the demand that a general contractor has to provide copies of licenses, although SACI itself manages the register of such licenses. Sometimes SACI makes other demands regarding the formulation of documents to receive permits and rejects applications because the submitted documents “do not comply” with current law.

## BOC Recommendations:

After the necessary amendments have been made to existing legislation, MinReg and SACI should jointly:<sup>17</sup>

- institute an “e-office” for submitting documents to SACI for the purpose of getting building permits;
- institute tacit consent for projects that represent a low level of complexity, in the form of an electronic notice that cannot be rejected by oversight agencies and gives the automatic right to begin construction;
- introduce check of information that is in state registers without involvement of applicant when preparing licenses to carry out construction works.

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<sup>17</sup> BOC recommendations have been partly included in draft Law of Ukraine #4733.

### 3 TRANSPARENCY AND PUBLIC OVERSIGHT IN THE CONSTRUCTION INDUSTRY<sup>18</sup>

#### A) Public procurement in the construction sector

The problems that arise with procuring works, including complex infrastructure projects, are an integral part of the general problems arising during state and public procurements. One clearly positive trend was the move to electronic procurements under the new Law of Ukraine “On Public Procurements” passed December 25, 2015, and the affirmation of the Strategy for Public Procurement Reform by Cabinet Instruction #175 dated February 24, 2016. Both of these documents focus on simplification of doing business with the state, bring Ukrainian procurement to EU standards and reduce corruption in this sphere.

At the same time, transparency and accountability for construction done at public cost still face a slew of problematic issues. This means improving public procurements, which have a specific dimension when what is being purchased is construction works, improving the effective use of taxpayer money, and reducing ineffective management during the construction and exploitation of infrastructure as part of the battle against corruption.

#### Proper calculations of anticipated construction costs

##### What is the problem?

- Public procurements of construction works often involve errors in calculating anticipated costs, leading to further problems with contractors fulfilling their contracts, planning the necessary expenditures, and establishing conditions for fair competition among market participants.
- When determining the scope of the works being procured for a construction project, the client should calculate the cost of all types and volumes of work that are needed to carry out the construction—the building, communication lines, and utility and transport infrastructure—, in line with the project documentation. One of the most common mistakes among government agencies commissioning work is to plan procurements based on annual estimated expenditures and not on the actual value of the works involved.
- In most cases in Ukraine, projects requiring construction works have one design phase, they do not take into account any other variables and adjustments that might be needed as the project progresses. Not having this option eventually leads to inaccurate assessments both of tender proposals from contractors and the results of contractor work. As a consequence, numerous changes are made to the project cost documentation and the General Contract during the course of the work. This increases both the timeframes and the cost of the work significantly. Meanwhile, changing project documentation is one of the more common areas carrying corruption risks precisely because it is most often tied into more work and growing costs.

<sup>18</sup> Some recommendations were presented through the National Secretariat of Construction Sector Transparency (CoST).

## BOC Recommendations:

MinEcon should work with construction managers working at oblast state administrations to include in their annual Action Plans regular methodological work with those who commission construction work on how to determine the value of a procurement item through workshops, including those funded by international technical assistance programs, and to publish recommendations that will reflect a number of key rules:

- Where funding for the construction of a facility is expected to last several years, the client should organize the procurement process based on the overall expected cost of the entire works and sign a long-term procurement contract with the successful bidder that establishes that the works will be ongoing for several years.
- In planning procurements, it should be kept in mind that the commissioning agent has no right to break up the procurement order into smaller parts to avoid having to hold open tenders or applying Sec. 5, Art.2 of the Law of Ukraine "On Public Procurements."
- To estimate the cost of procuring works, Ukraine's normative construction documents should be used as a guide, as they set the rules for determining the value of construction, design and survey works, and feasibility analyses of the actual plans according to domestic standards. The one mandatory document that should be used in estimating costs is the Rules for Determining the Value of Construction,<sup>19</sup> the national standard. This standard is mandatory when estimating costs for construction covered

by budget funds, the funds of state and community enterprises, institutions and organizations, as well as by loans guaranteed by the government. Its application has to be established by contract. This means that the conditions for calculating the value of a proposition and the draft procurement contract should include the use of this standard, that is, in the conditions that establish the agreed price of the awarded contract.

- Where participants plan to engage subcontractors to carry out works, tender bid prices should include the cost of all proposed works contained in the tender documentation, including works that will be executed by subcontractors.
- To prepare procurement and tender documents, the client should use a finalized working design<sup>20</sup> with all the necessary approvals and with all land issues confirmed and resolved, if this is required. The working phases of the project should be preceded by an explanation of any repair work in compliance with the quality control system for the relevant types of infrastructure, a feasibility study, and public discussions to identify all possible risks.
- Where there is no finalized working design with the necessary approvals, the recommended approach is to include a tender interview procedure to negotiate with participants and clarify any issues about the project directly during the tender process.

<sup>19</sup> GOST D.1.1-1: 201

<sup>20</sup> Design terminology should be used in accordance with MinReg Decree #45 "On approving the Rules for Drafting Project Documentation for Construction" dated May 16, 2011.

## Public access to information

### What is the problem?

When drawing up a contract for preparing project documentation or carrying out construction works and oversight, Ukrainian law does not provide for open access to

information. Many documents are marked “For internal use” that contain no secret information whatsoever. This simply complicates the process of overseeing the use of taxpayer funds.

### BOC Recommendations:

MinEcon and MinReg should jointly propose amendments to the Commercial Code of Ukraine to change the section on subcontracting agreements for the execution of works that are drawn up in line with the Law of Ukraine “On Public Procurements,” to require providing both the client and the executors—contractors,

subcontractors and engineers engaged in technical supervision—with open access to information about the progress of the works for the purpose of ensuring their accountability to the public at all stages of the procurement process, from design to completed construction and commissioning.

## Delays in paying for work

### What is the problem?

When inflation is high and the exchange rate is unstable, delays in payment for work on longer projects place additional financial burdens to those executing a contract. This kind of “fiscal” problem often emerges because of manipulation and abuse on the part of the

general contractor or executor who settles dilatorily or not at all with subcontractors while blaming the client. Doubts about the solvency and financial stability of government clients greatly diminish any successful reforms of legislation and the procurement system.

### BOC Recommendations:

To improve this situation, MinFin should draw up and submit a draft law to amend the Budget Code of Ukraine and other related regulatory acts, including:

- establishing clear deadlines by which payments for procurement contracts must be made, typically not more than 30 working days.
- instituting penalties for delaying payments.

## B) Better laws on public procurement for construction works in order to fulfil Ukrainian obligations in the light of EU-Ukraine Association Agreement

### Expanding the pool of participants in procurement tenders

#### What is the problem?

In contrast to EU law, public procurements in Ukraine only permit physical or legal persons to be involved, whereas international practice widely allows consortiums, that is, a group of companies, to participate in such tenders.

This concept is missing in Ukrainian law, which considerably reduces the options for preparing high-quality bids for large construction projects and infrastructure projects with a construction component.

#### BOC Recommendations:

MinEcon should draw up changes to the Law of Ukraine “On Public Procurements” by adding to the basic terms in the law, in Art. 1, the concept

of a consortium to ensure broader opportunities for companies to jointly submit a bid without having to establish a separate legal entity

## Changing the minimum mandatory weight of the criterion “low price”

#### What is the problem?

The calculation of a tender bid for construction works involves many factors that have to be presented in considerable detail in the project plans. Moreover, the extremely quick passage of tenders and selection processes often make it impossible to reduce the price of a bid while remaining within all the calculations and taking all the necessary factors into account.

This situation becomes even more complicated when the procurement is for works whose value

is less than €5.15 million, when the compliance of the technical part of the proposal of the potential winner with the project estimate documentation of the procured works is only verified after the electronic auction has taken place and the winner has been announced.<sup>21</sup> Under such circumstances, the risk of selecting an contractor who will end up unable to actually deliver in time and to standard is very high, as is the risk of unlawful revisions to a contract agreement signed after such an auction.

<sup>21</sup> Arts. 10 and 28, Law “On public procurements.”

## BOC Recommendations:

MinEcon should draft amendments to the Law of Ukraine “On Public Procurements” to reduce the mandatory minimum weight of the criterion “low price” from 70% to 50% for the procurement of works. When “low price” dominates the criteria while the terms of a

contract are poorly defined and requirements for the subject of the purchase, this could lead to the bidder with the lowest price failing to complete the works or to complete them inadequately.

## Procurements under concessions or public-private partnerships

### What is the problem?

The recent announcement by the Government that existing legislation on concessions<sup>22</sup> would be consolidated into a single working law merits attention. Concessions and public-private partnerships are very promising instruments at a time when there is an evident need to modernize all the still-soviet infrastructure in the country, starting with transportation and utilities, and raising the quality of many public services. The use of these instruments is almost always connected to the procurement of large-scale construction works, and all the phases and components that go with them.

In terms of European integration, it’s important for Ukraine to consider the concepts of concessions and public-private partnerships in the light of EU legislation on public contracts and concessions, such as the EU Directive 2014/23/EC on concessions. The new Ukrainian law on concessions should be based on this Directive and reflect Ukraine’s law on procurements regarding the publication of information on concessional tenders on the unified procurements portal.

## BOC Recommendations:

In preparing the draft Law of Ukraine “On Concessions,” MinEcon should take into account the need to amend the procurements

law regarding the publication of information on concessional tenders on the unified procurements portal.

<sup>22</sup> The Laws of Ukraine “On concessions,” “On the specifics of granting leases or concessions on community-owned assets in heating, water supply and sewage networks,” “On the specifics of granting leases or concessions on state-owned assets in the fuel and energy complex,” “On public-private partnerships,” and “On concessions to build and exploit roadways.”

## Further adaptation of public procurement legislation to EU laws

### What is the problem?

Ukrainian legislation on public procurements was prepared as part of the adaptation to EU Directives on public procurements in 2004.

However, recently the European Union replaced these with new directives.<sup>23</sup>

### BOC Recommendations:

MinEcon should add to its work plans the further adaptation of public procurement legislation to the EU's Directives 2014/24 on public procurements and 2014/25 on procurements by enterprises that operate in the area of water supply, power, transport and postal services. Of particular importance are

the provisions of EU legislation related to public procurements of construction works, including such criteria as life-cycle cost,<sup>24</sup> the influence of a company's reputation on its potential to participate in procurements, the concept of abnormally low price, and so on.

<sup>23</sup> Directives 2014/24/EU on public procurements and 2014/25/EU on procurements by enterprises that operate in the area of water supply, power, transport and postal services.

<sup>24</sup> This is particularly significant in construction, where the cost of servicing and maintaining the facility needs to be calculated at the procurement stage, along with warranties to eliminate defects for a guaranteed term.

<sup>25</sup> FIDIC (Fédération Internationale des Ingénieurs-Conseils, International Federation of Consulting Engineers), [www.fidic.org](http://www.fidic.org)

## ADDENDUM

### TYPICAL CASES WHERE GOV'T AGENCIES ACTED WRONG

#### **Complaint 1. SACI refuses to register permit documents, each time with new excuses**

The Complainant had been trying since January 2016 to get its notice of start of construction registered with DACI on a capital renovations project that did not involve changing the external appearance of the main wing, just partially altering floor plans and insulating the rooms.

Over January-May, the Complainant turned to SACI three times to register the declaration. Each time, SACI found new reasons to refuse the registration.

On January 21, registration was refused because of non-compliance with the extensive list of construction works in Para. 2, Point 1 of the Procedure for carrying out preliminary works, approved by Cabinet Resolution #466 dated April 13, 2011. However, Art. 36 of the Law of Ukraine "On Regulating Urban Development Activities" does not include compliance with this particular as grounds for returning such a notice.

On February 11, the Complainant was once again issued a refusal because of a "lack of supervision of the building site," which was established by SACI during an inspection of the company.

On April 5, the Complainant received yet another refusal to register the notice because "the category of complexity of the project has not been properly designated," although an expert assessment placing the project in Category III of complexity and CC2 for liability class was attached to the declaration. As of June 3, the notice still had not been registered.

In fact, the overall timeframe for registering such notices is 5 working days from the submission to SACI, according to Point 2, Art. 36 of the Law "On Urban Development Activities."

Finally, after the BOC intervention the permit was issued.

#### **Complaint 2. SACI officials keep making new demands for a permit**

A complaint was filed against officials at SACI Ukraine for delaying the registration of a permit to carry out construction works. Three times the agency refused to issue a permit to the applicant and kept making demands for additional documents and information, which was in violation of current law.

The BOC turned to SACI and pointed out that its reasons for refusing to issue the permit should

have been clearly stated, . and anticipated in current legislation. Moreover, these grounds could not change every time the applicant reworked documents and presented a new packet for the permit to be issued.

After the BOC intervention, the permit was issued within three working days.

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### Complaint 3. SACI officials delay the issuing of permit documents

In October 2015, the Complainant acquired a plot of land in Odesa to build a temporary parking lot for trucks and a drying plant.

In February 2016, the Complainant submitted notice of the start of preliminary work to the SACI office in Odesa Oblast, in compliance with current legislation.

Over February–April, the Odesa SACI office four times refused to register the notice of the

start of preliminary works for various minor reasons, which made the Complainant come to the conclusion that its staff were, at a minimum, incompetent, and possibly prejudiced.

After the company turned to the BOC, the Odesa SACI office sent confirmation within two days that they had registered the notice of the start of preliminary works.

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### Complaint 4. Winner of a competition to develop property in Kyiv faces court challenges

The Complainant said that pressure was being exerted by the prosecutor's office and people were trying to repeal an instruction from Kyiv City Council declaring the Complainant the winner of a competition for the right to develop a property in Kyiv. Considerable pressure was being exerted by filing suits in the court to cancel the investment agreement that had been drawn up between the KMDA Department of Economics and Investment and this private developer.

Having examined the materials in the case, the BOC concluded that attempts to challenge the results of a completed competition were undoubtedly one example of the kind of experience that scares potential investors away. This also blackens the business image of the Kyiv administration and does little to attract additional investment in developing the capital's infrastructure.

Moreover, given how critical the issue of parking is in the city of Kyiv, as City Council had admitted by adopting its Program for developing a consolidated parking environment in Kyiv on

January 22, 2015, the BOC recommended that the KMDA improve the process for investment competitions, including by taking specific, consistent steps:

- 1) The procedure for holding a competition for the right to utilize land through an investment contract should not be in conflict with the provisions of the Land Code of Ukraine.
- 2) Any competition to attract investors must be transparent and open. One of the conditions will be for the KMDA to establish the basic requirements for a feasibility assessment of the project. This will make it possible to confirm the economic rationale for the construction, determine the preliminary investment needed, and justify the choice of land plots for construction. Developing feasibility criteria will help ensure that the most economically effective decisions will be made on behalf of the citizens of Kyiv, and this will ensure that all the necessary building permits will be issued and minimize the risk of doubts on the part of oversight agencies and the public.

- 3) All disputed issues over land and property rights must be resolved between the client and the investor in the investment agreement.
- 4) The building owner and the organizer of the competition must be given all the necessary authority permitted under law to dispose of the land parcel that is being put to use.
- 5) The investor's right to build on the land parcel should be guaranteed and exercised, as long as all the provisions of the investment agreement are fulfilled.

At this time, KMDA, with the help of international experts, is preparing a new Procedure for holding investment tenders for the right to build.

### **Complaint 5. Developer waits for a street address since 2012 while Pechersk RDA vacillates**

The Complainant has had trouble getting a postal address assigned to a building that has been commissioned since 2012 and consists of several sections. Originally, after receiving the necessary permits, the Complainant turned to the Pechersk District State Administration (RDA) with a request to be assigned a postal address for a completed building complex. After reviewing the request, the Pechersk RDA issued an instruction that assigned a postal address to the site.

In time, however, this decision was repealed. Moreover, the Pechersk RDA, in contradiction to its own original letter, stated that the instruction assigning a postal address was only for the first commissioned building of the said residential and office complex. This position was diametrically opposed to the Administration's earlier explanation, which is what the builder, the investor, the owners of the apartments, the State Registration Service, and the notaries who handled the registration of ownership were counting on. At the designated address, the ownership rights of physical and legal persons

to residential and commercial premises have already been registered in this mixed-use complex.

By its actions, the Pechersk RDA has taken away the postal address of their real estate back-dated. As a result, dozens of people cannot exercise their right to these premises because under Ukrainian law, this cannot be done without an official address.

In contradiction to the current procedure, instructions issued by the KMDA and the Pechersk RDA, as well as its own initial explanation, the Pechersk RDA cancelled the decision it had earlier made and now insists that every future section of the office and apartment complex that is commissioned and formalized needs to have a separate instruction from the RDA for one and the same building site to be assigned the one and same address.

The BOC addressed the Pechersk RDA and the Justice Ministry. The conflict is in the process of being resolved and the registration of property rights is going ahead in a normal fashion.

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**Complaint 6. Builder finds his contract with Avtodor, the highways and roads agency, torn up**

The Complainant turned to the BOC over the unlawful termination of a contract with Avtodor, the State Agency for Roads and Highways. The contract to maintain roads had been signed based on the final outcome of the Kyiv-Chop highway. In addition, the Complainant filed a formal complaint in court regarding bank guarantees provided by the EBRD as part of the agreement.

To resolve the issue peaceably, the BOC organized a series of meetings with MinJust,

representatives of the Complainant, the EBRD and the project management. As a result, an agreement was reached to send the dispute for review to a competent specialist. In fact, MinJust met the Complainant halfway and did not insist that FIDIC assign an expert with knowledge of Ukrainian legislation.

The dispute has been handed over for review to an independent expert who satisfied all parties to the contract.





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