

TAR: CAM 37534

Proposed Technical Assistance to the Kingdom of Cambodia for the Restructuring of the Railway in Cambodia (Financed by the Government of France)

August 2005

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 5 July 2005)

Currency Unit	–	riel (KR)
KR1.00	=	\$0.0002439
\$1.00	=	KR4,100.00

ABBREVIATIONS

ADB	–	Asian Development Bank
ADTA	–	advisory technical assistance
CSP	–	country strategy and program
CTSSS	–	Cambodia Transport Sector Strategy Study
LPG	–	liquefied petroleum gas
MPWT	–	Ministry of Public Works and Transport
PPP	–	public–private partnership
PPTA	–	project preparatory technical assistance
PRC	–	People’s Republic of China
TA	–	technical assistance

TECHNICAL ASSISTANCE CLASSIFICATION

Targeting Classification	–	General intervention
Sector	–	Transport and communications
Subsector	–	Railways
Themes	–	Sustainable economic growth, Governance, Private sector development
Subthemes	–	Promoting economic efficiency and enabling markets, Public governance, Public–private partnerships

NOTE

In this report, "\$" refers to US dollars.

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I. INTRODUCTION

1. The government-owned railway in Cambodia is in a poor physical state. It also operates inefficiently and at a loss. To overcome these shortcomings the Government of Cambodia requested the Asian Development Bank (ADB) to provide support for physical rehabilitation of the railway's infrastructure and for restructuring the railway inclusive of establishing a public-private partnership (PPP) to operate the railway in the future. The purpose is to achieve efficient rail freight traffic and reconnect the railway in Cambodia with the railway in Thailand. The rehabilitation investment and the associated restructuring will together set the stage for efficient rail freight services, which in turn realizes the project's objectives: (i) improving the transport sector's efficiency by increasing the diversity of transport modes and routes, and (ii) resurrecting the railway on a sustainable basis.

2. This advisory technical assistance (ADTA)¹ assists with restructuring of the railway subsector and establishing a new PPP to operate the railway. The ADTA is associated with a project preparatory technical assistance (PPTA) for preparing of a project to rehabilitate the railway infrastructure.

3. Turnaround exercises for state-owned railways, involving partial spin-off, have been performed elsewhere, but the model has not been tested in the Greater Mekong Subregion, and will therefore be studied with substantial interest by the neighboring countries as a possible model for revitalizing of their railway sectors. In Cambodia, the project represents a first attempt at spinning off public service provision in a fully transparent and competitive manner, with the concurrent establishment of a proper regulatory framework. Thus, the project is expected to illustrate the advantages of transparency: reduced public concerns, better and more economic service provision, and maximized revenue streams for the Government. As such, the project will serve as a useful model for future establishment of PPPs in Cambodia.

4. The Cambodia Transport Sector Strategy Study (CTSSS)², which was completed in December 2002, concluded that a rehabilitated railway would be economically beneficial to Cambodia and could possibly become a profitable operation. The strategy study recommended further evaluation of the case for rehabilitating of the railway. In May 2003, a Reconnaissance Mission from ADB visited Cambodia and Thailand to review the possibilities for rehabilitating the railway in Cambodia and reestablishing its connection with the railway in Thailand. The ADB Mission found that rehabilitation of the railway would be realistic and relevant, provided the railway was restructured.

5. During the country programming mission in 2003, the Government requested the inclusion of a loan for restructuring and rehabilitation of the railway and an associated grant-financed technical assistance (TA) in ADB's 2004 country strategy and plan update. Two small-scale TA studies were undertaken in October 2003 to further assess and confirm the likely potential demand for improved railway services and the railway's business opportunities. The market study confirmed substantial potential demand, especially if the route to Thailand is reopened³. It also confirmed that improved rail transport would generate substantial economic benefits from reduced future transport cost and road maintenance cost by diverting heavy goods traffic away from the road network. The business opportunity study confirmed that the railway

¹ The TA first appeared in *ADB Business Opportunities* (internet edition) on 7 April 2005.

² ADB. 2001. *Technical Assistance to the Kingdom of Cambodia for the Transport Sector Strategy*. Manila (TA 3651, approved on 27 April 2001 for \$850,000).

³ The connection with Thailand was destroyed during the 1970s.

would become profitable, provided investments are limited to those necessary to enable efficient freight traffic and reconnect the railway with Thailand. The study recommended restructuring the railway to enable private sector investment to reduce the requirements for government-financed capital expenditure. The study documented that there are private investors who are interested in the proposed venture.

6. In June 2004, the Government and ADB agreed on the broad approach to development of a project for restructuring and rehabilitating the railway. Restructuring would involve establishing a PPP with the Government as minority shareholder to take over future railway operations and creating of an independent regulatory authority. Rehabilitation would restore the railway's fixed infrastructure. The infrastructure and all land would remain in government ownership. On 9–11 March 2005, an ADB TA Fact-Finding Mission reached an understanding with the Government on the objectives, scope, implementation arrangements, and costs for the ADTA required to prepare the restructuring component of the proposed project. The understanding was recorded in an aide memoire that was subsequently confirmed in a letter from the Minister of Public Works and Transport, dated 31 March 2005.

II. ISSUES

7. The CTSSS concluded that the railway in Cambodia is worn-out and requires extensive physical and institutional rehabilitation to regain financial and technical sustainability. The railway is currently incurring losses, and neither the Government nor the railway can finance rehabilitation from its resources.

8. Cambodia's transport system is economically inefficient due to limited choice of routes and modes of transport, which severely limits the scope for optimizing logistics, and permits the formation of cartels by transport providers and the exploitation of natural monopolies by private and public owners and operators of infrastructure. The enabling environment for these market failures is the physical and regulatory barriers⁴ that reduce the diversity of routes and modes available—often to only a single realistic choice—and effectively lock transport buyers into inefficient or overpriced services for lack of alternatives. As a result of these inefficiencies, as well as others that are not transport related, staple commodities on which the poor rely are significantly more expensive in Cambodia than in the neighboring countries, and Cambodia's nascent export industries—garments and tourism, which are the prime generators of new jobs and foreign currency—are threatened because their international competitiveness is being undermined by formal and informal transaction costs, inclusive of overpriced or inefficient domestic transport services. The scope for further diversifying the economy into other sectors such as agro-industry and assembly is correspondingly diminished.

9. The market study undertaken in October 2003 showed that widening the diversity of transport services and the number of external linkages would provide transport users with alternatives to overpriced services and increase the inherent economic efficiency of transport supply by providing a broader spectrum of routes and modes. This would allow transport users to better tailor logistic solutions to their needs. For example, consumer prices for liquefied petroleum gas (LPG), which is used for cooking in households, are about 65% higher in Cambodia than in Thailand partly because LPG at present cannot be imported in bulk.

⁴ Examples are the missing railway connection to Thailand, which was dismantled in the 1970s; and the ban on trucks crossing Cambodia's borders, which means that all trade across the land borders must be offloaded and moved by pushcart before being reloaded on the other side.

10. The proposed project aims to reduce consumer prices and increase the growth potential of Cambodia's economy by increasing the inherent efficiency of domestic transport and reducing the barriers that sustain monopoly pricing in the transport sector. The proposed project will also have immediate subregional impact by relinking the railway in Cambodia with the railway in Thailand and, then, with the network in Malaysia and Singapore. Looking further forward, connecting this greater network with the existing railway network in Viet Nam, and through it to the network in the Peoples Republic of China (PRC), will provide a rail-based transport corridor between Singapore and the PRC. The economic potential for such a corridor, which would require a new rail link between Phnom Penh and Ho Chi Minh City in Viet Nam, is presently under study.

11. The Government of Cambodia has previously invited private sector participation in the provision of transport infrastructure and services. Successful examples are the toll-financed road maintenance concession for National Road 4 and the concession for developing and operating the country's two international airports: Phnom Penh and Siem Reap. But there have also been failures due to inadequate regulatory oversight, such as the Cambodia Ship Registry. Furthermore, the process of concessioning in Cambodia is regarded with suspicion in many quarters because concessions in the past had been allotted in an opaque and noncompetitive manner. An important aspect of this TA is to overcome these shortcomings by establishing an adequate regulatory and contractual framework for the concession, and employing transparent and competitive bidding procedures to appoint the concessionaire. The process will serve as a model of best practice for future concessions in the country.

12. Potential issues that will need to be addressed during the ADTA include staff redundancy and the future of the existing passenger rail service.

III. THE PROPOSED TECHNICAL ASSISTANCE

A. Impact and Outcome

13. The goals of the project are to support economic growth by improving Cambodia's international competitiveness, and support poverty reduction by reducing the cost of living. The purposes of the project are to (i) increase the efficiency of the transport sector at large by increasing the competitiveness of the railway; (ii) secure the long-term sustainability of the railway sector; and (iii) reduce road damage and road traffic risks associated with the movement of heavy and dangerous goods. The project will achieve these goals by restructuring the railway and establishing a new PPP railway operator to provide efficient freight transport services on the restored railway infrastructure, inclusive of direct services to Thailand and the container port in Sihanoukville.

14. The outcome of the ADTA will be a restructured railway in Cambodia, possibly encompassing these entities: (i) a depository authority holding the railway's land and fixed infrastructure, which will remain government property; (ii) an independent transport regulator, initially providing regulatory oversight for the railway but designed to expand its coverage to other modes of transport at a later stage; (iii) a PPP-based commercial railway operator to run the railway's freight operations; and (iv) an entity, to be defined, to operate the railway's passenger services. The railway operator will be established as a joint venture between a selected consortium of private investors and the Government of Cambodia as a minority shareholder.

B. Methodology and Key Activities

15. The project will engage an international firm of institutional and transaction advisory consultants in association with domestic consultants to assist the Government with restructuring the railway. Emphasis will be on transparency at all stages of the process, establishment of a transparent and efficient regulatory environment, implementation of proper handling of staff retention and replacement, and selection of an efficient PPP consortium to undertake future operation of the railway. Emphasis is also given to public information and to documenting the process and disseminating the documentation so that it can serve as best practice for future spin-offs.

16. The key activities of the ADTA are to (i) plan and prepare the restructuring of the railway sector for freight and passenger operations; (ii) execute the formation of a PPP railway operator for the railway's freight operations based on international competitive bidding between interested private sector consortia; (iii) advise the Government on options for operating the railway's passenger service; (iv) advise the Government on the choice of depository authority for the Government's holdings of land and infrastructure used by the railway; (v) advise the Government on the best way of establishing regulatory oversight of the railway sector in terms of a regulatory regime, the scope of regulation, and the structure of the regulator; (vi) provide assistance in establishing the transport regulator and the depository authority; (vii) advise the Government on how best to handle staff retrenchment in a transparent and fair manner; and (viii) document the process in sufficient detail to allow for future repetition elsewhere. The design and monitoring matrix is in Appendix 1.

C. Cost and Financing

17. The total cost of the ADTA is estimated at \$2,143,000 equivalent comprising \$1,670,000 in foreign exchange and \$473,000 in local currency equivalent. ADB will provide \$1,352,000 (81%) of the foreign exchange cost and \$148,000 equivalent (31%) of the local currency cost. The ADTA will be financed on a grant basis by the Government of France and administered by ADB. The Government has agreed to finance local currency expenditures of \$300,000 equivalent in kind and the successful bidder for the concession as railway operator is required to finance the transaction advisor's profit upon closure of contract (fee plus success bonus remuneration) in the amount of \$343,000 equivalent. The payment is a bonus payment by the PPP operator under the PPP contract. ADB's standard procurement contract may need modification to enable the success bonus payment model. The cost estimates and financing plan are in Appendix 2.

D. Implementation Arrangements

18. The Ministry of Public Works and Transport will be the executing agency. The ADTA will be implemented by a consultant engaged by ADB to advise the Government on restructuring of the railway sector (institutional adviser) and provide advisory services for the establishment of the PPP railway operator (transaction adviser). The restructuring ADTA will be executed over 25 months from August 2005 to September 2007 and will require 57 person-months of expert input in the fields of law, financing, contracts, institutions, traffic and financial planning, and staff development and training. Outline terms of reference are in Appendix 3. The consultancy will be executed by an international consulting firm with substantial experience in railway restructuring, in association with domestic consultants. The consultants will be engaged by ADB through quality- and cost-based selection using a simplified technical proposal. Procurement will be in

accordance with the ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB for engaging domestic consultants.

19. The project is the first railway restructuring with PPP involvement to be executed in the Greater Mekong Subregion. The documentation produced and the approaches adopted in the ADTA can form the starting point for similar future exercises in Cambodia and elsewhere. To facilitate this, the project will produce a tool kit describing the procedural steps, information collected, and analysis performed in the course of executing the transaction advisory. The tool kit will also contain samples of the documentation produced during TA implementation. A similar tool kit will be produced for the institutional advisory associated with setting up the regulatory authority.

IV. THE PRESIDENT'S RECOMMENDATION

20. The President recommends that the Board approve ADB administering technical assistance not exceeding the equivalent of \$1,500,000 to the Government of Cambodia to be financed on a grant basis by the Government of France for the Restructuring of the Railway in Cambodia.

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Foreign Exchange	Local Currency	Total Cost
A. Government of France^a			
1. Consultants			
a. Remuneration and Per Diem			
i. International Consultants	563.0	0.0	563.0
ii. Domestic Consultants	0.0	98.0	98.0
iii. Per Diem	291.0	0.0	291.0
b. International and Local Travel	139.0	0.0	139.0
c. Reports and Communications	15.0	25.0	40.0
2. Equipment	0.0	0.0	0.0
3. Training, Seminars, and Conferences	65.0	0.0	65.0
4. Surveys	0.0	0.0	0.0
5. Miscellaneous Administration and Support Costs	0.0	25.0	25.0
6. Representative for Contract Negotiations	8.0	0.0	8.0
7. Contingencies	271.0	0.0	271.0
Subtotal (A)	1,352.0	148.0	1,500.0
B. Private Sector Financing^b			
1. Consultants			
i. International Consultants	318.0	0.0	318.0
ii. Domestic Consultants	0.0	25.0	25.0
Subtotal (B)	318.0	25.0	343.0
C. Government of Cambodia Financing			
1. Office Accommodation and Transport	0.0	15.0	15.0
2. Remuneration and Per Diem of Counterpart Staff	0.0	25.0	25.0
3. Others	0.0	260.0	260.0
Subtotal (C)	0.0	300.0	300.0
Total	1,670.0	473.0	2,143.0

^a Administered by the Asian Development Bank.

^b Funded by the successful bidder for the concession as railway operator. The amount is a bonus payment by the PPP operator under the PPP contract. ADB's standard procurement contract may need modification to enable the success bonus payment model.

Source: Asian Development Bank estimates.

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

A. Introduction

1. The Government of Cambodia intends to restructure its railway. The option considered is establishment of an independent railway regulator (the regulator), a railway operator company (the operator) established as a public-private partnership (PPP) with the Government as a minority shareholder, to operate the railway's freight services, and, if desired by the Government, an agency, to be defined, to operate the railway's passenger service. Advice to the Government on these matters will be provided through the Asian Development Bank (ADB)-financed advisory technical assistance (ADTA) to be implemented in accordance with these terms of reference. As part of the restructuring, the Government plans to rehabilitate the railway's infrastructure with support from ADB and other development partners, for which purpose a separate ADB-financed project preparation technical assistance (PPTA) will run in parallel to this ADTA, and be linked to it. Rehabilitation of the infrastructure will be completed in 2008. To implement structural reform in the railway sector, and facilitate the establishment of the railway operator, the Government desires to procure a consortium of advisers to advise and assist it in all aspects of the restructuring process and to act as transaction advisor during the establishment of the railway operator.

B. Objective

2. The objective of the assignment is to advise and assist the Government with all aspects of restructuring the railway and the successful creation and launch of the railway operator as a PPP. The transaction advisor will be required to undertake the following tasks:

- (i) Advise the Government on ways and means of implementing structural reform of the railway sector as outlined above and regulated by applicable laws.
- (ii) Advise the Government on the restructuring of the railways sector and its organization to facilitate the formation of the regulator and the operator, and prepare the associated activities.
- (iii) Advise the Government on options for the railway's passenger operations, including a study of subsidies, if required, at fare levels related to passengers' ability to pay.
- (iv) Advise and assist the Government in implementing of all activities related to the establishment and launch of the railway operator.

3. The work to be undertaken has, conceptually, been divided into six phases: preparation, reform and restructuring, marketing, prequalification, bidding and selection of private sector investor, and post-transaction. Prequalification and bidding and selection of a private sector investor will be carried out in accordance with applicable laws and regulations, and international best practice. Detailed terms of reference and the schedule for executing of the assignment are described in the following paragraphs.

C. Detailed Tasks

1. Preparation Phase

4. The transaction advisor will assemble and review all information, documentation, and data relating to the railway sector, and its potential. With this information, the transaction advisor will carry out the following:

- (i) Carry out asset, financial, and legal due diligence of the railway conditions.

- (ii) Project the traffic demand, revenue, and operational cost for the railway up to 2030, and make the outcome available to the rehabilitation PPTA consultants to form a common basis for design of the restructuring and the rehabilitation projects.
- (iii) Prepare financial forecast (annual profit statement and balance sheet) for the railway, covering at least the construction phase where the railway is being rehabilitated, and the first 10 years after completion of construction. Execute sensitivity analysis reflecting all identified risks and uncertainties. Two cases will be considered: freight traffic only and freight traffic as well as minimal passenger traffic.
- (iv) Review the completeness and adequacy of the existing policy, legal, and regulatory framework and recommend changes to facilitate restructuring of the railway.
- (v) Assist the Government with review and renegotiation of the railway cross-border agreement with Thailand, which was established in 1955.
- (vi) Determine future investment requirements of the railway network and identify possible sources of funding.
- (vii) Based on the findings of the preceding activities, the transaction advisor will prepare a strategy and a time-bound action plan for structural reform of the railway inclusive of contingency plans should it become apparent during the restructuring process that some or parts of the envisaged restructuring are impractical. The strategy will also include plans for retraining, replacing, or compensating of affected staff in case of staff redundancy, and for managing the railway's passenger operations.

2. Reform and Restructuring Phase

5. Upon government approval of the strategy and action plan for reform of the railway sector and restructuring of the railway, the advisors facilitate implementation of sector reforms and develop and establish the intended structures for the railway sector. The two activities will be handled concurrently. The advisors will undertake these tasks:

- (i) Assist the Government in carrying out structural reform of the railway sector.
- (ii) Assist the Government with restructuring the railway and advise the Government on the arrangements for a concession to operate the railway's freight operations. The transaction advisor will implement the approved restructuring strategy according to the time-bound action plan.
- (iii) Advise the Government on the best ways of handling staff redundancies in a fair and transparent manner, and develop an action plan.
- (iv) Advise the Government on suitable options for managing the railway's passenger service.

3. Marketing Phase

6. The advisors will facilitate the marketing of the operator through interaction with stakeholders and interested investors as follows:

- (i) Recommend a public relations strategy and provide input on design and implementation of the public information program for the reform and restructuring of the rail sector in Cambodia.

- (ii) Regularly consult with stakeholders, periodically prepare briefing notes and discussion papers outlining approaches and progress of the project, and present these to the relevant stakeholders in Cambodia for discussion and review of the process.
- (iii) Prepare an information memorandum for distribution to potential investors. As a minimum, include in the memorandum (a) general information on Cambodia and its climate for private investment; (b) current railway sector structure and the role of the various institutions (ministries, regulator, concessionaire, etc.), including public service obligations, if any, for operating passenger services; (c) current sector legislation and regulations; (d) current tariff structure and its regulation; (e) background and operations of the railway in Cambodia for at least the past 5 years; (f) Government's reform programs; (g) the proposed rail sector and the role of the various institutions; (h) the proposed sector legislation and regulations; (i) the proposed level of service requirements and their regulation; (j) the proposed concession, including list of main assets, future investment plan for fixed assets, environmental assessment, market analysis; (k) the proposed process for selecting concessionaires, including a tentative timetable; (l) summary description of draft contracts necessary, e.g., concession contract, agreements with neighboring railways, etc.; and (m) environmental audit report and the mitigation plan.
- (iv) Manage road shows and investor forums to attract potential investors and others—such as service providers—who may be interested in forming consortia to bid for the railways operator concession.
- (v) Design and implement any other promotional activities needed for maximizing the participation of qualified bidders for the concession.

4. Prequalification Phase

7. The advisors will undertake the following activities to prequalify interested investors/bidders:

- (i) Draft prequalification terms and conditions, based on objective and quantifiable criteria.
- (ii) Using the approved prequalification criteria, recommend bidders for prequalification, invite perspective bidders to submit their interest, review submissions, and prepare an evaluation report with the recommended list of prequalified bidders.

5. Investor's Due Diligence and Bidding Phase

8. The advisors will commence and conclude the concessioning of the railway's assets through a competitive bidding process. The advisors will therefore be required to undertake these tasks:

- (i) Organize a data room with all the necessary information for prequalified bidders to conduct their due diligence process. In conjunction with this work, prepare guidelines and procedures for use of the data room that assure equitable and fair access to all bidders and confidentiality of relevant information available to them.
- (ii) Update draft agreements/contracts and other documents that will be part of the transactions for review and consultation with prequalified bidders. Several drafts of these documents may be required before producing final drafts and after

consultations with relevant stakeholders and inputs from the market. A tentative list includes a concession contract and agreements with neighboring rail operators.

- (iii) Design a methodology for effecting consultation and review of draft contracts and other agreements with prequalified bidders in an equitable, fair, and transparent manner.
- (iv) Prepare bidding terms and conditions that are objective and quantifiable. Include as annexes to the bidding documents the final and binding versions of all contracts, and other documents necessary for completing the transaction. An indicative list of contracts and documents will include the following: (a) concession contracts; (b) license to operate; (c) agreements with regional rail operators; (d) contracts or other mechanisms for the transfer of liabilities; (e) contracts or other mechanisms for the transfer of labor; (f) deed of undertaking; (g) company's bylaws; and (h) the relevant sector regulations.
- (v) Prepare an evaluation report of the final bids and recommend the preferred bidder.
- (vi) Assist the Government with achieving financial closure.

6. Post-Transaction Phase

9. The advisors will provide guidelines for monitoring the performance of the sector and regulation of the concessions. The tasks will include the following:

- (i) Prepare guidelines to assist the regulator in monitoring compliance with the concession agreement and undertaking periodic tariff reviews.
- (ii) Prepare guidelines to assist the proposed government entity that will be responsible for monitoring and ensuring compliance with concession agreements and any other ongoing contractual obligations between the Government and the concessionaire.
- (iii) Develop specific, real, and measurable performance indicators for the railway sector and for operations of the railway related to relevant international standards which will subsequently be used to assess the effectiveness of the railway operator.

7. Training

10. The advisors will develop and implement a training program to build the capacity of identified staff in the railway and in the Government, to include the following:

- (i) seminars and workshops on postdivestiture operations of the railway and the operator, and regulatory activities of the regulator; and
- (ii) study tours to countries where similar divestitures have taken place, for better understanding and more informed decision making throughout the process.

D. Working Arrangements

11. The advisors will report to the Ministry of Public Works and Transport (MPWT). The Government will appoint a technical counterpart team to work with the advisors throughout the implementation of the assignment. The advisors will also report periodically to the Ministry of Finance and Economy and ADB, and will seek guidance from those entities as appropriate. Specifically, the advisors will provide an inception report 1 month after commencing the services, a midterm report at month 9 of the services, and a draft final report at the completion

of services, to be followed by a final report 1 month after receiving MPWT's and ADB's comments on the draft final report. In addition, the advisors will provide brief quarterly progress reports to MPWT and ADB. All reports will include working papers etc. prepared during the period to which the report refers.

E. Consultancy Terms

12. The assignment is expected to require about 57 person-months of international and domestic consulting services over 18 months, The indicative expert schedule encompasses 45 person-months of international experts distributed as follows (person-months in parenthesis): team leader (8), deputy team leader (8), institutional expert (2), railway engineer (2), rolling stock expert (2), financing expert (4), economist (1), auditor (1), legal expert (4), transport market expert (1), tariff expert (1), macroeconomist (1), environmental expert (2), labor/social expert (2), librarian (for the data room) (6); and 12 person-months of domestic experts distributed as follows (person-months in parenthesis): legal expert (6), other domestic experts to be specified by the consultant in the technical proposal (6).