

# Legal Aspects of Public-Private Partnership in Ukraine: Snapshot of Recent Experience and Current Processes

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*In spite of social and economic difficulties, that Ukraine is facing, the country remains a highly promising market for private companies to participate in construction of new and reconstruction of existing public infrastructure. Public-private partnership (PPP) is increasingly recognised in Ukraine as an innovative legal tool to accelerate private participation in infrastructure through effective risk sharing between public and private partners. This article provides a general overview of the Ukrainian legal environment relating to PPP and specific problems in the area. While preparing this article we tried to combine our specific knowledge of the Ukrainian legal and regulatory framework and the extensive experience in advising international investors on various infrastructure projects in Ukraine. With this purpose, the article provides a number of key examples from the Ukrainian practice in order to demonstrate the main challenges and obstacles blocking successful development of PPP in the country.*

## I. Introduction

Per our experience in Ukraine, we see a certain number of public infrastructure development projects, which are implemented mainly by local businesses ready to accept an increased risk. This trend has been increasing in Ukraine since 2000. We have noted an interest from the private sector, in particular, in seaports, roads, waste disposal and water/sewage infrastructure. For example, several tens of municipality owned heating structures were transferred into long-term lease or concession in Ukraine over the last decade. There are a number of successful projects in the sea port development, such as the expanding cargo handling facilities at the Berdyansk Seaport and developing a logistics service centre on the territory of the seaport of Odessa. Some of those projects are often called as “quasi-PPPs” or “not full-fledged PPPs”,<sup>1</sup> due to lack of effective responsibility of public authorities for risks in case of the project’s failure. At the same time, the overall private investment in public infrastructure is quite limited compared with other countries in the region and taking into account the size of Ukraine’s territory (603,628 sq. km, the largest country in Europe), and its population (42.7 million as of the end of 2015). Besides, so far it has mostly related to the telecom and energy sectors, which are now mostly privatised. More specifically, private in-

vestments into public telecommunication infrastructure amounted \$ 12 billion in 1990-2014, followed by \$ 2.2 billion of investments into electricity generation and distribution. In comparison to this, private participation in operation and development of, for example, the water and sewage as well as seaports infrastructure during the same period was significantly lower – \$ 202 million and 130 million respectively.<sup>2</sup>

One could say that there is great potential for private infrastructure funding in Ukraine. It is therefore that since 2000s a risk-sharing concept of PPPs is at the centre of numerous discussions between politicians, professionals and scholars<sup>3</sup> as a way to accelerate private participation in infrastructure. The re-

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- 1 Reference is made, amongst others, to Ye L Cherevykov ‘Institutional Environment for Public-Private Partnership in Ukraine: Do Institutions Really Matter?’ in L Zsuzsa (ed) *Eurasian Challenges – Partnerships with Russia and Other Issues of the Post-Soviet Area*, (Budapest 2013), 119-132.
- 2 World Bank and PPIAF, *PPI Project Database*, available on the Internet at <<http://ppi.worldbank.org/snapshots/country/ukraine>> Last accessed on 14 April 2016.
- 3 Although this article is not intended to comprehend the Ukrainian legal doctrine on PPPs, for the sake of reference there were several notable studies on the PPP problematic published over the recent several years. Reference is made especially to O Simson

ality is that over decades Ukraine experienced no large-scale projects, such as highway concessions, which reached financial closing. There were several projects in various industries, but many of them have not successfully undergone even the preliminary feasibility study, whereas others remain in the preparatory stage or are simply put on hold.<sup>4</sup> There are various legal and institutional issues preventing practical implementation of PPPs in Ukraine, further analysed in this article.

## II. Ukrainian Legal Framework for Private Participation in Infrastructure

The Ukrainian laws have since the early 90s offered a number of legal models enabling private participation in the public infrastructure with the aim at improving the quality of life for people, without considerable financing from the State or local budgets. These are, mainly, long-term lease, concessions and investment agreements,<sup>5</sup> followed by asset management and joint-venture agreements as more conventional contractual forms. Taking all together, the above-mentioned legal models are part of the Ukrainian positive law called “*economic law*”<sup>6</sup> and consisting of several layers, including the *Commercial Code of Ukraine*, the *Law of Ukraine on Concessions*, the *Law of Ukraine on Investments Activities*, and others. In addition, at the local level, private participation in infrastructure is supposed to be regulated by decisions of self-governing authorities (city and oblast councils). A typical example thereof is the 2007 Regulation on Investment Tenders adopted by the Kyiv City Council.

Similar to many other jurisdictions the above-mentioned models are strictly separated from public procurement and privatisation, as the latter two forms are totally different in terms of the funding method and ownership over the project assets. More specifically, in Ukraine the private participation in the public infrastructure development comes into question where a direct privatisation of public assets is either explicitly prohibited by law or commercially unattractive. At the same time, under the Ukrainian budget law any project directly financed by public funds, and those under which the public authority remunerates the private company for, as an example, availability of the infrastructure, are re-classified into public procurement.

Importantly, all of the above-mentioned forms assume that the business risk under the projects will be expressly borne by the private party. For example, the Ukrainian budget law expressly excludes a possibility to cover business risks of a private company by municipal or State guarantees. Furthermore, the legal definition of concessions includes various contractual arrangements between public authorities and private companies under the condition that the business risk is expressly borne by the concessionaire.<sup>7</sup>

The following main provisions illustrate the meaning of and difference between each legal model under the Ukrainian law.

### 1. Long-Term Lease Agreements

Under Ukrainian law, the lease confers to the lessee against remuneration a temporary right of use of property which is necessary for the lessee to conduct

*Legal model of private-public partnership in the area of innovations* (Kharkiv 2013) (in Ukrainian: О. Сімсон *Правова Модель приватно-публічного партнерства у сфері інновацій*); О Vinnik *Corporate forms of PPPs: legal problems and foreign experience* (Sumi 2012) (in Ukrainian: О Вінник *Корпоративна форма державно-приватного партнерства*), Р Zaharchenko *Projects on infrastructure: partnership between the state and private sector* (Kyiv 2010) (in Ukrainian: П Захарченко *Проекти в галузі інфраструктури*).

4 It should not be forgotten, of course, that international experience shows that PPPs may also be an advantageous means of financing and operating other forms of public services including hospitals, schools, and even prisons. Currently, there are a number of discussions ongoing in Ukraine concerning possible projects; however the number of projects that reached financial closing in these sectors is zero.

5 Seen historically, the participation of the private sector in the development of the country's infrastructure is well-established in Ukraine. Various lease and joint-venture mechanisms have been

present in Ukraine as part of the Russian Empire since the 19th century to enable development of the municipal infrastructure with specific focus on water treatment, electricity and telecommunications. Concessions were used actively in the 1920s enabling participation of foreign capital in areas of mining, construction, agriculture, transport and communications. Reference is made to S Sosna, *Development Prospects and Tasks of the Russian Concession Legislation* (Russian-European Centre for Economic Policy 2005) available on the Internet at <[http://www.recep.ru/files/documents/concession\\_legislation\\_en.pdf](http://www.recep.ru/files/documents/concession_legislation_en.pdf)> Last accessed on 14 April 2016.

6 H Znamensky, ‘State-Private Partnership: Ukrainian Version’ (2009) 39 *Law Herald of Ukraine* 7 (in Ukrainian: Г Знаменський *Державно-Приватне Партнерство: Українська Версія* (2009) 39 *Юридичний Вісник України* 7).

7 High Council of Ukraine Act on Concessions, 16 July 1999, No. 997-XIV, Article 1, available on the Internet at <<http://zakon3.rada.gov.ua/laws/show/997-14/print1452602334449348>> Last accessed on 14 April 2016.

a commercial or other activity.<sup>8</sup> A lease is understood as a contract pursuant to which the private operator ensures delivery of certain public services while operating the infrastructure and paying a fixed amount of fees to the public authority in exchange for the infrastructure's use. The difference between the income received from end-users of the infrastructure and payments to the authorities should be the income of the private operator. On top of that, the private operator bears the operational risk as well as investment obligations related to capital repairs and reconstruction/construction. The lease of municipal land plots is often used in Ukraine to structure green-field infrastructure projects.

## 2. Concessions

Public assets related to operation of infrastructure may be granted into concession under the 1999 Concession Law.<sup>9</sup> More specifically, in Ukraine concession confers to the concessionaire the rights to create, construct and/or operate and manage the object of concession for the purpose of satisfaction of the needs of Ukrainian citizens under condition of assumption by the concessionaire of material liability and business risk. From the Ukrainian law standpoint, lease and concession agreements have a lot in common. There are only a few differences between both models provided by industry-specific laws (e.g. in the area of water treatment). Concessions are more typical to structure private involvement into operation of existing infrastructure. At the same time, concessions are possible in relation to green-field projects as well. The Concession Law allows for the application of the BOT (build-operate-transfer). At the same time, the property created under the concession agreement should automatically become the property of the public partner. The concessionaire owns only the profit received from operation and maintenance of the relevant infrastructure. Under the concession scheme in Ukraine the concessionaire shall receive the maximum level of control but also commercial risks, which is why the low income and tariffs risks are quite high in these types of projects. This is the reason why concessions are rarely practiced in Ukraine, with exemption of water treatment industry and highways whilst the law on highways recognises concessions as the only form of private participation in infrastructure to date.

## 3. Investment Agreements

Investment agreements concluded under the 1991 Investment Activity Law<sup>10</sup> are pretty unique compared to the previously described legal models, as they allow transferring into ownership by the investor of some of the project's assets. To this end, one may say that investment agreements comprise a legal framework for BOOT (build-own-operate-transfer) agreements. On top of that, another clear advantage of investment agreements is that the law gives municipalities a broad discretion to negotiate investment conditions so that the project can be shaped very closely according to local needs. Further advantage of investments agreements is that they provide for a high flexibility for the private investor. More specifically investors, at their own discretion, determine the goal, field, type, and amount of the investment and have the right to engage partners to achieve the above; may raise financial resources in the form of credits, loans, as well as the right to issue securities and assign investment rights and investment results to third persons. Investment agreements are clearly preferred by the Ukrainian municipalities both on the level of municipal by-laws and on the level development policies. More specifically, municipal companies are usually given the right to involve private providers under investment tenders for rehabilitation of existing and construction of new infrastructure, subject to approval by the investments departments of city administrations acting on behalf of the community.

## III. Main Blocking Points to Successful Implementation of PPPs in Ukraine

### 1. Vague Commitment of Ukraine to Developing PPPs

Ukraine still lacks a single legislative act reflecting the government's commitment to supporting PPPs.

8 High Council of Ukraine Act on Lease of State and Municipal Property, 10 April 1992, No. 2269-XII, available on the Internet at <<http://zakon2.rada.gov.ua/laws/show/2269-12/print1452602801159759>> Last accessed on 14 April 2016.

9 High Council of Ukraine Act on Concessions (n7).

10 High Council of Ukraine Act on Investment Activity, 18 September 1991, No. 1560-XII, available on the Internet at <<http://zakon2.rada.gov.ua/laws/show/1560-12/print1452602801159759>> Last accessed on 14 April 2016.

The commitment to PPP-oriented models of infrastructure development appears to be sector-specific. Some sector-specific programmes or strategies for developing a particular business or industrial area sometimes reflect the pro-PPP commitment. Contrary to this, some other strategic documents provide for the budget-financed public construction and/or spending of foreign loans received by the public sector as the most economically justified way to develop the infrastructure.

For example, the State Economic Programme for Development of Motor Roads of General Use for 2013-2018<sup>11</sup> contains a very pessimistic approach to engaging private investors through road concessions in Ukraine, as concessionaires were unable to deliver the required volume of investments into reconstruction of roads during the past 10 years. Instead of PPP this concept considers classical public procurement financed by loans of international financial institutions as the most realistic model. Moreover, the Ministry of Infrastructure expressed most recently its actual distrust of PPP-based mod-

els of development of Ukrainian motor roads for the near future. On the other hand, the government expresses a clear intention to support the development of PPP in such areas as airports<sup>12</sup> and seaports.<sup>13</sup> An additional difficulty is that all above mentioned policy documents were issued under the authority of the Azarov's government, which rapidly left Ukraine in 2014. In other words, the real force of the above mentioned documents is rather questionable, although they remain to be formally valid.

Another example is the feasibility study on construction and operation of the fourth line of the Kiev metro ordered by the then Mayor of Kyiv in 2012-2013.<sup>14</sup> We participated in the project in our capacity as advisors on certain aspects of law. More specifically, our preliminary feasibility study was made to structure financing of construction and operation and included the analysis of various issues of Ukrainian law on concessions, public procurement and budget law. The amount of available municipal guarantees appeared to be not sufficient to cover the risks of the potential lender. The project was put on hold. In February 2016 we learned that, instead of supporting a PPP through lobbying sufficient government guarantees, the new Kyiv's major announced that, the project should be implemented as a standard public procurement<sup>15</sup> – notwithstanding an extremely difficult situation with the Kyiv's municipal budget.<sup>16</sup>

## 2. Low PPP Policy Sustainability and Integrity

Another blocking point is the low capacity of the Ukrainian public sector to support once indicated commitment to developing PPPs and ensure PPP policy sustainability and integrity in spite of possible government's changes.

A parking development project in Kyiv is a good example to show extreme dimensions of the above-mentioned problem.

In 2005, the Kiev City Administration decided to start preparing a tender to select a strategic partner for the PPP-based parking development in the city.<sup>17</sup> In spite of the fact that several international parking operators were potentially interested in participation in the tender, due to change of the Kiev mayor the tender plan was abandoned with immediate effect in

- 11 Cabinet of Ministers of Ukraine Resolution on State Economic Programme for Development of Motor Roads of General Use for 2013-2018, 11 July 2013, No. 696 available on the Internet at <<http://zakon5.rada.gov.ua/laws/show/696-2013-%D0%BF/print1452603515541897>> Last accessed on 14 April 2016.
- 12 Cabinet of Ministers of Ukraine Resolution on Concept of the State Airports Development Program – 2023, 30 October 2013, No. 944 available on the Internet at <<http://zakon3.rada.gov.ua/laws/show/944-2013-%D0%BF/print1452602334449348>> Last accessed on 14 April 2016.
- 13 Cabinet of Ministers of Ukraine Resolution on Concept of Sea Ports Development of Ukraine until 2038, 11 July 2013, No. 548 available on the Internet at <<http://zakon5.rada.gov.ua/laws/show/548-2013-%D1%80/print1452603515541897>> Last accessed on 14 April 2016.
- 14 See the notice of the news agency RIAN, “*Concept of Construction of the Fourth Line of the Kiev’s Metro shall be Ready by the End of the Year*” (8 October 2012), available on the Internet at <<http://rian.com.ua/economy/20121008/336026794.html>> Last accessed on 14 April 2016.
- 15 See the notice of the news agency Ukrainian News, “*Tender for Construction of Trojeshina Metro Announced*” (12 February 2016) available on the Internet at <<http://ukranews.com/news/199239.Kievskiy-metropoliten-obyavil-tender-na-stroitelstvo-metro-na-Troeshchine.ru>> Last accessed on 14 April 2016.
- 16 See the notice of the news portal DEPO, “*Budget of Kiev - 2016: Miserable Amount for Large Construction*” (21 December 2015), available on the Internet at <<http://kyiv.depo.ua/ukr/kyiv/byudzhets-kieva-2016--18122015190000>> Last accessed on 14 April 2016.
- 17 Kiev City State Administration Resolution on Conducting Tender to Select Strategic Partner for Traffic Management and Parking Development, 18 October 2005, No. 1917 available on the Internet at <[http://www.uazakon.com/documents/date\\_By/pg\\_gfgawc.htm](http://www.uazakon.com/documents/date_By/pg_gfgawc.htm)> Last accessed on 14 April 2016.

2006<sup>18</sup> and without any follow-up. Instead of maintaining the PPP commitment, in 2007 the Kiev City Council and the new mayor decided to start a publicly financed investment program.<sup>19</sup> This programme envisaged public investments into the network of park-o-mats, video-cameras, ticketing system etc. An exclusive municipal operator executed the programme through public procurements, rather than initiating a PPP. After all, the program ended in 2011 without further prolongation, allegedly due to the lack of appropriate public means. A large number of already installed park-o-mats are not used due to lack of awareness-raising or became out-of-order due to no technical maintenance. In 2013, under another new mayor, the Kiev City Council again adopted a new parking development program.<sup>20</sup> Unlike the previous program, this one did not envisage municipal budget financing, but was intended to include a mixture of own funds of the municipal operator and funds of private investors attracted through an open tender. In other words, this program tried to reproduce the 2005 approach. However, we are not aware of the practical results of this program. No single tender was conducted until the unexpected change of the mayor in November 2013.

In January 2015, under the current mayor the 2013 parking development program was terminated without any reasoning,<sup>21</sup> similar to the early termination of the 2005 tender. Instead, the new Kiev City Council and the new mayor adopted the new Parking Development Concept. As the city budget lacks sufficient funds, the concept explicitly excludes a possibility of budget funding and it does not impose any investment obligations on the municipal operator. Quite to the contrary, all funds required to develop the parking infrastructure must come exclusively from private investors. At the same time, the Concept recognises the lack of a working control mechanism over adherence to the parking rules and payment, as well as of imposing fines for violation of the parking rules, which, in turn, is regulated by the national legislation. To solve this blocking problem, a draft law was initiated before the Ukrainian parliament intended to improve the efficiency of law enforcement measures in the parking area.<sup>22</sup> The Ukrainian parliament was assumed to support the necessary law changes, because of the alliance existing between the main party and the Kiev' mayor. However, in July 2015 the Ukrainian Parliament refused to vote for this draft law, which, in turn, blocked

the successful implementation of the program. As of today we are not aware of any new PPP tender efforts to develop parking infrastructure in Kiev. The parking PPP policy seems to be put on hold.<sup>23</sup>

The Kiev's ring road extension project of 2012 serves another mini case study to illustrate the above problem.

More specifically, in 2012 we were retained by the National Projects Agency of Ukraine to prepare together with a team of international engineers and financial consultants the preliminary feasibility study on the above mentioned project.<sup>24</sup> Further to our study we identified as the main blocking point the lack of clear legal mechanisms of how to ensure compensation of expenses of a potential concessionaire due to unstable traffic. The project ended with recommendations related to amendments to the legislation required for the successful implementation of the concession, preparing justification of the direct municipal State involvement into the project, necessity and type of the State support required for its implementation, in particular through creation of a

18 Kiev City State Administration Resolution 12 September 2006, No. 1357, available on the Internet at <[http://www.uazakon.com/documents/date\\_8y/pg\\_gfgase.htm](http://www.uazakon.com/documents/date_8y/pg_gfgase.htm)> Last accessed on 14 April 2016.

19 Kiev City Council Decision on Approval of Investment Program on Innovations in Parking for 2007-2011, 22 August 2007, No. 145/1979, available on the Internet at <[http://kmr.ligazakon.ua/SITE2/\\_docki2.nsf/alldocWWW/2067F036D30AA6EBC22573FD006DF737](http://kmr.ligazakon.ua/SITE2/_docki2.nsf/alldocWWW/2067F036D30AA6EBC22573FD006DF737)> Last accessed on 14 April 2016.

20 Kiev City Council Decision on Approval of Program of Development of United Parking Area in Kyiv for 2015, 22 May 2013, No. 326/9383 available on the Internet at <[http://kmr.ligazakon.ua/SITE2/\\_docki2.nsf/alldocWWW/73493EBF3E4F4FC8C2257BAC006873A0?OpenDocument](http://kmr.ligazakon.ua/SITE2/_docki2.nsf/alldocWWW/73493EBF3E4F4FC8C2257BAC006873A0?OpenDocument)> Last accessed on 14 April 2016.

21 Kiev City Council Decision on Approval of Parking Development Concept for Kiev, 22 January 2015, No. 22/887 available on the Internet at <[http://kmr.ligazakon.ua/SITE2/\\_docki2.nsf/alldocWWW/7CB5A33458B140B7C2257DF9006DE917](http://kmr.ligazakon.ua/SITE2/_docki2.nsf/alldocWWW/7CB5A33458B140B7C2257DF9006DE917)> Last accessed on 14 April 2016.

22 High Council of Ukraine Draft Act on Rules Applicable to Parking No. 2228 available on the Internet at <[http://w1.c1.rada.gov.ua/pls/zweb2/webproc4\\_1?pf3511=54177](http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=54177)> Last accessed on 14 April 2016.

23 The above case study is based on facts we have learned while participating in the 2015 technical assistance for the parking management initiative in Kyiv assigned by USAID, available on the Internet at <[http://pdf.usaid.gov/pdf\\_docs/PA00KS8K.pdf](http://pdf.usaid.gov/pdf_docs/PA00KS8K.pdf)> Last accessed on 14 April 2016.

24 See the notice of the European Business Association "Gide Loyrette Nouel advises Zagope on the extension of the Kyiv Ring Road project" (23 November 2012) available on the Internet at <<http://www.eba.com.ua/en/information-support/news-from-members/item/3882-gide-loyrette-nouel-advises-zagope-on-the-extension-of-the-kyiv-ring-road-project>> Last accessed on 14 April 2016.

State roads fund. A draft law on the State Roads Fund of Ukraine was submitted to the Parliament in April 2015, in line with best practices existing in other European countries, such as Poland. However, until 2016 this draft law has not been passed even in first reading and after all procedural delays the Parliament voted for a reduced version of the State roads fund, essentially reproducing a model, similar to what existed in Ukraine in the past.<sup>25</sup>

The above two cases show the lack of PPP policy sustainability in spite of political changes as well as the low PPP policy integrity on the local (City council) and national (Parliament) levels, which in turn blocks a successful implementation of PPPs in Ukraine.

### 3. Lack of Single PPP Unit Responsible for Entire Implementation of PPPs

The Ukrainian legislation does not provide for a single authority responsible for *practical implementation* of PPP projects in all and every industry. In most

cases, the authorities and duties of governmental authorities and agencies responsible for PPP in Ukraine overlap. For instance, under Ukrainian law, the Ukrainian Ministry of Economic Development and Trade is responsible for policy making in the sphere of PPP.<sup>26</sup> At the same time, this body lacks clear authorisation to develop specific projects in some areas, like, the roads construction, where the State Agency of Motor Roads of Ukraine is exclusively empowered to define highway concessions.<sup>27</sup> Moreover, in almost each ministry and agency and even State-owned enterprise there is a PPP department dealing with PPP projects in a particular field (housing utilities, construction of roads, sports, etc.). These PPP departments act separately and do not take a single approach to future development. Each of these departments exercises different functions, which often overlap, ranging from a simple PPP think tank to more concrete functions, such as the evaluation, coordination and regulatory development/harmonisation of investment projects.

The National Projects Agency created in 2011 under the authority of the previous President of Ukraine was assumed to be a first practical example of the PPP unit in Ukraine, however its activities ended up with allegations of corruption in 2015.<sup>28</sup>

Generally, we see a clear necessity to create a single authority responsible for developing PPP legislation and for practical implementation of projects.

### 4. Low Quality of PPP Legislation: the 2010 Law Showcase

An attempt to increase the number of PPP projects was undertaken in 2010 with adoption of the Law on State-Private Partnership (the "Law on SPP").<sup>29</sup> It was aimed at introducing a unified and risk-sharing based definition of PPP. More specifically, the Law on SPP made it clear that PPP is aimed at increasing the efficiency of public infrastructure on a long-term basis, but under a strong condition that the private partner is assumed to take only a portion of the related project risks.<sup>30</sup>

Back in 2010, the experts' community seemed to welcome the adoption of the Law on SPP as a chance to improve bankability of the Ukrainian infrastructure projects, including on the municipal level through effective risk-sharing.<sup>31</sup> However, in reality it appeared that the Ukrainian public sector is high-

25 High Council of Ukraine Draft Act on State Roads Fund No. 2724 available on the Internet at <[http://w1.c1.rada.gov.ua/pls/zweb2/webproc4\\_1?pf3511=54927](http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=54927)> Last accessed on 14 April 2016.

26 Cabinet of Ministers of Ukraine Resolution on Certain Questions of State-Private Partnership, 11 April 2011, No. 384, available on the Internet at <<http://zakon2.rada.gov.ua/laws/show/384-2011-%D0%BF/print1452602801159759>> Last accessed on 14 April 2016.

27 Cabinet of Ministers of Ukraine Regulation on State Agency of Motor Roads of Ukraine, 10 September 2014, No. 439, Clause 18, available on the Internet at <<http://zakon3.rada.gov.ua/laws/show/439-2014-%D0%BF/print1452602334449348>> Last accessed on 14 April 2016.

28 Yu Nikolov "State Investment Agency Managed to Spend Millions Already after Dismissal of Kaskiv" (14 March 2015), available on the Internet at <[http://dt.ua/ECONOMICS/derzhinvestproekt-roztrativ-sotni-milyoniv-navit-pislya-vidstavki-kaskiva-166764\\_.html](http://dt.ua/ECONOMICS/derzhinvestproekt-roztrativ-sotni-milyoniv-navit-pislya-vidstavki-kaskiva-166764_.html)> Last accessed on 14 April 2016.

29 High Council of Ukraine Act on State-Private Partnership, 1 July 2010, No. 2404-VI, available on the Internet at <<http://zakon5.rada.gov.ua/laws/show/2404-17/print1452603515541897>> Last accessed on 14 April 2016.

30 A possibility to negotiate the distribution of risks does not necessarily mean that the private partner assumes all the risks, or even the major share of the risks linked to the project. It is well-recognised that the exact distribution of risks is determined on a case-by-case basis, according to the respective ability of the concerned party to assess, control and cope with this risk. Still, the possibility to shift even a portion of the commercial risk to the State (municipal) partner was seen at the time of the law's adoption as drastically increasing the attractiveness of PPPs for potential investors.

31 See the expert opinion 'Launching a Successful PPP Program in Ukraine: Legislative, Regulatory and Institutional Considerations' prepared by the Ukrainian Journal of Business Law in 2010, available on the Internet at <<http://www.ujbl.info/article.php?id=40>> Last accessed on 14 April 2016.

ly reluctant to take commercial risks in infrastructure projects, whereas the Law on SPP did not provide for any clear advantages to businesses. Furthermore, numerous requirements of the Law on SPP are rather difficult to understand and they comprise additional blocking points for practical realisation of projects, especially at the municipal level. For example, the Law on SPP introduced, most notably, the need to justify social and economic benefits of the project before the Ukrainian Ministry of Economy,<sup>32</sup> which would only make sense if the State budget subventions were granted to each PPP, which was absolutely not the case. Then, the Law on SPP imposed an obligation upon municipalities to get a prior approval from the same Ministry before entering into a PPP agreement, which is a rather ambiguous provision from the Ukrainian laws on local self-governance.

All in all, the Law on SPP appeared to be a declarative, rather than practical, legal tool, as it did not establish a clear mechanism of compensation of the low income risks with public funds. Other open issues included the right of a private partner to retain the ownership over newly created / acquired project assets, immunity against tax and customs law changes, derogation from jurisdiction of Ukrainian courts in assets-related disputes and a number of others. It is not surprising that, to our best knowledge, no “pure” PPP has been launched specifically under the Law on SPP since 2010 and until now.<sup>33</sup> Generally, the above case shows that the Ukrainian parliament tends to adopt highly problematic PPP legislation, which is not realistic and requires additional and serious improvement to make it work in practice.

## 5. Uncertain Status of 'Institutional PPPs'

In principle, under Ukrainian law the public and private sectors may establish institutional forms of co-operation.<sup>34</sup> At the same time, certain significant limitations exist with regard to the public participation in such institutional forms. More specifically, the Ukrainian law<sup>35</sup> expressly prohibits contribution of socially important public assets, delegated public assets, budget funds and loans into the charter capital of companies.<sup>36</sup> Besides, the law prevents public partners from contributing State and municipal land plots into institutional PPPs. Misuse of these limitations possess the risk of infrastructure development

projects being reclassified into covered privatisation, thus putting parties at risk of criminal prosecution, whereby the law does not provide for any special regime for contribution of public assets into PPP companies.

For example, in 2005 the city council of Kherson decided to contribute the aggregate of assets of the city's airport into the charter capital of a project company created together with a private investor on a parity principle. The project ended in 2008 with a criminal case launched by the State Prosecutor's Office with regard to the allegedly illegal alienation of the communal ownership over the respective airport in breach with the national legislation, which, according to the State prosecutor, prohibited the above-mentioned PPP model. Subsequently the city council of Kherson decided to exit from the project company.<sup>37</sup>

In a similar case, in 2004 the State Property Fund of Ukraine set up a PPP company with a Russian private investor willing to develop and operate a major State-owned hotel in Kiev. The Fund contributed the respective assets of the hotel into the charter capital of the project company. In 2005, the State prosecutor contested the project's validity in courts based on

32 Article 11 of the Law on SPP.

33 Notably, the Ukrainian Ministry of Economic Development and Trade mentions on its web-site 243 concession and joint-venture projects launched at the end of 2014, available on the Internet at <<http://www.me.gov.ua/Documents/Detail?lang=uk-UA&id=fc354c59-cb8f-4660-b7d5-1acd35f0ab7&title=InformatsiiaSchodoStanuZdiisnenniaDerzhavnoprivatnogoPartnerstva>> Last accessed on 14 April 2016.

34 State Property Fund of Ukraine Order on List of Founding Documents for Companies with Public Assets, 3 March 2000, No. 433, available on the Internet at <<http://zakon5.rada.gov.ua/laws/show/z0196-00>> Last accessed on 14 April 2016.

35 High Council of Ukraine Act on Commercial Companies, 19 September 1991, No. 1576-XII, available on the Internet at <<http://zakon5.rada.gov.ua/laws/show/2404-17/print1452603515541897>> Last accessed on 14 April 2016; High Council of Ukraine Act on Privatization, 4 March 1992, No. 2163-XII, available on the Internet at <<http://zakon3.rada.gov.ua/laws/show/2163-12/print1452602334449348>> Last accessed on 14 April 2016; High Council of Ukraine Act on Local Self-Governance, 21 May 1997, No. 280/97-BP, available on the Internet at <<http://zakon3.rada.gov.ua/laws/show/280/97-%D0%B2%D1%80/print1452602334449348>> Last accessed on 14 April 2016.

36 Article 13 of the Law of Ukraine on Commercial Companies; Article 5 of the Law of Ukraine on Privatization; Article 60 of the Law of Ukraine on Local Self-Governance.

37 See the notice from Transport news portal “Prosecutor's Office Prepared Documents to Return the Kherson Airport under the Municipal Ownership” available on the Internet at <<http://transport-journal.com/news/avia/prokuratura-podhotovyla-dokumenty-i-o-vozvrascheniy-v-kommunalnuyu-sobstvennost-aeroporta-herson/>> Last accessed on 14 April 2016.

alleged misuse of the State property in breach with the national law. In 2011, the State Property Fund decided to reallocate the hotel's assets and transferred them to the 100% State operator. Ukrainian courts confirmed the validity of the decision in 2012 and rejected claims of the Russian investor.<sup>38</sup>

The most recent case illustrating the above problem comes from Odessa. To enable reconstruction of the city's airport, the Odessa city council decided to create in 2011 a project company together with a local private partner holding a major stake. Afterwards the communal operator of the airport entered into the contractual joint venture with the same SPV and contributed key project assets into this joint venture. As a result, the community preserved its control over most important assets of the airport and the private partner acting through SPV received control over the assets to be reconstructed. In July 2012, the reconstruction process was launched by the SPV in close cooperation with the airport's communal operator and the Odessa city council. However, in 2014 the State Prosecutor's Office initiated a lawsuit seeking termination of the PPP due to unauthorised transfer of the project assets into the project company. Although the dispute seems to be settled for the moment, it has caused a significant delay of the project.<sup>39</sup>

## 6. Project Tendering and Contractual Issues

### a) Bidders Eligibility and Non-Discrimination

A private partner for conclusion of the agreement for the PPP project is selected through a tender procedure. If only one bidder applied, a PPP project agreement may generally be concluded with this bidder, as long as it meets the qualifying criteria, unless otherwise provided for by specific laws. Besides, a non-discrimination principle is widely recognised. There are no general limitations with regard to the origin

of the private partner in PPPs. It should, however, be emphasised that participation of foreign bidders in industry-specific PPP tenders may be restricted, e.g. due to specific qualification requirements (necessity of specific assets / experience and similar). From the practical point of view, it could be difficult for a foreign entity to directly act as a private partner if its activities require a license. It is not always possible for foreign entities to receive licenses without opening a local subsidiary in Ukraine. At the same time, it is also not always possible for newly created Ukrainian companies to benefit from the track record of their foreign parent companies. This considerable limitation puts a newly created Ukrainian subsidiary of an international PPP operator into the same position as any other newly created company, even though it is obvious that the former has an enormous edge in that it can benefit from the experience of its parent group in similar projects.

### b) Low Flexibility When Negotiating a PPP Project Agreement

The Ukrainian legislation distinguishes between "recommended agreements" and model agreements adopted by the Cabinet of Ministers (such as the model concession agreement and others), whose terms and conditions are obligatory. As an example, the current model concession agreement allows the parties to envisage specific provisions to adapt it to a specific project, but without changing the general terms and conditions. Apart from that, the Ukrainian economic laws (which are highly formalistic) provide for a list of provisions, the so-called "essential conditions", without which any commercial contract is invalid. The Ukrainian court practice clearly shows that even a formalistic missing requirement can lead to invalidation of a project agreement. If at least one of the essential provisions set by the law is missing, it is the ground for invalidation of the agreement itself.<sup>40</sup> Moreover, the public partner is usually reluctant to include a provision that the model agreement does not provide for.

### c) State Permits

A PPP agreement in Ukraine does not allow the private partner to proceed with operating an infrastructure facility until a license and/or a special permit has been procured, if such is required. The private

38 High Commercial Court of Ukraine Ruling, 23 January 2013, the case No. 61/425, available on the Internet at <<http://www.reyestr.court.gov.ua/Review/28840356>> Last accessed on 14 April 2016.

39 Odessa Commercial Court of Appeal Ruling, 13 October 2015, available on the Internet at <<http://www.reyestr.court.gov.ua/Review/52461469>> Last accessed on 14 April 2016.

40 Supreme Court of Ukraine Ruling, 18 July 2012, available on the Internet at <<http://www.reyestr.court.gov.ua/Review/25390631>> Last accessed on 14 April 2016.



partner is solely responsible for procurement of all permits and licenses. There is no general simplified public system for issuing licenses for PPP projects' purposes. Licenses and permits are not transferable in Ukraine. Besides, the Ukrainian legislation allows for licenses and permits to be issued only to one legal entity.

#### d) Immunity against Law Changes

The PPP law clearly provides for immunity of PPP contracts against changes in Ukrainian civil and commercial law. By contrast, a PPP contract must be brought into compliance with amendments in the licensing, customs, tax, environmental, and public order legislation, as well as with foreign exchange rules. Thus, the Ukrainian PPP law does not provide for a concept of special regimes for, e.g., importation or production of goods under the PPP arrangement.

#### e) Settlement of Disputes

Under the general rule, disputes between a public and a foreign (non-resident) private partner in a PPP may be settled before an international arbitration institution. At the same time, disputes between a public and a foreign private partner relating to immovable property covered by the PPP agreement must be settled exclusively by the courts of Ukraine. To the extent that many PPP disputes relate to the immovable property constructed by or transferred to the private partner, as well as pledge or mortgage thereof, the derogation from Ukrainian court's jurisdiction is not possible for such disputes.

#### f) Project Agreement Termination

According to the Ukrainian PPP legislation, upon expiration/termination of the project agreement the PPP facility should be returned to the public partner by the deadline set by the agreement or by legislation. The agreement may impose fines for a delayed handover of the PPP facility. The private partner may receive compensation for the improvements only if they were allowed and if they were not compensated for by depreciation charges. However, the legislation does not provide for any other compensation including in cases when the agreement is terminated due to the public partner's default (e.g. covering outstanding debts, lost property, etc.).

## 7. Issues Relating to Financial Structuring and Insurance against Low Income Risk

### a) Budget Subsidies and Availability Payments

The Ukrainian PPP legislation does not limit the private partner's revenue sources, which itself is positive. The project's revenues may include the following: payments from end users, partial financing from the public partner, subsidies, income from auxiliary services, etc. As an example, the concessionary's revenue in toll road projects may consist of: toll payments from end consumers, availability payments, subsidies from the state, and payments from the end consumers for using the service facilities (hotels, gas stations, etc.). Still, in practice, a public partner prefers to limit the financing from the State or municipal budget. Moreover, the financing from the State or municipal budget lacks clear mechanisms on the level of budget legislation. A further problem is that the Ukrainian legislation does not prohibit encumbering and putting a charge over property, unless it is public property transferred into use by the public partner. Under the general rule, public assets transferred to the private partner for project implementation and reconstructed property may not be transferred into private ownership within the effective period of the project.

### b) Compensation of Low Tariffs

In terms of compensation of the low-income risk, under PPP law, should prices (tariffs) for services rendered under a PPP project be lower than reasonable expenses for their provision, a private partner may receive compensation of such expenses. In addition, if the prices (tariffs) for services of the private partner are subject to the State regulation, such prices must include an investment component the amount of which has to ensure compensation of the private partner's expenses during the term of the PPP agreement. The procedure of the above compensations remains, however, yet undeveloped and may be problematic.

### c) State Guarantees

The last, but not the least, the Ukrainian legislation provides for very restrictive regulation and means of

securing the performance of PPPs. The State (sovereign) guarantees may be issued by the State to public sector entities and its maximum annual amount allowed by the budget law is rather low. It is therefore rather difficult for private partners or PPP companies to directly benefit from State guarantees. Besides, the State guarantee may not be issued if there is a risk that budget funds may be used to service the guaranteed loan (with exception for loans received from international financial institutions).

#### d) Financial Support of IFIs

A number of important international development financial institutions (IFIs), such as the European Bank for Reconstruction and Development (EBRD) or the International Finance Corporation (IFC - subsidiary of the World Bank), play an important role in the financial support granted to infrastructure development projects in Ukraine, as IFIs are ready to face the increased country risks of Ukraine. However, unlike in Russia, where EBRD and IFC were directly involved in a number of landmark PPP projects,<sup>41</sup> in Ukraine their role in supporting PPPs is rather limited. For example, the largest road infrastructure project - the Kiev – Chop highway connecting the Ukraine’s capital with the EU boarder – was financed by EBRD within a public procurement led by the Ukrainian government, rather than PPP. One of the reasons for this is the the lack of Ukrainian law provisions enabling direct spending by PPP companies of budget funds, including international loans.

#### e) Other Notable Issues Pertaining to Financial Structuring

The Ukrainian legislation does not prohibit encumbering and putting a charge over property, unless it is public property transferred into use by the public partner. Under the general rule, public assets transferred to the private partner for the project’s imple-

mentation and reconstructed property may not be transferred into private ownership within the effective period of the project. In addition, the Ukrainian legislation does not provide for clear rules concerning the substitution of the private partner in PPPs, e.g. in case of default. In principle, replacement of the private partner is conditioned only upon the public partner’s prior consent and the new agreement should be drafted and signed, which require in applicable cases a new PPP tender.

## IV. Conclusion

Since the early 90s, numerous public infrastructure projects have been initiated mainly by local businesses. Concessions, lease or investment agreements are the main models used to structure such projects. These models are well established in the Ukrainian law and practice. All of them assume that the commercial risk of projects will be borne clearly by the private party. The 2010 Law on SPP – the Ukrainian PPP law – was welcomed as a tool to start bankable infrastructure projects in Ukraine with the support of State guarantees and availability payments from the Ukrainian government to compensate low income risks. In reality, however, the Ukrainian government appeared to be unwilling to effectively guarantee compensation of risks. As a result, no single PPP project has been started in Ukraine since the adoption of the above-mentioned law in 2010. In addition, numerous provisions of PPP laws are not enforceable due to the absence of the necessary enforcement mechanism or because they contradict other legislation.

Although the practical implementation of PPPs is still at its preparatory phase, an important step towards the improvement of the legal framework is a complex amendment to the SPP Law voted by the Ukrainian parliament in February 2016.<sup>42</sup> This amendment contains a number of provisions aimed at making PPPs more attractive to private businesses compared to other legal models for private participation in infrastructure. Among other things, the new law entitles central and local governmental authorities to appoint a responsible public company to act as a public partner in the PPP project, which opens the door for “institutional PPPs”. Further, new opportunities are offered in connection with the use and ownership over PPP assets. More specifically, a

41 D Lasfargue, J Brusau Cuello and F Jaulin ‘Legal Framework and Structuring of Public-Private Partnership Projects in Russia: Current Situation and Future Prospects’ (2013) 1 International Business Law Journal 1.

42 High Council of Ukraine Act on Elimination of Regulatory Barriers to State-Private Partnerships, 24 November 2015, No. 817-VIII, available on the Internet at <<http://zakon3.rada.gov.ua/laws/show/817-19>> Last accessed on 14 April 2016.

private partner may retain the ownership rights over newly created / acquired PPP assets. Besides, the parties to PPPs may agree on joint ownership over the newly created assets. Last but not the least, the amended PPP law explicitly recognises the lenders' rights to directly participate in the PPP agreement and initiate replacement of the defaulted private partner under the PPP agreement. At the same time, the Ukrainian President signed the new Law of Ukraine on Public Procurement, introducing a possibility to delegate entirely the operation of public procurement to private companies.<sup>43</sup> It remains to be seen if this provision will be used in practice to intensify a variety of PPPs, as private partners may in principle be directly authorised to spend public funds alone or in combination with funds raised from private lenders.

Notwithstanding the generally positive effect of the above new laws, they do not change the existing budget law rule, which does not allow direct remuneration of private partners under PPPs. This leaves potential PPPs uncertain about the actual ability of the public authority to compensate the low-income risks, which is especially high nowadays in Ukraine.

The following years will certainly be decisive for the future development of the legal PPP framework in Ukraine and, as a consequence, for the development of infrastructure projects structured as PPP.

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43 High Council of Ukraine Act on Elimination of Regulatory Barriers to State-Private Partnerships, 25 December 2015, No. 922-VIII, available on the Internet at <<http://zakon3.rada.gov.ua/laws/show/922-19/print1452602334449348>> Last accessed on 14 April 2016.

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