

Ukrainian state and municipal infrastructure needs public-private partnership (PPP) investment if the country's infrastructure is to help, rather than hinder, further economic growth. But how viable is the existing legal framework for PPP project procurement? By Arthur Nitsevych

Is PPP viable under Ukrainian law?

Having gained WTO membership in February 2008, which should help boost the country's GDP and hence demand for infrastructure, there are a host of opportunities for foreign investment in PPP initiatives in Ukraine.

In 2012 Ukraine will host the UEFA Euro Championship 2012 in Kyiv, Donetsk, Lviv, Dnipropetrovsk, Kharkiv and Odessa. The championship will require development and upgrading of transport infrastructure in and to those cities, the modernisation of stadiums, the building of new hotels and development of local economies.

Ukraine will also gain as the defined pan-European corridors push eastward and the integration of neighbouring eastern countries into the Trans-European Transport Network (TEN-T) takes place, supported by European financial institutions. And rising economic levels and closer east-west partnership are encouraging greater road usage, requiring heavy investment, particularly in road infrastructure.

But there is a problem – there is no single approach to PPP at either the national or local level. And there is no single recipe for Ukraine. Models used in other countries can be considered as models only. They must be estimated and working elements adapted and used to suit. Ukrainian PPP needs more legal clarity.

Concessions

The legal status of PPP concessions in Ukraine is regulated by the Act On Concessions which came into force on 16 July 1999. It provides for an extensive list of the spheres in which objects of state and municipal property may be constructed, renovated and/or operated under a concession. It concerns motorways, ports, airports, communications, gas transportation and distribution, electricity generation and transmission, water supply, wastewater transfer and purification, waste collection and processing, postal services, housing construction and operation. In addition, local councils may, on a case-by-case

basis, decide to expand the above list to cover further municipal utilities.

Concessionaires are selected by open tender. Both national and foreign bidders can participate on an equal basis and under the model concession agreement approved by the Cabinet of Ministers of Ukraine there is sufficient contractual freedom to particular needs and specifics of a project.

A concessionaire is free to choose a form of incorporation. So, traditional project-finance structures are possible, including a special purpose vehicle (SPV), either wholly owned by an investor or partially.

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Joint activity agreement (JAA)

Non-corporate joint activity is one of the possible options provided for by Ukrainian civil and tax legislation. Joint activity is carried out via a contractual joint venture organised by a combination of funds or assets of participants, or without combination of contributions in order to achieve joint business purposes.

The joint activity does not have the status of a legal entity. There is no requirement for a minimum amount of capital to be contributed by the participants. The conditions of carrying out the joint activity are established by a written agreement among its participants. Joint activity is subject to registration with state authorities.

The management of joint activity and conduct of joint business of the parties as a rule is assigned to an investor. Profits are divided between the parties proportionally to contributions. The legislation of Ukraine requires separate bookkeeping and tax reporting under the agreements on joint investment activity. Articles 1130-1143 of the Civil Code of Ukraine (effective as of 1 January 2004) regulate the provisions of such partnership.

Lease

The lease of integral property complex or individual item of

movable (immovable) property is another way to PPP in Ukraine. In contrast to individual movable and immovable property, an integral property complex is an economic object with the accomplished production cycle including the land plot where it is situated, autonomous engineering communications and energy supplying systems. The lessor is the State Property Fund of Ukraine or local councils. The terms of the lease are similar to concession terms and are defined by the lease agreement.

Management

There are some new legal agreements which have good prospects. Management is among them. Under the property management agreement a settler shall transfer to a manager the property into management for a specific period of time and the manager shall be obliged to manage this property for fees on its behalf to the interests of the management settler or a person (beneficiary) determined by him. Benefits from the property transferred into management shall belong to the management settler. The manager shall have the right for the fees stipulated by the agreement including reimbursement for all necessary expenses in connection with the property management. The amount of remuneration is not determined by the legislation and may be fixed, for instance, in percentage to the amount of profits.

Existing PPP examples

Public-private partnership (PPP) has had some development in Ukraine in the port sector – our firm recently worked on the Eu26 million EBRD loan to the Port of Ilyichivsk, which required an enabling framework, and the port has developed a number of different PPP-like contract structures over the years.

For the port of Illichivsk (like for other state-owned ports) the lease of land and assets is not an interesting option since the lease contract is closed with the Municipality as the landowner. Lease for land is paid for 100% to the Municipality and lease for super structure (buildings and equipment) is paid for 70% to the State Property Fund. The remaining 30% rent is paid to the port and forms a small part of its revenues and net profits.

Since leasing of the waterfront and the berths to private sector parties is excluded by the Ukrainian legislation, the Joint Activity Agreement (JAA) gives an opportunity within the framework of Ukrainian legislation to include private parties in the handling of cargo and servicing vessels along the berth and the waterfront.

The JAA with Ukrtranscontainer (a part of NKK group) for container handling is an example of a long term JAA contract with considerable operator’s commitments for investments (\$51 million for the first phase) and where the private operator is responsible for joint administration and for quay operations. The operator has agreed to the transfer

of some 450 personnel from the port under negotiated social conditions.

In the port of Odessa there are a number of terminals operated on the basis of a JAA with private operators too. A special case of PPP in the port of Odessa is the container terminal where the port established a cooperation with a German port operator for developing and operating the container terminal covering various contracts: A Service contract for the cargo operations and Management contracts for the lease of assets – fixed assets and for current assets.

Requirements for successful PPPs

The PPP concept requires risk sharing between public and private sectors. So, one of the basics for the success includes political support and an enabling legislative framework.

Political support is important for the private sector because unless PPP is seen to offer continuing business opportunities, companies will be reluctant to develop the necessary resource required to bid for contracts.

There is a developed legal framework in Ukraine in this area but it is far from perfect. Due to the lack of government support and insufficient protection of investors’ rights in the recent past, there has been practically no record of big PPP deals in Ukraine. Nevertheless, it appears that, if due support of the state is ensured, PPP-based project finance could be successful in Ukraine, even on the basis of current laws and regulations.

Ukraine needs to develop clearer and more detailed PPP rules with principles of transparency, non-discrimination, proportionality and efficiency. The existing provisions regulating the project agreement give relatively clear guidance on the main issues to be covered and they remain sufficiently flexible to enable the parties to negotiate freely its terms.

Furthermore creating security structures for deals in Ukraine became common long ago. There are a number of security tools, such as enterprise mortgages, pledges of movable and immovable property, stock and asset charges, inventory, equipment and accounts receivable pledges, and assignments of supply, insurance and other contracts. But the main issue is that under project financing, PPP must be considered not just as a means of tapping private finance, but also benefits in terms of quality, management and creativity for development. ■

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