

# GLOBAL PUBLIC - PRIVATE PARTNERSHIP (PPP) GUIDE

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# UKRAINE



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### GENERAL

- 1. Is the PPP model commonly used to develop infrastructure projects in your jurisdiction? If yes, what types of PPP models (such as Build-Operate, Build-Operate-Transfer, Transfer of Operation Rights, Build-Lease-Operate-Transfer, etc.) are used?**

Taking PPP in the broad sense as joint public-private projects, PPP is quite common because of the number of remaining state assets. Specialized legislation was developed in the past to enable various forms of partnership, including concession. Several concession projects were initiated in the past for state roads development. The majority of such projects are of the Build-Operate-Transfer type. It is quite common for the projects, while considering application of PPP, to switch to the more common public procurement model because its structure is simpler and its procedures are polished by a much longer history of application. Besides, the private financing markets have little capacity nowadays in Ukraine. On the contrary, the government receives comparatively cheap financing from the international financial institutions (IFIs), which is purposed for particular target projects. That financing usually goes through

public procurement procedures, including specific procedures of those financing IFIs.

We note that profit sharing agreements, which are rather common in the oil and gas sector, are explicitly excluded from operation of the PPP regulations in Ukraine. For that reason, we do not comment on them here either.

- 2. Which sectors apply a PPP model to develop infrastructure projects?**

Road construction, utilities supply, and sea ports concession are the major sectors where the application of a true PPP model was considered and attempted. The Law of Ukraine "On Public-Private Partnership" allows the application of PPP in the following sectors:

- minerals research and mining, excluding those under production sharing agreements;
- production and distribution of heat, natural gas, and power;
- development and operation of roads and ports;
- machinery-production;
- collection, refining, and distribution of water;

- health care;
- tourism, recreation, culture, and sport;
- irrigation and draining;
- waste treatment, excluding collection and transportation;
- real estate management;
- social services;
- power saving;
- restoration of residential buildings ruined in the course of anti-terrorist operations;
- installation of modular and construction of temporary houses for internally displaced;
- education and health care services; and
- management of architectural monuments and cultural heritage.

The public partner may also decide to apply PPP in other areas, unless the law restricts the respective activity to state enterprises, institutions, and organizations.

**3. Is there any new PPP project in the pipeline of the government? Is there any new sector to which the PPP model is planned to be applied in the near future?**

Over the past couple of years there was a lot of discussion around pilot road concession projects: Kyiv Outer Ring Road, Lviv – Krakovets toll road, etc. Last year the Ministry of Infrastructure of Ukraine initiated three PPP projects for concession of sea ports and development of sea port infrastructure. The Ministry intends to focus on those projects as a pilot to prove that established foreign PPP

practices work in Ukraine. The government would probably postpone application of the PPP model in other sectors.

## LEGISLATION & REGULATION

**4. What are the principal laws and regulations? Is there a framework PPP Law?**

The Laws of Ukraine "On Public-Private Partnership", dated 01 July 2010, No. 2404-VI, with further amendments, should be considered as the framework PPP law in Ukraine. It is a comparatively recent development, which still waits for its full application. In 2016, major changes to it came into effect, making significant improvements to PPP regulation and prospects of its application.

Another framework law is the Law of Ukraine "On Concessions", dated 16 July 1999, No. 997-XIV, governing procedures for the most widespread PPP form – the concessions. It has rather developed subordinate legislation covering nearly all peculiarities of the concession process.

A number of specialised laws govern concession in particular sectors, most suitable for such kind of projects. Among them: the Law of Ukraine "On Concessions for Construction and Operation of Automobile Roads", dated 14 December 1999, No. 1286-XIV; the Law of Ukraine "On Particularities of Transferring in Lease or Concession of Municipally-Owned Items of Heat Supply, Water Supply, and Canalization", dated 21 October 2010, No. 2624-VI; and the Law of Ukraine "On Particularities of Lease or Concession of Items of Fuel and Energy Sector being in State Ownership", dated 08 July 2011, No. 3687-VI, all with further amendments and relevant subordinate regulations.

The World Bank and the EBRD are now financing several projects for developing amendments to PPP laws or introducing new regulations. However, they are not adopted yet, therefore we do not comment on them here.

Another separate law governs lease of state assets, but it is rather seldom used to structure true PPP relations, therefore we do not comment on it either.

**5. What are the principal regulatory bodies for PPP? Is there a centralized PPP Authority?**

There is currently no principal regulatory body for PPP under the laws of Ukraine. There used to be a dedicated body, but it proved to be ineffective because it lacked powers. The Ministry of Infrastructure of Ukraine is responsible for the currently initiated PPP projects for development of sea ports infrastructure. The Law of Ukraine "On Public-Private Partnership" requires the Cabinet of Ministers to adopt necessary by-laws as well as gives to it most of the authority concerning PPP projects with state-owned property.

**6. Are there any restrictions for foreign investors to develop/operate PPP projects?**

The laws of Ukraine make no difference for foreign or local investors for PPP projects. The national regime is established for foreign investors.

**7. Does the legislation or the project agreements envisage a long-stop date for the completion of construction?**

A PPP agreement cannot be made for a period of more than 50 years. That limitation also provides a theoretical limit for completion of construction. Aside from that, the laws do not

limit that term. However, the PPP agreement must determine that term.

**8. How are force majeure events defined, and what are the consequences of their occurrence?**

There is no special regulation of force majeure for PPP. Under the laws of Ukraine, a party is not responsible for non-performance caused by an event beyond the party's control. The agreement and obligations are usually postponed for the time of effect of such event. As a matter of good business practice, the force majeure event must be certified by the Chamber of Commerce of Ukraine or a competent authority, unless differently specified in the agreement.

**9. How are the political and legal risks (e.g. expropriation, change in law, adverse court decisions, etc.) allocated between the parties, and what are the consequences of their occurrence?**

The Constitution of Ukraine protects the right of private ownership as one of the core and inviolable rights. It guarantees that no expropriation can take place, unless on the grounds of public need in cases and under the procedure specifically prescribed by laws and subject to prior and full compensation. Furthermore, in case of foreign investments, the Law of Ukraine "On Foreign Investments" prohibits their nationalization. Ukraine is also a party to a significant number of bilateral investment treaties (BITs) which protect foreign investments and forbid their expropriation.

There are several guarantees to deal with the change in law risks. Formally, the laws which were effective at the time of making the PPP agreement and directly regulate the mutual rights and duties of the parties shall continue to apply in case of change of legislation. However, the rule applies only to civil and

commercial laws, and does not cover many areas, including national security, taxation, currency regulation, customs, and any other area, where there is not equality of parties. If the tariffs for services or goods rendered in the result of PPP are state regulated, a change of such tariffs must be justified. Otherwise, the private partner may terminate or suspend the agreement. In case of violation of rights under the agreement by a state or local authority, the private partner is entitled to compensation of damages.

The adverse court decisions risk has no specific approach in the laws. However, the parties may resort to international arbitration, which by itself largely mitigates such risk.

**10. Is a reinstatement test envisaged, under the legislation or the project agreements, to determine whether the insurance proceeds would be used to reinstate the facilities or to repay the debt to lenders?**

The laws do not provide for such reinstatement test. It is rather a contractual matter.

**11. Is the concept of “insurability” recognized in the project agreements?**

The framework PPP law in Ukraine does not cover insurance. The special concessions law requires insurance for accidental loss or damage of the property which is transferred into concessions. There is no concept of “uninsurability”.

**12. Does legislation allow the relevant public authority or the lenders to take control of the PPP projects through step-in and/or substitution mechanisms in case of default of the project company?**

There is no step-in or substitution mechanism in case of default of the project company. The

public partner would usually have to cancel the contract and launch a new tender. We have come across several matters when the financing partners insisted on a kind of step-in procedure. To a certain extent such or similar provisions can be included in the PPP transaction documents.

**13. Is international arbitration available to settle disputes under the project agreements and direct agreements with lenders? Is it possible to have foreign law as the governing law of these agreements?**

If it is agreed in the PPP agreement, the disputes with foreign partners can be settled through arbitration. If the state partner under the agreement is the Cabinet of Ministers, it may decide that the state of Ukraine waives its immunity for this agreement if the private partner requires so.

Direct agreements with lenders may provide for arbitration clauses as well, provided at least one party to it is a foreign company.

A foreign law cannot be the governing law of the agreement. Only the law of Ukraine can.

**14. Is a regular market testing procedure envisaged under the legislation or the project agreements to procure the services to be provided by the project company?**

Under the PPP law, the public partner shall perform an efficiency assessment for the PPP project after the PPP is initiated and before arranging a tender for the private partner. The procedure for assessment was adopted by the Cabinet of Ministers of Ukraine. The efficiency assessment includes:

- detailed substantiation of socio-economic consequences of PPP (including economic and financial characteristics of PPP and

changes in the quality of the services and products supply) and ecological consequences of PPP (including influence on the environment);

- substantiation of higher efficiency of PPP in comparison to not involving a private partner;
- risk assessment of PPP and determination of risk management;
- determination of form of PPP; and
- social, economic, and ecological perspectives after the PPP agreement termination.

**15. How is the acceptance of the facilities performed? Is an independent technical adviser or the project company involved in the acceptance process or is it solely done by the public authority?**

The law does not specifically govern acceptance of facilities from the private partner. The agreements would usually provide for involving an independent engineer or a technical adviser on the grantor's part for the acceptance procedures. The public partners would hardly be capable of accepting the facilities merely on their own.

In certain cases, the law provides for mandatory commissioning procedures. For example, the procedure for acceptance of real estate depends on its risk assessment. The state building and architecture authorities may verify information in the developer's application on completion of complex construction.

**16. Are there any expected changes or reform of the existing legislation?**

The Law of Ukraine "On Amendments to Certain Laws of Ukraine On Removal of

Regulatory Barriers for Development of Public-Private Partnership and Stimulation of Investments into Ukraine", dated 24 November 2015, No. 817-VIII, which came into effect on 24 May 2016, started a new wave of reform of PPP regulation and provided significant improvements to the Law of Ukraine "On Public-Private Partnership", including introduction of the notion of "project companies", possibilities for temporary ownership by the private partner of the created property, introduction of new types of state support and guarantees, possibility of arbitration, etc. The adoption of respective changes to the subordinate legislation is ongoing.

The World Bank and the European Bank for Reconstruction and Development (EBRD) are now financing several projects for developing amendments to PPP laws or introducing new regulations. However, they are not adopted yet, therefore we do not comment on them here.

## FINANCING & INCENTIVES

**17. How is the payment mechanism regulated for PPP projects? Does the relevant legislation provide inflation and/or foreign exchange protection?**

There is no specific regulation on the payment mechanisms. This is largely a contractual provision.

The common business practice provides that the inflation, unlike foreign exchange protection, however, is usually acceptable as a stabilisation coefficient in the financial model. The foreign exchange risks may theoretically be treated similarly, but we expect that would raise certain objections on the public partner's part and require thorough substantiation, in which part it should or should not apply.

**18. Is there a guaranteed rate of return or a cap on the rate of return for the project company or sponsors?**

In practice, the return is calculated from the project parameters according to the pre-agreed terms. If the revenues depend on the state-regulated tariffs of the goods or services delivered by the PPP project, they may not be unreasonably changed by the state authority. That rule should also work, but may be problematic to enforce, if the public authority which is responsible for the tariff is not a party to the PPP agreement. If the state authorities fail to comply or perform other actions which violate the rights of the private partner, the private partner could be authorised to a compensation.

**19. Is there any payment guarantee provided by the relevant public authority for PPP projects (e.g. service payment guarantee, availability payment guarantee, Treasury guarantee etc.)?**

The public partner may, theoretically, provide state guarantees of its obligations under the agreement. In case of state property, the Cabinet of Ministers of Ukraine decides on providing such guarantee. We note that such guarantees are rather uncommon so far.

**20. Do the obligations of the relevant public authority qualify as State (Treasury) obligations? If not, does the Treasury provide separate guarantees to the concessionaire or the lenders?**

The state guarantee, if provided, does qualify as a state obligation to be paid from the state budget of Ukraine. Otherwise, the obligations are not covered by state guarantees. However, it does not free the state partner from compensating damages. The State Treasury would probably not directly act as respondent to the claims from PPP agreements since

public authorities usually have their own contractual capacity. However, all public authorities are so-called budget organisations and are financed through and keep their funds on the treasury accounts. The treasury thus would have to perform any claim, satisfied by the court against the public authority, but on the account of funds available at relevant treasury account of the public authority. If such funds are not available, the state authority would have to ask for additional financing from the State Budget then.

**21. Are deductions from the service and availability payments subject to a cap?**

The PPP law does not provide for any such deductions. It is purely a contractual matter consequently.

However, we note that when PPP is structured as concession, the concessionaire should pay a concession fee for its right to perform construction or manage assets. The calculation of that fee shall be determined in the concession agreement in accordance with the rules adopted by the Regulation of the Cabinet of Ministers of Ukraine, dated 12 April 2000, No. 639, with further amendments. The fee is calculated as a percentage from the value of the item granted into concession, from the revenue in fact, plus a fixed fee determined during tender. If the number of items granted or managed in concession changes during the term of concession, e.g. because of decommission of a building or because of construction completion, the concession fee shall be recalculated in accordance with the terms that were in effect at the time of making the concession agreement.

**22. Are variations that the public authority may request at the construction and operation stages subject to a cap?**

The laws of Ukraine do not provide for such cap. From the practical point of view, the

expenses will be limited by project stage budget and procurement procedures.

**23. Is there a requirement to share any gains arising from refinancing of the PPP project-with the public authority?**

There is no such requirement.

**24. Do the lenders sign a direct agreement with the relevant public authority? If yes, what rights do the lenders typically have under such agreements?**

This option is not governed by the regulations, but may be practically available to the financing party. The direct agreement would usually institute some additional security on the provided financing: in terms of direct cash flow to the financing parties, for example, their access to information and other project company's default preventive opportunities. It may as well govern the step-in and change of the project company procedures and relevant consequences for the project and earlier extended financing.

**25. Is there a debt assumption mechanism, whereby the public authority undertakes to assume the debts of the project company to the lenders in the event of termination of the project agreement? If yes, does it cover the full amount of the equity, and is it payable in all termination scenarios including project company default terminations?**

There is no such mechanism, unless the government provides state guarantees, which is rather rare, however. Those may be used to ensure state obligation under a loan taken by the state or a third party for the purposes of the PPP financing. It may cover the full amount of the loan. The exact amount and the conditions shall be determined in the agreement.

**26. What are the payments to be made by the relevant public authority to the sponsors, the project company and the lenders in case of termination of the project agreement and are they payable in all termination scenarios including project company default terminations?**

The private partner may claim compensation of damages if the termination of the project was caused by violation by the public partner of its obligations.

If the state guarantees are provided, the terms are covered by the agreement of the parties.

In all cases the settlements are governed by the relevant agreements among the parties concerned. It is rather uncommon, however, that the public partner undertakes responsibility before the sponsors or lenders of the private partner.

**27. Is there an incentive for domestic (local) manufacturing of equipment or materials used in the construction of PPP projects?**

No In general, the legislation does not provide for material origin incentives or requirements for PPP projects anymore. Practically, usage of local equipment and materials may be an advantage in comparison to other PPP candidates if the tender documentation suggests or requires so.

**28. Are there tax advantages available to PPP projects?**

No.

**29. What are the other incentives available to PPP projects?**

The state partner ensures availability of land which is required for the project, including negotiations with competent authorities to

provide lease or servitudes, as well as buy-out of land from private owners for public needs.

**30. What are the number, investment amounts and sectors of the PPP projects developed in your jurisdiction during 2016?**

In 2016, there were three pilot PPP projects initiated for sea ports infrastructure development. The amount of investments is being estimated.

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