Public-Private Partnerships: Quo Vadis, Ukraine?

Yevheniy DEYNEKO

Managing Partner, EVERLEGAL
Education: INSEAD, (Broadening Business Perspectives Programme, 2015); Kyiv National Economics University (Masters in Finance, 2009); University of Connecticut School of Law, (LL.M., 2001); Lviv National University Law School (Specialist's Degree in Law, 2000). Mr Deyneko is qualified to practice in Ukraine and admitted to practice in New York State, USA

Andriy OLENYUK

Partner, EVERLEGAL
Education: Georgetown University Law Center (LL.M., 2010); Lviv National University Law School, (Master's Degree, 2008). Mr Olenyuk is admitted to practice in Ukraine

What are PPPs?

Public-private partnerships, or PPPs, stand for contractual arrangements between the entities of the public and private sectors with a view to implement certain projects of public significance.

The typical features of PPPs include the following:

(i) a long-term contract between a public entity and a private investor relating to the performance of works or services by a private investor with the support of a public entity;

(ii) the transfer of enterprise risks (e.g. risks relating to designing, building, operating and financing a project) from the public entity to the private investor; and

(iii) the public entity usually maintains/acquires title to assets in relation to which the services are rendered by a private investor or work products in relation to which the works were performed by a private investor.

The most popular PPPs among private investors involve the rehabilitation of existing facilities with established demand, whereas PPPs with excessive budgets and risks of unknown demand are less attractive for private investors. This is especially true in the Ukrainian context of early stages of economic recovery following several years of political and economic instability.

Why does Ukraine need successful PPPs?

The political and economic turmoil of 2014-2015 in Ukraine puts off the country's ambitious plans to implement certain large-scale infrastructure projects initiated by the government (e.g. the LNG terminal project in Odessa, the Kyiv-Boryspil Airport railway project and the new Kyiv metro line project). Such projects were, to a considerable extent, planned to be implemented through PPP arrangements which would allow the public authorities to leverage private investments in exchange for predictable returns. But the prevailing perception of increased political risks associated with the military conflict with Russia and lack of financing with maturity matching the duration of the PPP contracts did their job. Unfortunately, as of today, none of them has matured into a financial close.

There is a considerable backlog of demand for large-scale PPP projects in Ukraine because of the need to repair certain worn-out infrastructure currently maintained by the public entities, such as highways, railways, airports and sea ports, or create new infrastructure facilities, such as LNG terminals, high speed railways, metro systems and even the prison infrastructure. However, the Ukrainian public sector cannot afford to implement such infrastructure projects through conventional procurement procedures due to excessive associated costs. Ukrainian banks cannot afford to finance such projects due to liquidity and regulatory issues while foreign lenders often lack confidence in Ukrainian borrowers. PPP arrangements with the participation of foreign private investors and IFIs can be considered a viable alternative here.

Ukraine desperately needs a number of success stories in PPP projects for the following reasons:

— with the private investor's participation offering additional "value for money" to the public sector through increased quality of services or project outcomes, the general public would benefit from better services or goods for a lower public spending;

— the positive effects of modernising the infrastructure is the key to the increase of internal and cross-border trade in goods and services originating from Ukraine;

— the risk-sharing element of PPP arrangements between the public entity and the private investor enables hedging against financial risks relating to potential operational failures of a project's outcome;

— this would allow Ukraine to tackle its impeding economic challenges, such as high unemployment and the continuing infrastructure shortfall, and reinforce its economic recovery; and

— a strengthening of the general investor confidence in the PPP market and increasing the chances of further PPP projects in Ukraine.

What is the Current Regulatory Framework for PPPs in Ukraine?

The key laws and regulations governing PPPs in Ukraine are:

(i) the Law of Ukraine of 1 July 2010 No. 2404-VI *On State and Private Partnership*;

(ii) the Law of Ukraine of 16 July 1999 No. 997-XIV *On Concessions*;

(iii) the Law of Ukraine of 8 July 2011 No. 3687-VI *On Specific Issues relating to Concessions of the Fuel and Energy Industry Facilities that are Owned by the State*;

(iv) the Law of Ukraine of 21 October 2010 No. 2624-VI *On Specific Issues relating to Transfers into Lease or Concessions of Facilities in the Field of Heat Supply, Water Supply and Water Disposal that are Owned by Municipalities*; and

(v) the Law of Ukraine of 14 December

EVERLEGAL

Address:
4 Rylskyi Lane,
Sofyiska Square, 6th Floor,
Kyiv, 01001, Ukraine

Tel.: **+380 44 337 0016**
Fax.: **+380 44 337 0018**
E-mail: **info@everlegal.ua**
Web-site: **www.everlegal.ua**

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1999 No. 1286-XIV *On Concessions for the Construction and Operation of Automobile Roads*.

There is also a considerable volume of secondary legislation enabling the primary PPP rules and detailing the PPP related procedures.

Which PPP Projects are Currently Implemented?

According to the website of the Ministry of Economic Development and Trade of Ukraine and based on the data received from the central and local authorities, as of 1 August 2016 185 projects were implemented under PPP arrangements. Among those projects, 153 have been implemented under concession-type arrangements, 31 projects - under joint activity agreements and 1 project - under the public-private partnership (sic!) contract. The most popular sector for PPP projects in Ukraine seems to be waste treatment with 112 projects. Other sectors include collection, purification and distribution of water (37 projects); construction and exploitation of roads, railways, bridges and other transport infrastructure facilities (16 projects); production, transportation and supply of heat (6 projects); production, distribution and supply of electricity (5 projects); exploration for and production of minerals (1 project); tourism, recreation, culture and sport (1 project) and others (5 projects).

The number of PPP projects signifies the viability of the current PPP regulatory framework. At the same time, the above numbers demonstrate that certain sectors (e.g., transport infrastructure, energy, healthcare or defence) that could benefit from PPP, are of little interest to private investors. This will need to be changed, including by implementing improvements outlined below.

What is in the Pipeline?

PPP is showing signs of early recovery in Ukraine. The Government and international donors are making efforts to revitalise PPPs, including through creation of task forces at the authorities and supporting development of PPP policy and legal framework.

For example, the task force (PPP Management Office) was created at the Ministry of Infrastructure of Ukraine with the support of international donors. The role of the task force is to revitalise PPPs in Ukraine's infrastructure sector and its various subsectors. The task is basically twofold: to improve the legal framework and to launch and implement PPP pilot projects. The focus is on the improvement of the policy framework for PPPs/concessions and the Law of Ukraine *On Concessions*. Reportedly, this initiative is being funded by the EBRD. Following modernisation of the policy and regulatory framework, there are three concession-based pilot projects on the agenda. They are concessions of: State Enterprise Stevedoring Company Olvia, State Enterprise Kherson Sea Trade Port and railways/ferry complex of State Enterprise Sea Trade Port Chornomorsk. The success of these pilot projects would be a signal for private investors.

Improvements Needed

The PPP legal landscape has been notably improved in Ukraine in May 2016, when the new legislation was passed providing, for example, for possibility of foreign arbitration under PPP contracts, use of SPVs by private investors, step-in rights by creditors, streamlining the process for assessment of PPP opportunities and selection of a private investor, etc. Nonetheless, certain issues remain unresolved. Among a number of actions to tackle those issues are the following:

— to design and implement a clearer PPP institutional and regulatory framework, strategies and projects, including to clearly set priority sectors for the implementation of PPP in Ukraine;

— to reinforce and sustain the institutional capacity of public entities for the implementation of PPP projects;

— to codify and/or clearly define the hierarchy of statutes regulating PPP and its various forms in different sectors;

— to provide additional public entity support to private investors through the implementation of various Government co-lending structures, sharing the cost of investments and issuing long-term guarantees, including by amending the current wording of the Budget Code to enable long-term commitments in connection with the PPP by the public entity;

— to improve and simplify the rules on access to land for private investors;

— to simplify permitting system for implementing PPP projects, including for subcontractors of private investors;

— to introduce clear step-in rules to improve bankability of PPP projects and allow financiers to secure cash flows by changing a private investor in case of the original private investor's default and without the need for a new tender;

— to grant currency controls and tax benefits for private investors to draw attention to Ukraine and add a cutting edge in the competition for capital;

— to streamline interaction between rules on supply of goods/services by a private investor to the public entity as a type of PPP state support measure with public procurement rules and newly-introduced rules on state aid;

— to extend the scope of the stabilisation clause to cover, in particular, adverse tax and capital controls legislative amendments; and

— to consider allowing foreign governing law for PPP contracts.

Conclusions

PPPs proved their viability in Ukraine regardless of the difficult environment. To boost the development of PPP projects in Ukraine further improvements are needed, including, among others, through designing and implementing a clearer PPP institutional and regulatory framework, strategies and projects.