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RF Law on Concessions and prospects for private-public partnership infrastructure projects in Russia

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Law on Concession Agreements



- ◆ July 21, 2005: RF State Duma adopts long-awaited RF Law No. 115-FZ on Concession Agreements (the “**Concession Law**”).
- ◆ Intended to create a framework for private-sector investment in and operation of Russian public utilities and infrastructure.
- ◆ The Concession Law applies to all forms of public sector concession arrangements.

Need for Infrastructure Reform – the Significance of Concessions



- ◆ Infrastructure is in catastrophic state due to minimal financing and capital investment in the 1980s-2000s.
- ◆ State to abandon monopoly and reduce its role as the provider of funding for infrastructure.
- ◆ Concessions: an alternative to privatization – investors get opportunity to earn profit from the use of property remaining in state hands.
- ◆ Increases competition in the infrastructure sector.

Need for Infrastructure Reform – the Significance of Concessions (continued)



- ◆ Initial assessment of Concession Law in 2006 OECD Investment Policy Review: Enhancing Policy Transparency.
- ◆ The Concession Law called “the first step to using PPP in Russia”.
- ◆ The success of PPP projects depends on the ability of state (1) to offer appropriate projects, (2) to hold competitive tenders, and (3) to provide adequate regulation.

Types of Concessions



- ◆ Concession Law authorizes RF Government to adopt model concession agreements. The RF Ministry of Economic Development and Trade started this process in November 2005, inviting the local and international infrastructure community to attend a roundtable meeting and comment on its model agreements.
- ◆ 12 of 14 model concession agreements adopted, however, both Concession Law and model concession agreements have serious defects impeding PPP projects.

Concession Solutions Law: Issues and



- ◆ International practice demonstrates 60-80% of infrastructure project finance is debt finance - bonds or loans from financial institutions.
- ◆ Projects with structures satisfactory to Lenders attract funds and are successful. Unfortunately, projects that cannot be financed do not go forward.

Concession Law: Issues and Solutions (continued)



- ◆ Force Majeure

The Concession Agreements need detailed, well-drafted force majeure provisions, which expressly preclude the concession authority citing its own actions (or the actions of other state authorities) as events of force majeure.

- ◆ Obligations of the Concession Authority

The obligations of the concession authority must be substantially expanded. Where the state determines tariffs, the concession authority's undertakings should include covenants to assure that the revenue stream generated is sufficient for the concessionaire to make required debt service payments, cover other project costs, and earn a reasonable profit.

Concession Law: Issues and Solutions (continued)



- ◆ Notice of Default and Right to Cure

The concession agreement must expressly provide that the concession authority must give the concessionaire and the lenders reasonable written notice of default with grace period sufficient to cure, prior to early termination of the agreement.

Concession Law: Issues and Solutions (continued)



- ◆ Termination Payment of Fair Market Value for Assets and Improvements

The Law must specify grounds for early termination of the concession agreement to protect the financial interests of the concessionaire and the lenders.

The Agreement must provide clear rights for the concessionaire/lender in the event of early termination on any grounds (including the concessionaire's own default) to receive immediate payment from the concession authority of the full, fair market value of all assets constructed by the concessionaire.

- ◆ Tax Gross-Up

Any payments at termination should be adjusted upwards to account for any taxation on the receipt thereof by the concessionaire.

Concession Law: Issues and Solutions (continued)



- ◆ Assignment/Pledge of Concession Agreement as Security for the Lenders

The Concession Agreement must specifically permit assignment/pledge of the Concession Agreement as well as the infrastructure objects built by the concessionaire to the lenders as security.

- ◆ Dispute Resolution – Ability to Arbitrate

The Concession Agreement must permit dispute resolution by international arbitration in accordance with the RF Law on Arbitral Tribunals and international law including the 1958 NY Convention.

Concession Law Issues and Solutions (continued)



- ◆ Recognition of Entry into Direct Agreement

The agreement should also expressly recognise that the concession authority may entered into a separate, direct support agreement with the concessionaire's Lenders.

- ◆ Where Necessary, Provision of State Guarantee

The agreement and the Concession Law should expressly recognise the need for state guarantees to the concessionaire and the Lenders in respect of termination payments and other obligations of the concession authority.

Practical Implementation of Concession Law: WHSD



- ◆ At present the only concession project in Russia is the **Western High-Speed Diameter** (WHSD) toll road in St Petersburg.
- ◆ WHSD will be a toll road in St. Petersburg to improve transportation in the center and to link the road network of St. Petersburg to highway E 18 “Skandinavia” and main federal roads (M10, M11, M20 and the Ring Road).
- ◆ Russian Federation via Federal Road Agency and St. Petersburg Government will act together as the Concession Authority.
- ◆ The total length is 46.6 km, including various elevated sections, 5 major bridges and 14 interchanges with existing and projected roads.
- ◆ The cost of designing and constructing WHSD has been officially estimated at approximately 80-85 billion rubles (USD 3.0 - 3.2 billion equivalent).
- ◆ The Russian Federation Investment Fund and St. Petersburg Government will invest approximately 57,37 billion rubles.

Practical Implementation of Concession Law: WHSD (continued)



- ◆ March 16, 2007 the Tender Evaluation Committee announced pre-qualification of four consortia to participate in the tender for the concession agreement, however, the process was not objective and transparent.
- ◆ The winner of the tender will be announced on October 10, 2007 (unless extended).
- ◆ WHSD is to be completed in 2010.
- ◆ The concession agreement will have a term of 30 years.
- ◆ Other toll road projects are expected soon using the concession agreement structure: Moscow – St Petersburg high-speed toll road and the Orlovsky Tunnel in St. Petersburg and Abinsk-Kabardinka high-speed toll road in Krasnodarsky Krai.



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