Insights and Commentary from Dentons

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Concessions in Russia: further legislative developments

The Russian Federal Law on Concession Agreements was adopted in Russia in summer 2005. Since then nine sets of amendments have been made, most of which were substantial and had considerable legal significance. Despite this, the concession structure remains unpopular and is not widely used in practice. The 10th amendment package has made another attempt to change the situation and make it more flexible and attractive to investors.

Federal Law № 38-FZ on Amendments to the Federal Law on Concession Agreements and article 16 of the Federal Law on State Company Russian Highways, and Amendments to Certain Legal Acts of the Russian Federation (“Law No 38-FZ”) was adopted on April 25, 2012. The primary purpose of Law № 38-FZ is to establish a special legal procedure governing concession agreements with respect to roads or sections thereof, protective and artificial road structures, industrial facilities used in capital repairs, repairs or maintenance of roads, facilities for collecting payment and road services (“Highway Infrastructure Facilities”). At the same time, Law № 38-FZ makes amendments to certain general provisions of Federal Law № 115-FZ on Concession Agreements (“Law on Concession Agreements”), applicable to other facilities.

Below we provide a brief summary of the key changes in Law № 38-FZ:

- If a concession agreement is concluded with respect to Highway Infrastructure Facilities, then at the time the agreement is concluded, the facilities may belong not only to the Russian Federation, members (constituent subjects) of the Russian Federation, municipalities, or State Company Russian Highways, which are expressly recognized as public partner entities in the Law on Concession Agreements, but also to state or municipal enterprises.

by Karina Chichkanova and Olga Lovtsov, Salans St. Petersburg
and/or state budget-funded enterprises holding the facilities under operational management or economic management. These enterprises are now able to act for the public partner in undertakings under a concession agreement, and to exercise certain powers of the public partner along with the public partner itself (i.e., the Russian Federation, Russian Federation members, municipalities, State Company Russian Highways). In this connection, additional rules are provided with respect to termination of the rights of state budget-funded enterprises to Highway Infrastructure Facilities and transfer of Highway Infrastructure Facilities to the concessionaire.

- The Law on Concession Agreements provides that the public partner may undertake to pay a part of the cost of building (constructing) and/or renovating and operating the concession properties, and may provide the concessionaire with state or municipal guarantees. In addition to these general provisions, it is provided that a concession agreement with respect to Highway Infrastructure Facilities may also provide for the public partner to make a certain payment to the concessionaire, provided that (1) the public partner’s payment under the concession agreement must be determined in the criteria of the tender for the right to conclude the agreement, and (2) a concessionaire receiving such payment from the public partner shall not have the right to collect payments from other parties for the creation, renovation, or operation of the Highway Infrastructure Facilities. This means that it effectively provides for the conclusion of concession agreements in the form of “life-cycle contracts”. This form should be desirable for building and operating “free” (public) roads. The public partner’s failure to perform the obligation to pay under the concession agreement constitutes a material breach of agreement, which may result in termination of the agreement by court decision.

- It is established that if the concessionaire raises funds from creditors for the performance of its obligations under a concession agreement with respect to Highway Infrastructure Facilities, the rights of the concessionaire under the agreement may be used to secure the performance of the concessionaire’s obligations before creditors in the manner and on the terms stated in the concession agreement.
Moreover, in this case it is possible to conclude a trilateral agreement: among the public partner, the concessionaire, and the pool of creditors, which, inter alia, can resolve issues relating to liability for non-performance or improper performance by the concessionaire of its obligations under the concession agreement.\(^1\)

For the first time it becomes possible to replace the concessionaire without holding a new tender, if (a) the concessionaire’s non-performance or improper performance of its obligations resulted in a material breach of the concession agreement and/or (b) caused death or harm to individuals, or threatens to do so; a resolution of the RF Government is required upon either condition for replacement without a tender arising, which shall be issued with consideration for the opinion of creditors.

- When replacing parties to a concession agreement it is not permitted to amend the conditions of the agreement determining the technical characteristics of the concession property.

- It is clarified that the term of the concession agreement is established with consideration for the performance of the public partner’s obligations, as well as the concessionaire’s.

- The list of dispositive conditions that may be included in the concession agreement now includes (a) the size, conditions, procedure, and terms of payment of penalties for breach of the concession agreement; and (b) the procedure for determining the amount of reimbursement of the parties’ expenses in the event of early termination of the concession agreement in the cases provided in the Law on Concession Agreements.

- A rather important amendment is that when concluding concession agreements for Highway Infrastructure Facilities in federal ownership, the model agreements provided in the Law on Concession Agreements do not have to be used.

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\(^1\) However, at the same time, Law № 38-FZ excludes the ability previously provided in the Law on Concession Agreements for concessionaires to use a similar mechanism in agreements with respect to public utilities systems and infrastructure.
The Law on Concession Agreements now provides that the conditions of a concession agreement based on the resolution on conclusion of the agreement and the concessionaire’s bid in accordance with the tender criteria may be amended by agreement of the parties on the basis of a resolution of the public partner.

A new ground for termination of a concession agreement has been introduced. The agreement may now provide for early termination by decision of the public partner, if the concessionaire’s non-performance or improper performance has resulted in death or harm to individuals, or created a risk of such harm.

Provisions have been added to the Law on Concession Agreements establishing criteria for tenders for the conclusion of a concession agreement. As criteria, the tender may establish obligations to be undertaken by the concessionaire if the expected income from use/operation of the concession property is not received; additional expenses arise during the creation and/or renovation of the concession property, or use/operation of the concession property. At the same time, if the concession agreement provides that the public partner must pay a part of the cost of creating and/or renovating the concession property, use/operation of the concession property, or make payments under the concession agreement, the size of such expenses and payments of the public partner must be established in the tender criteria.

New provisions have been added to the Law on Concession Agreements governing the procedure for conclusion of concession agreements after a tender. Law № 38-FZ establishes that after the members of the tender commission have signed the report on the results of the tender, the authorized public partner shall, on the basis of a resolution on the conclusion of the concession agreement, conduct negotiations in the form of joint meetings with the winner, or another party with whom it was decided to conclude the concession agreement, to discuss the conditions of the concession agreement.
and potential amendments upon the results of negotiations.\footnote{These amendments effectively fix the existing practice.} Conditions that were tender criteria and/or were determined on the basis of the bid by the party chosen to conclude the concession agreement cannot be amended in negotiations. The term and procedures for the negotiations shall be set out in the tender documentation. The tender documentation must state which conditions of the concession agreement are not negotiable, and/or conditions which may be amended in accordance with the procedure provided in the tender documentation. Notice of the conclusion of the concession agreement shall be published.

As we can see, these amendments are important, relevant, and intended to improve the concession structure – to make it more attractive to private partners and financing organizations. However, unfortunately the amendments are the result of lobbying and the most “progressive” amendments concern mainly a narrow range of subjects – Highway Infrastructure Facilities. Furthermore, a significant number of legal issues impeding the use of concessions in Russia (such as, limited arbitration clauses, insufficient tariff regulation, short-term budget planning, etc.) remain unresolved. Therefore, regrettably, it is unlikely there will be any boom in concession PPPs following the adoption of these amendments.