



Russia

This section is devoted to Russia, the country where the 2007 EBRD Annual Meeting of Governors is taking place. This is also the vast country where the EBRD plans to have 41 per cent of its annual commitments by 2010. The section offers a variety of views and topics authored by practising lawyers, Russian government officials and academics.

In the first article, Yulia Zvorykina, Director of the Investment Department at the Russian Ministry of Transport, presents the Russian experience with PPPs, bridging harmoniously the two focus areas of this issue of *Law in transition*. Jay Allen of the EBRD examines the insolvency system

in Russia, while Gian Piero Cigna and Elena Sulima of the EBRD dedicate their article to the quality of Russian capital markets legislation.

The Deputy Chief of Staff of the Russian Government, Mikhail Kopeikin, offers his comments on the status of the economic and legal situation in Russia as viewed from the 'White House'. Finally, Vladimir Peysikov, Provost of the Russian Academy of Justice, details the experience his institution has had with the training of judges, an area of critical importance for the development of the rule of law in the country.

A photograph showing three women gathered around a wooden table in what appears to be a library or office. The woman on the left is wearing a grey blazer and glasses, looking down at an open book. The woman in the middle is wearing a red and white striped shirt and jeans, also looking at the book. The woman on the right is wearing a black top and has her hand to her chin, looking towards the book. The background shows bookshelves filled with books.

**Public-private partnerships
in the transport sector:
a Russian view**



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The Russian transport sector has chosen the concession model as the main model of public-private partnerships (PPPs). If the public and private sectors are able to change their patterns of thinking and of doing business together, PPPs could prove to be a key element in the development of the Russian transport sector.

Fundamental changes to different sectors of the economy are being made in most countries and concern sectors which, until now, have invariably been under state ownership and management.

Enterprises working in these areas, mostly monopolies, cannot be privatised because of their strategic, public, social and economic importance. On the other hand, state budgets do not possess sufficient resources for adequate levels of funding. In such cases, the state may, on a medium- to long-term basis, grant to privately owned companies the right to operate gas, energy, transport, water supply and sewer systems, although it would retain the right to regulate them and control their activities.

These contradictions create the need to consider attracting private investment to sectors of the economy that have always been thought of as the prerogative of the state. Some countries have used PPPs in order to resolve such contradictions.

Nowadays PPPs are being used in more than 100 countries worldwide. PPPs have become the main tool used by states to address economic and social service resource issues and budget

limitations. This is due to the fact that private sector management is considered to be more effective than that of the state sector.

PPPs have been rediscovered in contemporary Russia. They could not be used in the former Soviet Union for obvious reasons. However, in Russia during the 1920s – the New Economic Policy period – PPPs in the form of concessions were a very popular and effective tool. Nowadays the public and private sectors need to relearn how to use this tool.

During the final stages of its transition to a market-based economy, Russia has been able to use PPPs as an institutional and organisational alliance between the public and private sectors. This type of partnership enables the state to implement socially important projects in a wide spectrum of activities ranging from the development of strategic branches of industry to the advancement of social services. As a rule, each PPP is established for a specific time-scale and a specific project. Partnerships or alliances are considered to be temporary, because they end after the project in question has been completed.

This article will focus on current challenges in the transport sector. In Russia, the level of financing and infrastructure for this sector does not meet the country's macroeconomic and social needs. The level of investment in transport infrastructure is less than 2 per cent of gross domestic product (GDP) even though in most countries it is at least 4 per cent of GDP or higher.

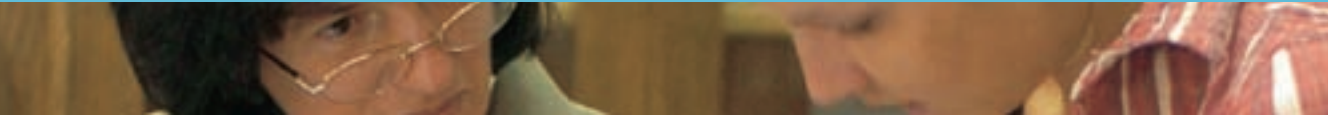
PPPs in Russian transport

Experts estimate that the potential volume of private investment in transport infrastructure in Russia is €12-15 billion per year. Private sector investors are interested in financing transport infrastructure but they are also keen for the government to set out clear goals in its long-term strategic plans.

In recent years the state has established several preconditions for increasing the use of PPPs. These preconditions, listed below, have largely been met:

- increased cooperation between state and private business, as well as consultations about the use of PPPs

From a legal point of view, one particularity of the Russian concessions law is that the agreement is construed as a private law contract.



- passing of the federal *Law on Concession Agreements*¹
- transition from one to three-year plans as part of budget reform
- adoption of the *Regulation on Investment Funds*
- adoption of standard concession agreements
- establishment of special economic zones and industrial and technological parks.

Concession agreements are regulated by the federal *Law on Concession Agreements*. The law governs the relationships that arise in the planning, conclusion, performance and cancellation of concession agreements. It also establishes the rights and interests of the parties to an agreement.

Developing concession agreements in Russia

A decision was made to use the concession model of PPPs in Russia. Concession agreements include elements of different types of agreements which have been approved by federal law. They focus on immovable property, the creation and/or reconstruction of which is stated in the agreement. The following types of projects can be the subject of concession agreements:

- motorways and transport infrastructure
- railway and pipeline transport
- sea and river ports
- sea vessels, river vessels and mixed-use vessels
- airport facilities

- unified air traffic management facilities
- underground and other types of public transport
- medical, social and welfare projects.

Land cannot be the subject of a concession agreement. The period of an agreement's validity is established by the agreement itself according to the date of the construction and/or reconstruction of the subject matter of the concession agreement, the investment volume and pay-back period and other obligations of the concessionaire under the agreement.

The concession payment should be specified in the contract. It can be set in the form of definite payments, product share, income from the activity which is the subject of the agreement or a transfer of the property belonging to the concessionaire. The functions of government authorities during the preparation, conclusion and execution of the agreement are established, as are the rights and duties of the parties including the concessionaire's duties toward third parties. According to the law, the agreement is entered into on the basis of the results of an open competition.

From an economic point of view, concessions allow the public sector to reduce state expenditure and attract external investment and management resources into areas which have high expenditure and are not very profitable. The use of concessions stimulates competition and helps to develop the investment market, which needs more private investment. From a legal point of view, one particularity of the Russian concessions law is that the agreement

is construed as a private law contract, even though in other countries other models are also used. The legislators adopted this approach as a matter of principle.

There are several reasons why the concession model of PPPs was chosen. Concessions are the most highly developed and complex form of partnership. Unlike most other types of contracts, concessions are long term and this allows both parties to carry out strategic planning.

With concessions, the private sector partner is given administrative and management flexibility. This decision-making freedom distinguishes this type of PPP from other models such as joint ventures and work contracts. In addition, the state retains the ability to exert pressure on the concessionaire if it breaches the terms of the contract or if the public interest has to be protected. The state transfers ownership and use of the assets to the concessionaire for the term of the contract. However, the public partner is responsible for monitoring the performance of the private partner and at the end of the contract ownership of the assets reverts to the public partner.

The *Law on Concession Agreements* forbids the pledging of assets that are the subject of a concession agreement and of the rights of the concessionaires selected by open competition. Most assets that are the subject of a concession agreement naturally remain in the public sector because they are for the public's use. Concession agreements may not be used to transfer assets that should remain state property, such as motorways, into private ownership.

The challenges of establishing concessions in the transport sector

The passage of the *Law on Concession Agreements* cleared up many of the difficulties attracting investment into transport infrastructure, but some issues still remain. It is important to create special-purpose funds for developing infrastructure or to develop a sector-specific concessions law that will specify which transport projects will be the subject of PPPs and concessions.

Limited development of and serious restrictions in domestic financial markets, in particular where long-term finance is concerned, cause problems with raising investment funds. One possible source of investment could be pension funds guaranteed by the state.

Another serious problem is that land legislation is not very advanced. In particular, the most difficult issues in the field of transport are the absence of specific rules governing the reservation and seizure of land, and issues related to the tenure of land upon which transport and infrastructure stands.

Improvements to the legislative system are being made with a view to facilitating the granting of concession agreements. Federal authorities must provide consultancy support at the regional and municipal levels. Consultants could help with supporting and monitoring concession projects, promoting best practices, retraining state and municipal employees and establishing centres of competence.

It is necessary to provide consultancy support to executive authorities at all levels during the preparation of concession agreements, co-financing for agreement implementation and budget guarantees. This should be done through the Russian Investment Fund and targeted budget programmes.

The Ministry of Transport has created an advisory council on PPP development in order to assist with entering into PPPs. The ministry has signed an agreement with the Russian Vneshekonombank whereby the bank acts as an investment adviser with respect to large infrastructure-based PPP projects.

and engineering infrastructure, including bridges, overpasses, tunnels, parking, checkpoints and toll booths for trucks.

The Ministry of Transport has developed and forwarded to the Ministry of Economic Development and Trade draft standard concession agreements based on Resolution 319 in the following areas:

- airports, buildings and/or facilities intended for take-off, landing, taxiing and parking of aircraft and industrial and engineering airport infrastructure
- sea vessels, river vessels, mixed-use river/sea vessels, ice-breakers, hydrographic and research vessels, ferries and floating and dry docks
- sea and river ports, hydraulic engineering constructions in ports, industrial and engineering infrastructures in ports
- railway transport facilities
- underground and public transport
- water engineering facilities.

At this stage the draft standard concession agreements mentioned above have been reviewed and revised by the Ministry of Economic Development and Trade and have been sent to the federal government.

Federal authorities must provide consultancy support at the regional and municipal levels. Consultants could help with supporting and monitoring concession projects, promoting best practices, retraining state and municipal employees and establishing centres of competence.

Legislation pertaining to state obligations, including the Budget Code and the Civil Code, should be amended. In order for concessions to be effective the legislation should be simplified, especially the sections that deal with permits, licences and so forth. Legislation on book-keeping and real estate registration should be harmonised with new laws.

The transport sector needs qualified employees and managers who are capable of undertaking large infrastructure projects. A special education programme was organised by the Transport Engineering Institute of Moscow to provide the Ministry of Transport with specialists in the field of transport concessions.

Russian Government Resolution 319 of 27 May 2006 approved standard concession agreements for motorways

The Russian Investment Fund (Investfund) was created in 2005 to provide state co-financing for large projects of federal importance. The use of Investfund resources is set to become the most important instrument of budget support for private business investment projects.²

Investfund is a PPP instrument that aims to make it easier for business to finance strategically important long-term projects which have low levels of return.

The availability of Investfund resources will expand the opportunities for businesses to invest in projects which cost no less than 5 billion roubles through direct co-financing. Up to 75 per cent of the cost can be provided by the federal budget and there will also be state guarantees.

State support will be provided in three ways:

- direct co-financing of the projects
- equity participation in the company managing the projects
- state guarantees, which will be different from current Ministry of Finance guarantees.³

Investfund plans to provide transitional financing, in the form of a long-term investment agreement between state and private investors. The possibility of sharing commercial risks also exists.

We will now turn from discussing ways to develop PPPs in Russia to individual investment projects and their particular features.

PPP projects in the Russian transport sector

The construction of a toll road, the Western High-Speed Diameter (WHD), in St Petersburg is a very good example of a concession-style project. This project has gone beyond having merely a regional purpose and is of great importance for the development and increased competitiveness of the entire Russian transport system. The WHD connects the large seaport of St Petersburg to a network of federal motorways and the European system of international motorways.

concession projects and basic liability for Russia's commitments under road concession projects lie with Rosavtodor, the federal road agency.

However, only the basic requirements for such documentation, membership of the tender commission and the terms for concluding the concession agreement were approved. The procedure for the transfer of federal government powers listed above to Rosavtodor was not stipulated.

A comprehensive list of areas of Rosavtodor's authority has not yet been determined. It is important, however, that the agency be given the following areas of authority:

- to decide which land to requisition to let to concessionaires
- to regulate and approve the tariff level

A PPP is a compromise between the public and private sectors. Taking into account the fact that the state budget is only approved for one year at a time, the state cannot guarantee that payments will be made in second or subsequent years of a project.

We should note that, during the first stage of PPP development in a country, the state must take risks in order to reassure private partners. In time and after a certain level of experience has been reached, risks may be shared more equitably between public and private partners. If this does not happen, the partnership mechanism will lose its meaning.

A PPP is a compromise between the public and private sectors. Taking into account the fact that the state budget is only approved for one year, the state cannot guarantee that payments will be made in second or subsequent years of a project. That is why the shift to a three-year budget plan is an important step in concession planning and creates a certain level of stability in public-private relations.

In addition, the southern section of the WHD directly adjoins the line of the ring road around St Petersburg and connects the seaport with 13 federal and territorial roads from St Petersburg in the direction of Belarus, Estonia, Finland, other parts of Russia and Ukraine.

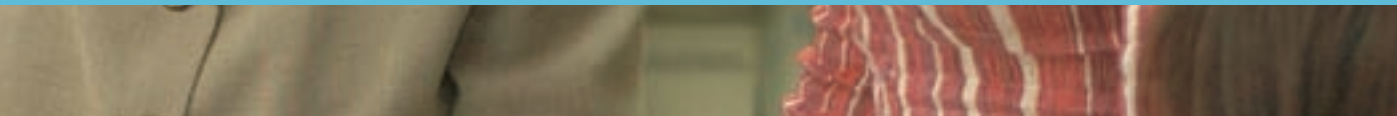
On the basis of Russian Government Order 1494-r of 31 October 2006, draft documentation for competitive tenders has been prepared. It has been reviewed by the Ministry of Transport and forwarded to the Ministries of Finance and Economic Development and Trade.

The federal government has approved the guidelines for carrying out competitive tenders for the WHD concession. The guidelines stipulate that the functions of the concedent on behalf of the state with regard to road

- to grant minimum income guarantees.

A market study showed that potential participants would definitely refuse to take part in concession tenders if there were not minimum income guarantees for pilot concession projects.

The tender documentation for concession agreements to construct high-speed motorways is now ready and has been circulated for review and revision. A motorway will be built on kilometres 15 to 58 of the Moscow to St Petersburg road. A new exit from the federal M-1 Moscow-Minsk motorway (the Odintsovo bypass) is also being planned.



The tender documentation was prepared with input from the draft concession agreement developed by the Freshfields Bruckhaus Deringer legal team, taking into account recommendations from the EBRD, World Bank, Ernst & Young, Citigroup and Macquarie Bank as well as investment market requirements and expectations.

Projects to design documentation for the investment project for the construction of the Krasnodar-Abinsk-Kabardinka toll motorway and for the construction and subsequent operation on a toll basis of the M-4 Don motorway from Moscow

The M-4 Don from Moscow through Voronezh, Rostov-on-Don and Krasnodar to Novorossisk project on kilometres 21 to 117 and 330 to 464 will create a 233 kilometre network of toll motorways. The project will entail the construction or reconstruction of 128 kilometres of road. The five pre-existing sections of toll motorways on this part of the road will be subsumed into this project.

The project will be carried out in two stages. During the first stage the design and estimate documentation will be developed, preparatory work will start on construction sites and a competition

- the share of domestic transport companies in the Russian international transit services market will increase to 50 per cent
- the tonnage of the merchant marine fleet in Russian waters which is registered in the national register and controlled by Russia will increase to 56 per cent.

The development and approval of the Development of Export Transport Services portion of the modernisation project has allowed us to take the first step towards creating effective tools to tackle existing problems. This, in turn,

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to Novorossisk were approved on 21 November 2006 by the government commission for investment projects and are described below.

The civil engineering design of the Krasnodar-Abinsk-Kabardinka toll motorway has been approved by the commission for investment projects. It provides for the construction of a 147 kilometre four-lane toll motorway with seven tunnels and 76 bridges. The project will take place in two stages.

The first stage will comprise the development of the technical, design and estimate documentation and the preparation of the construction sites. The second stage will be the construction of the road. It is estimated that 50 per cent of the funding will come from the federal government, 24 per cent from the Krasnodar territory and 26 per cent from the private sector partner. The commission has allocated 1.2 billion roubles from Investfund for the preparation of the design and budget documentation during the first stage of the project.

will be held to attract private investors. The second stage of the project, which will begin in April 2008 and will last for approximately two years, will entail construction of new sections and reconstruction of the remaining sections of the road.

Investfund will allocate 167 million roubles for the first-stage design and estimate documentation. During the second stage, the construction of the road, it is estimated that not less than 50 per cent of the costs will be covered by a private sector investor.

The Modernisation of Russia's Transport System (2002-10) project is forecast to achieve the following results by 2010:

- transport services volume will double to US\$ 13.1 billion
- the growth of transit traffic will be 25-30 million tonnes
- numbers of airport transit passengers will increase by five to seven times, to 3 to 4 million passengers per year

has allowed us to depart from standard schemes to increase the proportional output of different types of transport infrastructure and to start using complex tools to enable infrastructure projects, including PPPs.

Examples of projects within the export transport portion of the project include the construction of port complexes in Murmansk and Novorossisk. These investment projects have been approved and private sector companies have competed in open tenders.

Projects related to the development of complex transport infrastructure include the construction of a versatile reloading complex, in the Ust-Luga seaport and the development of transport infrastructure in the port of Taman, including a dry cargo area. These projects have been positively received by the Ministry of Transport's Advisory Council on PPPs and have been recommended for consideration by the Investment Commission of the Ministry of Economic Development and Trade.

PPP projects have also been developed for building access roads to the Elginskoye and Elegestskoye coal deposits in the Tyva Republic and the development of port railway stations.

Conclusion

It is estimated that the completion of the complex transport infrastructure development projects mentioned above will increase Russian gross domestic product by 0.2 to 0.3 per cent. Transport infrastructure concessions could reach an annual investment volume of up to US\$ 2-3 billion by 2010.

In summary, I would once again note that in Russia today, the implementation of large projects for the construction of motorways, railways, ports and airports is only possible through the attraction of domestic and international capital on the basis of PPPs. Given current budgetary limitations, the adoption of the widespread international practice of using PPPs is the only way forward.

We must not allow narrow-minded perceptions, that private sector companies are efficient and the public sector companies are not, to persist. It is extremely important to dispel illusions about easy opportunities for private business in certain sectors to acquire a natural monopoly by using loopholes in relevant legislation, and then to establish their own rules of the game discriminating against other players.

The future of public-private partnerships in Russia depends on the success of large infrastructure projects. Both the public and private sectors need to prove that they are reliable partners that are capable of meaningful dialogue and mutual cooperation.

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Notes

- ¹ Law on Concession Agreements, Number 115-FZ, 21 July 2005.
- ² Pursuant to Russian Government Resolution 694 of 23 November 2005.
- ³ They will not have to be included in the annual budget and will not be terminated at the end of each year.

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