

Client Update

PPP Projects with Full Compensation of Investor Costs

The *Arbitrazh* Court of Moscow and the Ninth *Arbitrazh* Appellate Court considered a precedent case for the private-public partnership (“PPP”) infrastructure projects market relating to potential compensation from the budget of all investor costs incurred in the project.¹ The findings of the courts have revealed gaps in the relevant legislation and inconsistencies in court practice that threaten the implementation of PPP projects that adopt similar structures and have prompted the government to commence preparing amendments to the legislation.

FACTS OF THE CASE

The Federal Antimonopoly Service of Russia (the “FAS”) issued a compliance order for the cancellation of a tender for a road construction concession in Bashkortostan due to, among other things, the fact that the tender documentation provided for the compensation of all the concession holder’s costs for the construction and operation of the road to be covered entirely by the regional budget. Bashkirdorstroy Company as the tender winner and the Bashkortostan State Transport Committee challenged the FAS compliance order for the cancellation of the tender in court.

STATUTORY REGULATION

Since 2012, the Law on Concession Agreements² provides for a “concession provider’s payment” in addition to possible reimbursement by the concession provider of a portion of the costs for construction, redevelopment and operation of the facility under the concession agreement (known as a “capital grant”). The absence of a legal definition of the concession provider’s payment or a detailed regulation governing such payment has left many legal issues (e.g., procedure and timing of the payment, its relation to the capital grant) unresolved, and may cause disputes in practice. The case analyzed in this update clearly demonstrates this problem.

¹ See Federal Law No. 44-FZ on the Contract System for the Procurement of Goods, Work and Services for State and Municipal Needs dated April 5, 2013.

² See Federal Law No. 115-FZ on Concession Agreements dated July 21, 2005.

Further, the law does not expressly state whether the investor is required to have experience in financing of the execution of the concession agreement or to provide a bank guarantee as a security for the execution of such agreement.

POSITIONS OF COURTS

The *Arbitrazh* Court of Moscow³ dismissed the application for a declaration that the FAS compliance order was invalid. The Ninth *Arbitrazh* Appellate Court⁴ vacated the judgment and granted the claim, thus recognizing the possibility of obtaining full compensation of investor costs for the construction of a concession project from the budget in the course of implementing PPP projects.⁵ We set forth below a table outlining the positions of the *Arbitrazh* Court of Moscow (“ACM”) and the Ninth *Arbitrazh* Appellate Court (“9 AAC”) on the principal issues of the case.

Issue	ACM Position	9 AAC Position
Financing of concession facility from the budget in full	<ul style="list-style-type: none"> Not permitted under the Law on Concessions. When a concession agreement is executed, procurement must be carried out pursuant to the Law on the Contract System. 	<ul style="list-style-type: none"> Possible, but only through the use of different financing instruments: the capital grant and the concession provider’s payment. The capital grant and the concession provider’s payment have different legal implications: the Law on Concessions does not permit full coverage of a concession holder’s costs for the development of the facility by a capital grant alone; however, the concession provider’s payment may be applied to compensate for the remaining portion of the costs.

³ See Judgment of the *Arbitrazh* Court of Moscow dated June 8, 2017 in Case No. A40-23141/17.

⁴ See Ruling of the Ninth *Arbitrazh* Appellate Court dated September 4, 2017 in Case No. A40-23141/17.

⁵ The Ruling of the Ninth *Arbitrazh* Appellate Court may be appealed to the cassation court.

Issue	ACM Position	9 AAC Position
Financing experience	<ul style="list-style-type: none"> The full compensation of private investors' costs is not permitted in connection with other PPP structures (investment agreements, PPP agreements, etc.). Could not be required from a concession holder as it unreasonably limits the range of potential bidders. 	<ul style="list-style-type: none"> Unlike the capital grant, the concession provider's payment is not made for a particular purpose and may be applied for purposes other than the compensation of the costs of developing the facility. May be established as a qualification requirement along with the requirement for construction experience, and it is intended to identify, at an early stage, any risk of the concession holder's failing to perform its obligations under the agreement.
Bank guarantee as a security for the execution of the agreement	<ul style="list-style-type: none"> This is contrary to the Law on Concessions, which provides for earnest money as a security for the execution of the agreement. 	<ul style="list-style-type: none"> The Law on Concessions does not prohibit the use of other tools in addition to earnest money to secure the execution of the agreement. The use of bank guarantees is less burdensome because when earnest money is paid, the bidder's funds are held permanently by the tender organizer.

PROPOSED STATUTORY REGULATION

The government decided to reform the current regulatory framework to minimize the risk of contesting PPP projects that provide for full coverage of investor costs out of their respective budgets.

FAS has prepared a draft law that provides for the full compensation of investor costs by the concession provider only upon the completion of construction and commissioning of the facility, but in any case not earlier than the fifth anniversary after the date of execution of the concession agreement; however, this rule will not apply to existing concessions.

Therefore, when structuring PPP projects that contemplate the compensation of investor costs from the budget, the parties should ensure that their agreement clearly states the purpose of each payment made by the concession provider to the concession holder, keeping in mind the distinction enumerated by the courts between capital grant and concession provider payments.

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Please do not hesitate to contact us with any questions.

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