

Public-Private Partnerships: Are They the Answer to Russia's Vast Infrastructure Needs?

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RAPID REPLACEMENT and modernization of aging, decrepit and in some cases, non-existent infrastructure is one of Russia's most critical and pressing needs as it faces the challenge of becoming a major economic power in a globalized world. Indeed, its ability to sustain the rapid economic growth of recent years and to build the foundation for future economic development will depend on its ability to implement major infrastructure projects rapidly and successfully in all key sectors (transport, power, heating, water, and waste treatment), and at all levels of government, municipal, regional and federal. This is clearly recognized within the Russian government, which has announced plans to spend \$1 trillion over the next ten years in Russian infrastructure, an unprecedented level of investment.

Many of these infrastructure investments will be carried out as public-private partnerships (PPPs) implemented under Russia's recently adopted (2005) "Law on Concessions." That Law, together with a series of model concession agreements for different types of infrastructure, established the basic legal framework and foundation for PPPs in Russia, supplemented in some cases by ancillary legislation adopted at lower governmental levels (e.g., the December 2006 "Law on the Participation of St. Petersburg in Public-Private Partnerships").

This legislation is meeting its first test as public tenders launched early

last year on a series of high profile PPP projects advance through the tender process. These include major road, rail, and air transport projects, such as the Western High Speed Diameter Motorway, Orlovski Tunnel, Nadzemnyi Express and Pulkovo Airport projects in St. Petersburg, and the Moscow-St. Petersburg and Moscow-Belarus Toll Roads.

Hurdles Ahead

Already, the experience of these first projects has led to significant proposed amendments to the Concession Law, but there are many hurdles ahead, as the projects present novel and difficult legal, financial, commercial, and political challenges. Market timing also has not favored Russia, as international markets have become increasingly roiled in a US-spawned sub-prime crisis that is far from running its course just as Russia seeks to roll-out a new and complex legal regime for PPP. The concurrence of political will, economic necessity and continuing strong domestic economic growth in Russia will ensure that these projects go forward, but the path will not be an easy one.

The first series of obstacles are practical impediments resulting from the sheer number and size of some of the Russian infrastructure projects and their funding requirements. The Russian Investment Fund, the source of capital grants for many PPP projects in the current pipeline, is well funded, but nevertheless entirely inadequate to

support all of the upcoming needs. Multilateral development banks and institutions can be expected to be sources of some of the long-term financing required for Russian infrastructure projects, but they cannot lend on a scale sufficient to serve as primary financing sources. Meanwhile, few Russian municipalities or regions have sufficiently strong credit ratings yet to support commercial financing independently on the needed terms and scales.

Infrastructure development also places enormous demands on key inputs, such as concrete, steel, as-

al PPP arrangements, requiring novel financing, cost-indexing and other risk allocation approaches in a still young and evolving legal framework not yet developed to accommodate them.

Finally, municipal infrastructure development through PPPs is also currently hampered by a number of legal constraints, which affect the bankability of projects in particular, making financing even harder to find. Such constraints run the gamut from unreasonable constraints on the ability to assign a concession agreement by way of security and overly restrictive tender procedures that limit the ability of bidders to propose changes to the draft concession agreement, whether it be in the course of the tender process or after the choice of the winning bidder. This increases the risk profile and reduces the bankability of projects. Unreasonably short statutory timeframes for negotiating and concluding the concession agreement and financing arrangements post-tender and the policy positions of the Russian government against international

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phalt and other construction materials, in a world market where demand already outstrips supply, leading to hyper-inflationary construction costs. This complicates the risk sharing balance in tradition-

arbitration for dispute resolution further constrain potential bidders, create uncertainty, and increase risk for lenders.

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proach to the legal and regulatory challenges mentioned above and has recently organized a series of round tables with the main participants in PPP projects to solicit feedback on key legislation such as the Concession Law and Investment Fund Regulations. Amendments addressing a number of the points above are currently under discussion in the Duma. These changes are expected to address some of the major shortcomings of the current legislative framework.

Accumulating the Know-how

Finding solutions to current legal and practical difficulties will not be sufficient to make PPP projects in Russia a reality, however, as an evolution in mentalities, perceptions, and know-how is also needed. PPP structures are legally, commercially, technically, and financially complex, and the know-how and experience needed to structure and implement these complex structures is almost non-existent within Russian regions and municipi-

palities. One proposed solution is the establishment of a dedicated federal PPP unit to coordinate PPP development at various Russian governmental levels, to standardize contracts, and to spread know-how, experience and best practices. This may help accelerate movement up the steep learning curve on PPP projects.

A vast store of know-how and experience is now becoming available to Russia's regions and municipalities via the world-class construction, engineering, and design companies cur-

rently bidding on the first Russian PPP projects. A mutually beneficial dialogue is under way, and as tender processes conclude over the next three to six months, the structuring of major PPP projects should allow solutions to be found to the most pressing issues. Russia can only gain from this process and the accumulated experience of the bidders, while the latter enter a market with huge potential for development, cementing what promises to be a long and mutually beneficial partnership.