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## Problems of Implementation of Public-Private Partnership in Russia

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**Abstract:**

*The article is devoted to investigate the problem of creation and improvement of country's infrastructure based on public-private partnership (further referred as PPP). As an object of research, authors look at public relations, that arise during the implementation of projects under the framework of the PPP law. The article considers the norms of the PPP law, as well as other laws, that regulate various aspects of agreements under PPP.*

*As a result of conducting research, authors conclude that first of all, the difference between PPP and other forms of collaboration between the state and private sector (e.g. rent, privatization) is in its private principles, legal mechanisms and forms of realization. Such relations require a well-developed normative-legal basis. Secondly, the main idea of the stated law is not the opportunity for the private party to purchase the object of the agreement, but a wide opportunity to develop an effective form of PPP. Given this, authors point out, that the law about PPP possesses a number of features, that need to be considered alongside with various branches of legal rights.*

*After the law was accepted, there was a need to reconsider a number of normative-legal acts of federal and regional significance in the aspect of public investment and budgetary guarantees. Given this, it is necessary to investigate the problems of public-private relations regulation in a complex manner, which will allow to define the key directions for the development of this institution.*

**Keywords:** *Public-private partnership (PPP), concession, public-private partnership agreement, property rights, financial provision, subsidizing, government guarantee, infrastructure bonds, collateral legal relations.*

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## **1. Introduction**

The term “public-private partnership” has emerged in the beginning of 1990. A notable, historical example of PPP development can be the German experience, where the projects based on PPP were used in cooperative construction projects. The first non-commercial construction societies were created on the basis of private investment in the middle of XIX century. As a result of collaboration between non-commercial companies with the public sector, the given companies were forced to impose certain regulations on their own business activity and profits distribution. The state in turn was granting these companies with tax shields and breaks.

In the 19<sup>th</sup> century Russia practiced the interaction between public and private capital collaboration in the form of concessions. Further development of PPP wasn't successful given the command economy of the USSR.

The first stage of modern PPP is seen in the period 1995-2009. During this period, the Federal Law had been passed as of 30.12.1995 № 225-FL “*About agreements in production*”, which has established the following form of agreement; agreement according to which Russia passes the exclusive rights to search, investigate, extract mineral raw material in designated areas to an investor. Investor in turn is obliged to carry out operations at his own expense and risk. During such an agreement, the parties settle down on the conditions and order production distribution. In theory it is common to believe that this law has given a start to the legal mechanism of PPP.

## **2. Theoretical, Empirical and Methodological Grounds of Research**

In Russia, research of concrete forms of PPP is a complicated process, as the following institution is relatively new for the Russian practices and there is no official register or data about PPP projects.

According to the Infrastructure Projects Director of Gazprombank P. Brusser there are three main forms of PPP in Russia; concession, agreement about public-private partnership in compliance with the regional legislation and privatization (entry into the state companies share). The instruments used can vary being the investment loan, infrastructure bonds and shares, as well as any form of structured project, including those, that are currently not used in Russia, yet successfully applied in the West.

Therefore, we can conclude, that while choosing the form of a project, the parties engaged in PPP need to analyse the project, as well as an optimal model for collaboration. PPP projects are not just a form of public-private partnership, as such an agreement implies a selection of individual rights and bonds configuration for the parties. State pursues publically significant interests, while the aim of the private partner is profit maximization. Given such opposing aims, the agreements made under PPP are mixed, and are not labelled in the Russia rights code. Therefore, it is

up to the parties in PPP to choose the optimal form for project realization, relying on the type of rights, conditions for construction and object transfer, cost of the contract, deadlines and relevant experience of both parties in relation to the project.

Defining factor for development of various forms of PPP is the opportunity, provided by the PPP law, for the private party to obtain property rights for the object under the agreement. Moreover, the property right in the context of the law and page 209 of the Civil Code of the Russian Federation (Part 1) as of 30.11.1994 № 51-FL (later as CC RF) is different, as the ownership right under the PPP law is initially limited by the bonds of the private party. Furthermore, the provision of this particular right is a significant element of PPP.

It should be pointed out, that the formation of the ownership right for the object of the agreement from the private side defines the main difference between the concessional agreement and the PPP, as during the concessional agreement the ownership right will always belong to the public side. Part 12, p. 12 of the PPP Law proves the limitation of ownership rights, according to which the ownership right should be limited and is registered together with the ownership right for the object in the agreement. An example of such limitation is described in Part 13, p.12 of the PPP Law – private partner has no right to independently take control of the object in the agreement before the agreement becomes invalid, except for a change in the private partner, where the limitation of right doesn't terminate.

Rights limitation is also evident in the prohibiting the private partner to pawn the object, despite using it as a collateral for the financing party, given the presence of the direct agreement (Part 6, page 7 of the PPP Law). The borders of the ownership rights are formed in the process of right transfer to the public partner over a period of time, defined in the agreement (Part 4, Article 12 of the PPP Law). Therefore, relying on the examples stated above, it is possible to determine, that the PPP Law enforces a limited ownership right for the private partner in relation to the object of the agreement.

Given the registration of rights limitation (Part 12, Article 12 of the PPP Law), there are also limitations in transferring the object of the agreement to the third parties for them to utilize, as the group of these parties is seriously limited. We believe that the legislator has introduced a model of rights ownership, that doesn't fully reflect the interests of the private partner, as the main feature that distinguishes the PPP Law from the concessional agreement was in fact in emergence of "fully-fledged" ownership right for the private partner, while such right is limited while the agreement is valid and is no different from the rights for the object of concession.

The PPP Law doesn't allow multiple parties on the side of the public partner, although Part 1, Article 20 states that *"in the interest of the private-public partnership agreement, the municipal-private agreement allows for 2 or more of the public partners to carry out a collective tender"*. However, Part 3 of the stated

Article states, that a separate PPP agreement is made with each winner of the collective tender. The following rule complicate both the process of agreement, and the process of changing the agreement conditions, which may result in problems of implementation.

Therefore, in direct interpretation of the PPP law, there is an uncertainty regarding the expediency of holding a joint tender, as it can result in legal risks. On the other hand, the later conclusion of a separate agreement with each of the public partners questions the effectiveness of the tender, as the main aim is a joint implementation of the PPP agreement, and a joint implementation should be agreed to by all the parties. Given the specifics of relations between the parties and terms for participants of the PPP, we believe that there is a need to correct the PPP law, in the part that relates to the parties that can be allowed during the realization of the project. Reform of the PPP law is possible through normative definition of the criteria of allowing third parties to participate in the project on the side of the private partner.

The specifics of the PPP projects are in its large-scale financing not only by the public side, but by the private capital as well. Our view is that the government, as a participant, who should be more interested in implementing the PPP projects, as they are viewed as instruments of country's infrastructure development, should bear some sort of financial responsibility not only in project financing but also as a budget guarantor.

As the PPP institution in Russia is not well spread and developed, there are certain lags in legal-normative regulation of PPP financial mechanisms. This is further supported by the fact that at the moment, public financial entities, are mainly oriented at budget administration, tax collection, financial control and etc. While we believe that budget legislation should reflect the modern needs of infrastructure projects, as investment policy is directly related to PPP.

The PPP law foresees not only the right for the public partner to "extra" finance the PPP project, but also the opportunity of full financial and technical provision for the object. Part 5 of the Article 6 of the mentioned law states that project financing from the budget can only be carried out through the provision of subsidies in accordance with the budget law (Emelkina, 2016; Shekhovtsov and Shchemlev, 2017).

Therefore, the PPP law limits the instruments for financing, state support for the PPP projects is provided solely through the provision of subsidies. It is also important to point out, that Article 19 of the PPP law, that sets out the criteria for the competitive selection of the private partner, doesn't contain the criteria that evaluates the applications of participants to obtain the subsidy. These participants, given their independence in defining the order by public-legal formation, as well as budget investment given individual character, do not require the use of competitive procedures in order to select the receiving parties (Shatkovskaya *et al.*, 2017).

Negative consequences of the excessively investment oriented budget policy, can lead to worsening of factors stimulating economically effective behaviour, as well as increasing power abuse from the officials. Statement 3 of the Part 3, Article 6 of the PPP law establishes the right of the partner to “ensure” financing. The law doesn’t explain what is meant by the word “ensure”, however it is sensible to assume that the ensuring instrument can be one or more ways to provide for the liabilities stated in the Article 329 CC RF (forfeit, collateral, guarantee, independent guarantee, deposit, provisional payment or other ways stated in the law).

From the abovementioned ways of liability guarantees, it is obvious that not all of them are applicable in the case of PPP project financing. However, if we consider other ways of guarantee stated in the law, then the application of state and municipal guarantees is possible, which can ensure the liabilities of the public partner.

### 3. Results

Implementation of the PPP project is relatively long-term, on the basis of which it is necessary to provide for the government guarantees for the whole term of agreement. Unequal time periods for the projects and guarantees is a legal problem, as the Budget Code of the Russian Federation (later BC RF) contains limitations in relation to the length of state guarantee duration (30 years), which at first glance is sufficient for the PPP project. However, the guarantees can only be satisfied in the case that annual budget law foresees the suitable budget item in relation to the terms of guarantee liabilities (Part 1 of Article 116, Part 1 of Article 117 BC RF). In other words the duration of the guarantee is formally defined by one year, i.e., by the budget law.

The following case is the deficiency in budget financing, which doesn’t allow to establish certainty about the long-term financing of the PPP project, which in turn, can create long-term risks, for both private party and the investors. It is also important to point out another aspect, which opposes the realization of government guarantee issue to the private investors. In accordance to Part 5 of the Article 115 of BC RF, government guarantee should contain the information about presence or absence of the right of the guarantor to the principal regarding the refund, which have been paid to the beneficiary, given the state or municipal guarantee (regressive claim of the guarantor to the principal). According to Part 1 of the Article 115.2 BC RF, in case of the presence of a regressive claim, principal must provide the guarantor with provision, which complies with Part 3 of the Article 93.2 BC RF, according to which, the provision has to be of the following form *“bank guarantees, bails, state and municipal guarantees, collateral of the sum that is no less than 100% of the loan. Provision of liabilities should be highly liquid.”*

Obviously, such criteria do not fully reflect the commercial relations of the private party and the investors. If the principal (private partner) had the mentioned provision, then the need to obtain the state guarantee would be eliminated, as in

market price terms, the provision is very similar to the guarantee and the principal can directly ensure its own liabilities in front of the investors, for example on the security of liquid assets, without having to use the mechanism of state guarantees. While making the decision about guarantee provision, a deep financial analysis of the private partner is performed. The results of this analysis may never be disclosed, even in case of the guarantee being issued.

Another important factor of budget financing of the PPP is the use of targeting programs, budget events aimed at co-financing of PPP projects from the side of the public partner. According to Article 179 BC RF, state programs are confirmed by the government entities of the same level as the one where PPP project is being implemented. The type of support should be established in the program; subsidy, or costs refunds (Article 78 BC RF), or budget investment (Part 5 of the Article 79 BC RF). At the moment, the provision of budget investment for the PPP projects is possible, but only for projects related to object of capital construction in compliance with concessional agreements. Therefore, we can also need for amendments in BC RF, as the procedures of budget investment provisions not complying with the PPP law requirements.

Therefore, after the PPP has been passed, there has been an emerging need for reconsideration of a number of normative-legal acts of federal and regional significance in the aspects of public investment and guarantees provision. We believe that in the first place BC RF needs to be amended in the following aspects:

1. Provision of long-term state and municipal guarantees;
2. The opportunity to finance the PPP projects via accepting the target programs;
3. Regulation of long-term budget spending in the form of financial liabilities of the public partner in the PPP projects.

Apart from traditional sources of PPP financing, it is necessary to consider the new market mechanisms of financial sources. One of these sources of financing can be the “infrastructure bonds”, which do not have a normative consolidation in Russia, however are used for large scale projects realization. The use of “infrastructure bonds” in Russia was first mentioned in 2007-2008. The “Strategy for Railroad Transport Development of the Russian Federation until 2030” defines the aim to finance railroad transport, including the use of such instruments as infrastructure bonds. The program for infrastructure bonds development is also included in the “Strategy for Financial Market Development in the Russian Federation for the period until 2020”.

The abovementioned strategy for financial market development is offered for “aims to attract investment resources into the long-term projects for transport, energy, property and social infrastructure development, implemented on the basis of PPP, to foresee measures targeted at stimulating the investment into infrastructure bonds. In

order to achieve these aims, there are required changes that need to happen to the Russian legislation, which will provide for rights protection of infrastructure bonds owners, as well as will provide the opportunity to invest the funds of credit organisations, pension savings accumulated by the Pension Fund of the Russian Federation, as well as private non-government pension funds into such bonds”.

The mentioned directions for development are contained in the “Events plan from the Ministry of Economic Development of the Russian Federation regarding the implementation of actions aimed at improving the health of financial sector and other sectors of the economy” – “provision for issuance of infrastructure bonds, including the guarantees from Russian Federation and Vnesheconombank, for infrastructure product financing, realized on the principals of public-private partnership”.

Despite the collective interest of government and business-societies to make investing in infrastructure bonds common, at the moment this institute is not normatively regulated, which creates uncertainty regarding its capabilities in the framework of the PPP agreement.

In order to achieve successful project implementation on the PPP basis, with investor interests being satisfied, the PPP law offers the private partner the right to transfer the rights regarding the PPP object on security terms. However, the actual PPP law doesn't disclose the institution of this security, which means that there is a need for complex analysis of security rights relations in the Russia law, accounting for the tendency to reform civil legislation. The PPP law accounts for imperative foundation to justify security:

1. The use of security to support the liability to the financing party;
2. The presence of direct agreement between the project agreement and the financing party. The PPP law doesn't contain any other basis for transfer of the agreement or private partner rights.

Therefore, relying on the interpretation of these rules, we can conclude that the circle of subjects of collateral relations is defined in three ways by the PPP law:

1. Depositor – private partner;
2. Creditor – financing party;
3. Public partner – status is not defined in the classic understanding of the term “security”.

The public partner is given a special role, as one should act as guarantor of the project realization and unsure that no rights are breached from the side of the private partner and the financing party, as their actions can result in intended penalty for the object of security.

However, under the current framework of depositing a PPP object there is a number of deficiencies; Part 6 of Article 7 sets the delay period before incurring a penalty regarding the deposit at 180 days since the emergence of the reason to chase the penalty. It also establishes a ban on the penalty in case of early dissolution of the PPP agreement, given serious agreement breaching from the private side. Given such relationship, property protection of the financing party from violations by the private party seems ineffective.

According to the newly published Part 2 of the Article 336 CC RF, the object of the deposit can be in the form of property, which will be created or purchased by the depositor in the future. *“Deposit is registered only after the main liability or purchase of the stated property by the depositor, in the exception of the case when the law or the agreement state otherwise”*.

However, the stated norms may complicate the realisation of depositor rights in case, when the object of the deposit is included in the property that need registration. Part 1 of the Article 339.1 CC RF states that deposit is subject to government registration if, in accordance to the law, the deposit rights are subject to government registration (Article 8.1 CC RF).

Therefore, the agreement of depositing non-existing property can result in burdening of the property which doesn't require government registration. The problems of depositing were pointed out by Makovski: *“two serious threats caused by universal deposit are observable. First of all, it allows the more dominant party to technically enslave the other. Secondly, depositing all of the property to “your trustworthy” creditor, it is possible to exclude any other creditors issuing a penalty regarding your property”*.

Furthermore, the deposit agreement proposed by the PPP law, which doesn't define the status of the public party, imposes extra risks for the private party. Such risk is defined by Part 7 of the Article 7 of the PPP law, which states that *“in case of penalty being imposed on the deposit, the public partner has the dominant right to purchase the object of the deposit at the price, equal to the debt of the private party, but no more than the price of the deposit itself”*.

It is obvious, that if the parties make a deposit agreement, where the property being deposited hasn't been created and registered yet, then at the moment of penalty request, the price of the deposit can be lower than the amount of monetary input from the financing party.

Therefore, in the case of unsuccessful project implementation, the public partner is protected by the law, as it has a dominant right to purchase the deposit at the price, higher than its actual price. At the same time, the private partner, while borrowing the funds to implement the project, is at risk to face responsibility before the financing party (Part 2, Article 334 CC RF).



An important update regarding the institute of creditors should be pointed out. According to the Article 335.1 CC RF it is possible to have a number of creditors in relation to the same property, or a number of solidary and share creditors in relation to the liability ensured by the deposit.

According to the BIS data (The Bank of International Settlement), in 2007, in Russia alone, the number of syndicated credit deals exceeded 2 billion US dollars. For comparison, the volume of syndicated credits issued in 2005 globally was around 3,5 trillion US dollars. Such a big difference doesn't only illustrate undeveloped institutions for large investment project financing, but also shows that deals related to syndicated loans, were mainly concluded under the foreign legal framework, even if both parties were Russian.

According to the International Court of Arbitration data in 2009, the majority of cases were based on the British law. Actuality of development of Russian rules for syndicated crediting is also supported by the Federal Law Project № 204679-7 *“Regarding the changes in separate legislative act in the Russian Federation (regarding syndicated credits)”*, which has been introduced to Duma in 21.06.2017. The stated law proposal also focuses on the deposit legal relations.

#### **4. Conclusions and recommendations**

Based on the abovementioned facts we can conclude that at the moment, the focus of legislature is centred around the creation of new instruments to finance large scale investment projects, including those based on PPP. After the law about syndicated crediting being passed (given the right to use the PPP objects as a deposit), Russian business communities have been given an opportunity to conclude investment deals with the use of syndicated credit under the Russian rules, which should increase the attractiveness of PPP projects.

We believe that the actuality of reforming the Civil code in the sphere, if deposit relations cannot be overvalued as the changes are progressive and have potential for development, the deposit institute is not defined by the PPP law to have full capacity.

Therefore, in order to ensure effective rules implementation regarding depositing the object of PPP, the Russian Civil Code sets out new rules with respect to the deposit. At the moment, it is too early to talk about the direction of such a development, as creditors will have extra guarantees for the funds invested.

It is necessary to point out that the problems of implementing the agreements on the basis of the PP law are relevant, which is caused by the emergence of new forms of PPP agreements, and lack of research in the sphere. Effectiveness of the implementation of PPP mechanisms while creating large scale infrastructure products is defined by successful international practice, which proves that there is a

need to research and improve the legal potential of PPP in Russia. The new opportunities for private capital attraction offered by the PPP, allow to define the need between the public and the private side. The rights to purchase the object of agreement and use the PPP object as a deposit, illustrate the development of Russian law in the sphere of connecting the interests of government and private business.

However, new legal mechanisms need to be developed. In the conditions of insufficient budget funds and decreasing interest for Russian economy from large scale investors, the government should take the responsibility to develop the legislation, in order to improve economic attractiveness, as well as PPP related activity. In order to achieve the targets of country's innovative development it is not only necessary to improve the current normative-legal base, but also the creation of new legal mechanisms, which will be able to support the effective legal and financial state of the project.

The key problem in achieving the stated target is the limited budget planning, which doesn't allow for long term liabilities between the public and private partners neither in project financing, nor in government guarantees provision. As the process of normative regulation development goes, it is necessary to refer to the concept of PPP legislation development, as well as account for the needs of parties implementing large scale projects. A good example of market relations overtaking the current normative-legal base is the implemented instrument for project financing in the form of infrastructure bonds issuing – such factors highlight the deficiencies of the legal regulation of project financing.

Given the fact that PPP are of public importance, their realisation should result in positive public effect. Wide conditions for agreement provided by the PPP law, allow the parties to carry out effective government policy simultaneously economically stimulating the private partner.

Bearing the functions of the main regulator of PPP, the government should also apply indirect methods for project support, as well as indirect influence innovation project, which are largely defined by public interest. We believe that such indirect methods include collaborative engagement of parties in ecological programs, aimed at reducing the negative impact on the environment. The development of such form of partner relations will not only ensure public result, but will also allow the private partner to extract the benefits, to obtain extra guarantees which are not implied in independent project implementation.

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