

TO: Clients and Friends of the Firm

FR: Frishberg & Partners

RE: Law “On Concessions”

## **I. Introduction**

On July 16, 1999, Ukraine passed its first law “On Concessions,” No. 997-XIV (the “Law”). As with many Ukrainian legal terms, the meaning of “concession,” as set forth in the Law, does not correspond to the Western understanding of concession. To understand the reasons for this curse, it is necessary to describe the history of “concessions” on the territory of Ukraine.

In the beginning of the 20th century, the Russian Empire, of which Ukraine was an integral part, saw the most dynamic development of foreign investment in its long history. In that period, 55% of the total investments in the Russian Empire’s economy were foreign. At the time, the most widespread vehicle for foreign businesses was concessions (grants for assisting the State in exploiting important natural resources). These concessions were granted on minerals, transportation, etc. The list of foreign investors who took part in concessions included such famous names as Rudolph Diesel and the Noble brothers. Even after the 1917 revolution, concessions remained as the only islands of economic activity where operations could be effectuated with the injection of private foreign capital.

The Decree of the Council of the Peoples’ Commissars, dated January 20, 1920, entitled “General Economic and Legal Terms and Conditions of Concessions” was subsequently issued, which unequivocally favored granting concessions for the exploitation and extraction of natural riches. True, the above Decree was later canceled and, as a result, all concession agreements between Soviet Russia and foreign concessionees were canceled. Consequently, the properties of many famous foreign concessionees, such as the Swiss Sandoz, French Credit Lyonnais, etc., were nationalized without any compensation.

After the fall of the Soviet Union, the former republics rich in oil and gas saw the renaissance of foreign concessions. Immediately after Ukraine’s independence, Ukrainian legislation also stated that significant foreign concessions could be effectuated on the territory of Ukraine, but only with the permission of the Parliament. Henceforth, Ukrainian legislation continued to improve the conditions for carrying out foreign aided concessions. For example, Decree No. 55-93 of the Cabinet of Ministers of Ukraine “On the Foreign Investment Regime,” dated May 20, 1993, encouraged foreign concessionees to effectuate concessions after signing a separate agreement with

the Cabinet of Ministers. These separate agreements gave the foreign concessionees immunity from the frequent changes in the legislation and established more transparent rules for carrying out concessions.

Unfortunately, few foreign companies were interested, and for a good reason. As a consequence of the swift development of Ukrainian legislation, a rather unique meaning for the legal term “concession” arose as the original text of the Law “On Concessions” excluded the prospecting of mineral wealth and other natural resources as objects of concessions. This omission with respect to the regulation of mineral rights was corrected when the Parliament adopted Law No. 1039-XIV “On Production Sharing Agreements” on September 14, 1999, but the Law “On Concessions” remained rather impotent.

The Law defines a concession as a grant of rights from the State or local bodies of self-governance to legal or physical entities (which are registered subjects of entrepreneurial activity) to create, construct and/or administer concession objects with the purpose of “satisfying the social needs of the Ukrainian people”. Grants are made on the basis of a concession agreement to any subject of entrepreneurial activity, resident or non-resident, who expresses interest in receiving a concession. As a rule, the State must hold a concession tender to determine who offers the most favorable conditions for exploiting a specific concession object. Both the concession tender and the concession agreement are discussed in more detail below.

## **II. “Concession Objects”**

In a nutshell, the following spheres of activity may be the subject of a concession agreement: the construction and exploitation of hotels, tourism complexes, camping grounds and other similar objects of the tourism industry (new as of 2002); water-supply; draining and cleaning of sewage waters; collection and disposal of garbage; provision of services connected with the supply of heat, telecommunication (including the use of the network) and postal services and undertakers’ services; construction of roadways, roadway facilities and infrastructures, airports, freight and passenger ports, and residential buildings; transportation and distribution of natural gas; manufacture and/or transport of electrical energy; and public parking for automobiles, among many others. Additional spheres may be added to the list of activities in which municipally-owned organizations may be granted for concession upon approval by local councils at plenary sessions.

The above list of concession objects includes property that belongs to an enterprise, which is a part of the system of integrated property complexes used to provide the above services, as well as unfinished construction which needs to be completed in order to satisfy the public needs and specially built objects for carrying out any of the above activities.

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