Certain Issues of Applying Kazakhstan Legislation in Concession Projects

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Introduction

Over the past few years, Kazakhstan has been trying to boost the development of public-private partnership (PPP) against the backdrop of global economic trends. Specifically, in addition to other initiatives and activities, such as the creation of specialized institutional entities in the field of PPP (the so-called PPP Units), road maps, formation of ready-made project document packages for local-level projects and other measures to promote the PPP, it has also been manifested in the adoption of a special PPP Law and relevant amendments to the then almost non-operational Concession Law of 2006. Despite the said amendments and subsequent changes thereto, the Concession Law still leaves unresolved or insufficiently clear a number of crucial issues.

The domestic concession legislation's readiness and attractiveness is put to a serious test when implementing concession and PPP projects of special importance, the authors of this article having had an opportunity to directly participate as advisors in the first such project.

Taking into account all the above circumstances and the experience of implementing the first concession project of special importance in Kazakhstan, we believe that the legislative regulation over concession relations in certain aspects (and similar PPP issues in general) requires improvement.

In particular, we deem it necessary to attend to the following primary issues, which may become serious obstacles for private partners and lenders when implementing, first and foremost, concession projects.

Personality of the Grantor

One of the key issues that can jeopardize a concession project implementation is the issue of grantor's personality. The amendment of November 30, 2017 to the Concession Law mandated that the grantor was to mean, instead of the Republic of Kazakhstan, «*governmental agencies of the Republic of Kazakhstan having entered into concession agreements in accordance with this Law and/or into a direct agreement with the concessionaire's lenders*.» This amendment came to conflict not only with other legislative acts of the Republic of Kazakhstan, but perhaps with investor expectations as well.

Pursuant to the PPP Law, concession is defined as one of the types of PPP (Article 7), and the state partner - as the Republic of Kazakhstan (Article 1). Meantime, according to the purport of Article 7 of the PPP Law, peculiarities of the Concession Law must apply only «to the extent not regulated by this Law.»Accordingly, the grantor (i. e., the state partner) must be the Republic of Kazakhstan (since the PPP Law already contains a regulation defining the state partner), not a separately taken governmental agency.

If we proceed from the literal interpretation of the concept of «grantor» in the current version of the Concession Law, such governmental agencies «having entered into concession agreements» must, by virtue of Articles 163 and 165 of the State Property Law, be considered as state institutions acting on their own behalf in civil law relations, therefore, liable for their obligations (in this case - concession obligations) only with the money at their disposal (with subsidiary liability of the Republic of Kazakhstan). It is unlikely that serious counterparties would be willing to plunge into costly transactions (whose value can be hundreds of millions in the USD equivalent) under such an arrangement, where they would have to mostly rely on the budget of a single governmental agency, and there is no practice of holding the Republic subsidiarily liable for the obligations of state institutions.

As suggested by Article 160 of the Budget Code of the Republic of Kazakhstan, there cannot be any concession obligations of governmental agencies and institutions, and state concession obligations are subdivided into (1) state concession obligations of the Government of the Republic of Kazakhstan, and (2) state concession obligations of local executive authorities.

The Law of the Republic of Kazakhstan «On Amendments to Certain Legislative Acts of the Republic of Kazakhstan on the Issues of Economic Growth Recovery» dated January 2, 2021 amended the definition of «grantor» in the Concession Law. At the same time, the proposed wording differs from the concept of «state partner» definition laid down in the PPP Law and cannot be called adequate. In particular, the grantor is now understood as *one or several governmental agencies of the Republic of Kazakhstan acting on behalf of the Republic of Kazakhstan or the Government of the Republic of Kazakhstan and entering into a concession agreement in accordance with this Law, or a local executive authority of the Republic of Kazakhstan entering into a concession agreement in accordance with this Law on behalf of an administrative-territorial unit (oblast, or a city of national significance, or the capital).* Obviously, the reference here to the RK Government is incorrect and excessive: the Government does not have the status of an independent subject of law and, accordingly, cannot act as a party to the concession agreement, which in this case can only be the Republic of Kazakhstan.

Issues Relating to the Registration of Concession Agreements and Supplementary Agreements Thereto

One of the key issues is the registration of concession transactions (concession agreements) and registration of supplementary agreements thereto.

Pursuant to Article 155 of the Civil Code of the Republic of Kazakhstan, transactions subject to mandatory state or other registration in accordance with legislative acts are deemed executed from the moment of their registration, unless otherwise provided for by the legislative acts. Article 22 of the Concession Law requires mandatory state registration of concession agreements «*in accordance with the procedure established by the legislation of the Republic of Kazakhstan.*»

Article 161 of the Budget Code says that the concession *agreement registration* procedure is determined by the central authorized agency for budget performance in coordination with the central authorized agency for state planning. This procedure is determined by Order No. 540 of the Minister of Finance dated December 4, 2014.

Although neither the Civil Code, nor the Budget Code or the Concession Law itself mention the registration of supplementary agreements to concession agreements, the aforementioned Order No. 540 additionally establishes the

procedure for registration of supplementary agreements to concession agreements (subject to certain conditions), which raises the question of a right-conferring effect of the fact of supplementary agreements registration. Since the Minister's Order is not a legislative act (as required by Article 155 of the Civil Code), it is evident that the necessity to register supplementary agreements established by the Order should not determine the legal validity of the transaction (i. e., the registration should not determine whether or not the transaction out of a supplementary agreement is deemed executed). By virtue of Article 161 of the Budget Code, Order No. 540 should determine the registration procedure, i. e., only the process of registration, not the grounds for registration. According to Article 155 of the Civil Code, the requirements to register transactions can only be established by legislative acts. Thus, any supplementary agreement to a concession agreement must be deemed executed from the moment of its signing (unless another moment is stipulated by the parties); accordingly, the registration of such supplementary agreement should play only the role of registration of a state concession obligation (which is quite in line with the requirement of Article 161.1 of the Budget Code), but not the role of registration of the transaction as a whole.

At the same time, some legal practitioners believe that the registration of supplementary agreements has a right-conferring nature, since a legislative act (i. e., the Budget Code) provides for the necessity to register supplementary agreements via a reference rule that the registration procedure is determined [in this case] by Order No. 540, and the Order No. 540 itself, in turn, requires registration of supplementary agreements (which contain certain conditions). We do not hold the same position, because (1) the phrase «registration procedure» means only the process of registration, (2) Order No. 540 is not a legislative act, and (3) none of the applicable legislative acts provides for the mandatory nature of, and the grounds for, the registration of supplementary agreements to concession agreements in order to recognize them executed.

We believe that a clear and unambiguous regulation concerning registration of supplementary agreements to concession and PPP agreements should be introduced into the legislation.

Concessionaire Substitution

The legal regulation of concessionaire substitution represented in the Concession Law by several scenarios also requires certain revisions.

Article 26-2 of the Concession Law entitles lenders to demand substitution of a concessionaire in the event of a material breach by the concessionaire of its obligations under the concession agreement and/or in the event of a material breach by the concessionaire of its obligations under agreements with lenders. At the same time, the materiality of the breach is determined through whether or not it can entail early cancellation of the concession agreement or the lenders' demand to early perform obligations under financial agreements. Presumably, the procedure for concessionaire substitution under this scenario (i. e., in the event the concessionaire is in material breach of its obligations) should be subject to the provisions of Article 21 of the Concession Law: «*In the event of concessionaire substitution at the request of concessionaire's lenders, the assignment of claim and/or transfer of concessionaire's debt under the concession agreement shall be made without holding a tender in the manner determined by the direct agreement*.»

Also, the same Article 21 provides for another scenario of concessionaire substitution where, on grantor's consent, the assignment of claims or the transfer of concessionaire's debt under the concession agreement is allowed, provided that the person(s) to whom the rights and obligations of the concessionaire are transferred meet the qualification requirements.

The third scenario is presented in Article 26-3 of the Concession Law, which is expressly entitled «Concessionaire Substitution» and provides for the possibility to substitute the concessionaire by agreement between the lenders and the grantor in the event the concessionaire fails to perform or improperly performs its obligations. In this case, a tender is required to select a new concessionaire. Considering that the concessionaire's failure to perform its obligations may also entail the agreement cancellation (in other words, failure to perform the agreement may have all the features of material breach provided for in Article 26-2 of the Concession Law), the wording of the provisions of Article 26-3 cannot be called adequate. Since the Article is entitled «Concessionaire Substitution,»it would be more appropriate to regulate therein all scenarios and grounds for concessionaire substitution and to elaborate on the relevant wording more carefully.

Concession and National Security

We would also like to draw your attention to one of the Concession Law regulations whose vagueness gives rise to problems with its interpretation. To demonstrate this, it is necessary to quote the said regulation word for word: «*A concession agreement shall provide for a condition of the grantor to unilaterally amend the terms of, or cancel, the concession agreement in the interests of the public and the state, and the concession agreement shall include an exhaustive list of such conditions not contradicting the legislation of the Republic of Kazakhstan, including where such actions are performed to ensure the national and environmental safety, healthcare and morals*.»

Firstly, it is obvious that the phrase «a condition of the grantor» should read as «a condition regarding the grantor's right» and this technical flaw should be fixed.

Secondly, it is not clear what interests of the state can cause a unilateral amendment and cancellation of the agreement, if the state itself enters into the public-private partnership agreement as a party thereto, hence, by virtue of Article 111 of the Civil Code - on a par with other parties to the agreement.

Thirdly, the national security is subdivided into six types, or constituent elements, of security: public security, military security, political security, economic security, information security and, finally, environmental security. In view of the above, it is unclear why the Concession Law specifically emphasizes, alongside with the national security, the environmental security, which is already one of the constituent elements of national security, and also specifically mentions healthcare and morals, which form part of the concept of public security: «*the state of protection of life, health and well-being of citizens and the spiritual and moral values of the Kazakhstan society….»*

Apparently, in this case there is a potential risk that the grantor would broadly construe the grounds for unilateral amendment or cancellation of the concession agreement. In particular, the grantor might go beyond the frames of the National Security Law and put forward extra arguments about some public and state interests, environmental reasons or other concerns about healthcare and morals.

Foreign Arbitration

In our view, Article 27.2 of the Concession Law concerning dispute settlement also requires serious attention.

The first part of the Article in question contains a general rule that disputes relating to the performance and termination of a concession agreement are to be settled in court or by submission to arbitration in accordance with the Arbitration Law.

What immediately catches eye is a not quite adequate wording of this regulation, which boils the possible disputes under a concession agreement down to disputes relating to the performance and termination of the concession agreement, whereas the list of possible disputes is more expansive and includes disputes relating to the validity, conclusion, amendment and interpretation of the concession agreement, as well as non-contractual disputes in connection with the concession agreement.

The second part of the regulation in question provides for a special rule for concession projects of special importance. It states that where at least one of participants in the concessionaire is a nonresident of the Republic of Kazakhstan, arbitration must be determined «by agreement of the parties.»Does this mean foreign arbitration? We believe that it does, since no other options are available, given reference to the Arbitration Law in the first part of the regulation in question. The wording «by agreement of the parties» used by the legislator also leaves much to be desired. Firstly, in this context the Kazakh arbitration is somehow juxtaposed to the arbitration by agreement of the parties, although the former also results from the agreement of the parties. Secondly, if desired, one might strike a long debate about what is meant by the arbitration by agreement of the parties and whether foreign arbitration is the only possible option here.

Putting the details aside, it would be important to mention that the regulation in question essentially allows foreign arbitration between two Kazakhstan residents. Dispute settlement by foreign arbitration means its settlement outside Kazakhstan. For instance, if the parties have agreed on the place of arbitration in London, this would mean that the national arbitration law of England, not the Kazakh arbitration law, would apply to the arbitration proceedings.

The question of whether two Kazakhstan residents may agree on applying the law of another country to their arbitration is not expressly regulated in Kazakhstan. The civil procedure legislation contains no pertinent regulations. Proceeding from the rules of private international law (Article 1084 of the Civil Code), foreign law may be applied to civil law relations involving foreign persons or complicated by another foreign element. In the case at hand, the Concession Law seems to speak about such foreign element by stating that foreign arbitration and, consequently, application of foreign procedural law is allowable, if at least one of the concessionaire's participants is a Kazakhstan nonresident.

In our view, the above enables two important conclusions, which can extend, by analogy of the law, onto other legal relations (unrelated to concession):

1) Participation of a nonresident in a Kazakh legal entity qualifies as a foreign element, i. e., such participation complicates such legal entity's civil law relations with third parties by the foreign element.

2) At the legislative level, there has appeared a regulation allowing two Kazakhstan residents to submit to foreign arbitration.

Granting of Rights to Land Plots for Concession Facilities

The issue of transferring to concessionaires the rights to land plots for concession facilities causes lots of difficulties in practice.

Article 6 of the Concession Law only mentions in this respect the transfer of the right of land use to the concessionaire and further refers us to the Land Code. In turn, the Land Code sets forth that the concessionaire is granted a land plot under the right of temporary free-of-charge land use for the entire term of the concession agreement (Article 36.1).

However, this arrangement does not work for concession projects based on the BTO (build-transfer-operation) model, because the said concession model does not in principle require the concessionaire to have title to a land plot underlying the concession facility or to the built concession facility itself.

Specifically, the term of concession agreement implies the period of construction of the concession facility and the period of its subsequent operation. Upon completion of construction, the built concession facility is registered as the state property and is subsequently transferred to the concessionaire for management as an immovable property item (the land plot and the facility located thereon). This means that upon completion of construction, the rights to the land plot transfer to the state partner, which, accordingly, excludes the possibility for the concessionaire to hold those rights for the entire term of the concession agreement. Hence, the Land Code provision transferring to the concessionaire the right of temporary free-of-charge land use for the entire term of the concession agreement is unenforceable in respect of a BTO concession.

Transferring to the concessionaire the rights to land plots for concession facilities may also be practically infeasible due to another prohibition set by the same Land Code. If we look at practice, land plots for concession facilities are registered in the name of the governmental agency to which the built concession facility is intended to be assigned in the future. In turn, the governmental agency cannot further transfer the rights to land plots to the concessionaire, because transactions with land plots held under the right of temporary free-of-charge land use are prohibited (Article 33.2 of the Land Code). Moreover, by virtue of its status of state land user, the governmental agency falls within the prohibition on transferring land plots owned by it (Article 39.5 of the Land Code).

In our view, in case of BTO concession projects, land plots should be transferred to the concessionaire in the manner prescribed for construction contracts. This would be generally consistent with the nature of concession projects, as construction is one of the stages in the BTO concession project implementation.

If we turn to the Civil Code provisions relating to construction contracts, Article 658 establishes a general employer's obligation to timely provide to the contractor a land plot for construction. Expanding further on this issue, RK CN 1.03-00-2011 says that the construction site is transferred to the person performing construction on the basis of an act. In view of this, transferring a land plot to the concessionaire for the purposes of concession facility construction on the basis of a relevant act of transfer and acceptance seems to be the optimum option for BTO concession projects.

Sources:

1) Budget Code - Budget Code No. 95-IV of the Republic of Kazakhstan dated December 4, 2008;

2) Civil Code - Civil Code of the Republic of Kazakhstan (General Part) dated December 27, 1994;

3) Land Code - Land Code No. 442-II of the Republic of Kazakhstan dated June 20, 2003;

4) PPP Law - Law No. 379-V of the Republic of Kazakhstan «On Public-Private Partnership» dated October 31, 2015;

5) Concession Law - Law No. 167-III of the Republic of Kazakhstan «On Concessions» dated July 7, 2006;

6) State Property Law - Law No. 413-IV of the Republic of Kazakhstan dated March 1, 2011 «On State Property»;

7) Arbitration Law - Law No. 488-V of the Republic of Kazakhstan «On Arbitration» dated April 8, 2016;

8) National Security Law - Law No. 527-IVI of the Republic of Kazakhstan «On Concessions» dated January 6, 2012;

9) Order No. 540 - Order No. 540 of the Minister of Finance of the Republic of Kazakhstan «On Approval of the Rules of Budget Performance and Its Cash Servicing» dated December 4, 2014;

10) RK CN 1.03-00-2011 - RK Construction Norm 1.03-00-2011 «Construction production. Organization of construction of enterprises, buildings and structures.»