

## RAILWAY REFORM IN UKRAINE AND THE ROLE OF THE PUBLIC-PRIVATE PARTNERSHIP IN IT

### РЕФОРМА ЗАЛІЗНИЦІ В УКРАЇНІ ТА РОЛЬ У НІЙ ДЕРЖАВНО-ПРИВАТНОГО ПАРТНЕРСТВА

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The article is devoted to highlighting one of the actual theoretical and methodological problems of economic law regarding the issue of attracting investment instruments, in particular, public-private partnerships as an effective means for the renewal of transport infrastructure and the development of the transport sector of the economy of Ukraine as a whole.

Public-private partnership (PPP) is one of the effective mechanisms for attracting capital to the state budget through the interaction of authorities and the private sector. This partnership is based on a cooperation agreement, according to which resource participants are united with the appropriate distribution of responsibility. The main goal of such a partnership is long-term and effective cooperation between participants to obtain a synergistic effect from it for the restoration of objects of strategic importance and the creation of new critical infrastructure objects, in particular in transport sector of the national economy. A whole well-managed complex of transport networks is needed for the quality functioning of the Ukraine's economy. Railways play an important role in it. As railways connect with roads, sea (river), air networks, and ports, they create opportunities with important elements how people will be able to use them. The perspective way of the PPP development in infrastructure projects, from the author's point of view, is corporative way – a legal entity based on the institutional nature with the state majority in ownership, according to which the interaction of the public and private sectors takes place within a certain structure, and can realize through creation transport cluster or transport hub. The need is to factor in the network effect, across the whole transport system of any individual addition by connecting different transport and door-to-door connection.

PPP can be an effective way to recover and rebuild transport infrastructure. It can be a transparency and real beneficial way to solve transportation and economic problems. It is so important to make rethink to approaches the investment instruments, in particular PPP.

**Key words:** public-private partnership, reform, transport infrastructure, contractual and corporate of PPP.

Статтю присвячено висвітленню однієї з актуальних теоретико-методологічних проблем господарського права щодо питання залучення інвестиційних інструментів, зокрема державно-приватного партнерства як ефективного засобу оновлення транспортної інфраструктури та розвитку транспортної галузі України. економіка України в цілому.

Державно-приватне партнерство (ДПП) є одним із ефективних механізмів залучення капіталу до державного бюджету через взаємодію влади та приватного сектору. Це партнерство базується на договорі про співпрацю, згідно з яким учасники ресурсу об'єднуються з відповідним розподілом відповідальності. Головною метою такого партнерства є довгострокове та ефективне співробітництво між учасниками для отримання від нього синергетичного ефекту для відновлення об'єктів стратегічного значення та створення нових об'єктів критичної інфраструктури, зокрема у транспортній сфері національної економіки. Для якісного функціонування економіки України необхідний добре керований комплекс транспортних мереж. Велику роль у ньому відіграють залізниці. Оскільки залізниці з'єднуються з дорогами, морськими (річковими), повітряними мережами та портами, вони створюють можливості доступної мобільності для того, щоб людям було зручно даними можливостями користуватися. Перспективним шляхом розвитку ДПП в інфраструктурних проектах, з точки зору автора, є корпоративний шлях – юридична особа, заснована на інституційній природі з більшою часткою державною власністю, за якої відбувається взаємодія державного та приватного секторів. Саме в межах структури ДПП, і може бути реалізовано створення транспортного кластера або транспортного вузла. Необхідно врахувати мережевий ефект у всій транспортній системі, можливості окремого доповнення шляхом з'єднання різних видів транспорту та налагодження зв'язку «від дверей до дверей».

У зв'язку зі збройною агресією Російської Федерації питання розвитку транспортної галузі стали одними з актуальних, наша транспортна галузь також забезпечує обороноздатність країни. Тому дуже важливо переглянути існуючі підходи до залучення ДПП у транспортну сферу, зокрема залізничного транспорту, та знайти механізм дійсно ефективної співпраці між державою та приватними партнерами з встановленим високим рівнем довіри та діалогу між партнерами.

**Ключові слова:** державно-приватне партнерство, реформа, транспортна інфраструктура, контрактна та корпоративна форма ДПП.

The Ukrainian transport industry requires proper modernization, enhancing competitiveness, and adapting to European standards. Much of the rolling stock is worn down and the operational processes of UZ, a state-owned railway company, require meaningful changes. The average wear rate of freight cars is 89.06% [1], and passenger cars is 88–93% [2].

The government's efforts to reform the railway sector are focused on four main areas: 1) improving and harmonizing Ukrainian legislation with the EU norms; 2) restructuring of Ukrzaliznytsia JSC; 3) upgrading the rolling stock, allowing the use of private locomotives and developing railway routes; 4) implementing the European railway safety standards. The Government has approved Drive Ukraine 2030, the National Transport Strategy to 2030 [3]. In April 2021, the Government has endorsed the order "On approval of the Action Plan for the implementation of the National Transport Strategy of Ukraine for the period up to 2030" [4].

A good example for UZ is the railway reformation of Poland railway, where was established a separate freight company – PKP Cargo and passenger PKP Intercity. PKP Cargo became profitable, and this allowed it to more actively attract

investments and loans and became one of the fasts growing Eub railway freight companies. PKP Intercity unfortunately has remained fully state-owned and continues to be unprofitable, but there have been certain significant changes in the quality of its service. In Ukraine, passenger traffic by railway also is still unprofitable. All passengers financing goes within UZ in the form of cross-subsidizations, when the company itself directs funds from one profitable direction (freight transportation) to passenger. In addition, the quality of passenger transportation service and comfort is low during railway passenger transportation.

#### The most important achievements and progress in the railway reform in Ukraine

The first stage of the reform, which involved the merger of the assets of 6 railways and about 40 enterprises into the Ukrzaliznytsia public joint-stock company (PJSC Ukrzaliznytsia), was generally successful. The question that should decide during the second stage of the reform at the end of 2016 – real implementation of the creation of two-separated companies (a sort of blueprint for the Ukrzaliznytsia Cargo Company and Passenger Company) is open.

Since July 1, 2017, the Passenger Company branch has been operational, which includes passenger transportation units of all six regional branches. But, in real life, this Passenger Company isn't separated from UZ and is part of it and of course under the control of it, and its development needs real separating and foreign independent consulting. So, on December 31, 2021, the Passenger Company branch announced a tender for the provision of consulting services. On August 26, the private joint-stock company Kyiv Electric Car Repair Plant (owned by UZ) agreed with Deutsche Bahn Engineering & Consulting to provide consultations for UZ. The value of the contract was 891 thousand Euros. In August–November 2021, DB conducted 7 energy audits of production units of Ukrzaliznytsia. Based on the results of the work, DB should provide UZ with recommendations; develop an energy efficiency investment plan for Ukrzaliznytsia.

In addition, developed in 2012 the separate branch “Ukrainian Railway High-Speed Company” of the public joint-stock company “Ukrainian Railways”. Also, “Station Company” was founded in 2020 with the main goal is to make stations efficient and bringing them to a break-even level, but in reality is not implemented till nowadays and is not so effective. The stations are used both during passenger and freight transportation, but not as the centre of transport-logistic hub.

Other important events in the activities of JSC “Ukrzaliznytsia”, 2020–2021 are related to the following:

1) The memorandum of a partnership between JSC “Ukrzaliznytsia” and the All-Ukrainian Integrity and Compliance Network (UNIC): promoting the idea of ethical and responsible business conduct, enhancing transparency, fighting corruption and abuse.

2) JSC “Ukrzaliznytsia” and China Railway Construction Corp. Ltd signed a memorandum of understanding: cooperation in the development of Ukraine’s railway infrastructure and the development of railway transportation between the countries. On September 28, 2021 Ukrzaliznytsia dispatched the first container train with export cargo on the route Ukraine – People’s Republic of China.

3) Ukrzaliznytsia with the European Bank for Reconstruction and Development and the European Investment Bank has announced a tender for the purchase of works under the project “Electrification of the railway line Dolynska – Mykolaiv – Kolosivka” total length of 253 km, which is part of the TEN-T network.

4) Work is going according to the project Eurobonds with USA “Ukraine Railway Eurobonds”

5) The following digitalization of state-citizen relations and the launch of the “Diia” project.

6) As part of the pilot project, Ukrzaliznytsia, together with the National Police of Ukraine and the paramilitary guards of UZ, launched an escort of passenger trains by police officers.

7) The Company has published the text of a new contract for the carriage of goods, which come into force on July 01, 2020.

8) The Company signed a memorandum with the German company HHLA International GmbH, its subsidiary “Container Terminal “Odesa” and “Ukrainian Intermodal Company” LLC. Its goal is to develop new logistics products for customers. In particular, intermodal and multimodal transportation within Ukraine and in connection with the countries of Eastern Europe and the Baltic.

9) The Company together with Transparency International Ukraine has launched a project to visualize procurement data online.

10) Ukrzaliznytsia has signed memoranda of cooperation with Visa and MasterCard: e-tickets to all services.

11) Memorandum of Partnership between Ukraine and the Swiss Confederation on the implementation of the Swiss Cooperation Program in Ukraine for 2020–2023.

12) JSC “Ukrzaliznytsia”, Lisky Transport Service Center, and DHL Global Forwarding signed a Memorandum of Understanding and Cooperation to developing China-Europe container rail transportation and introducing new routes.

13) Ukrzaliznytsia has signed the first agreement to participate in a private traction project.

14) The Company began to create modern traffic control centers. The first such center started operating in Kharkiv.

15) The Law “On the State Budget of Ukraine for 2021” was adopted, which takes into account the proposals of Ukrzaliznytsia and for the first time provides funding for important projects to upgrade passenger railway rolling stock and infrastructure.

16) Management changes – the Company has established a Department of Strategy and Transformation based on the Department of Strategic Development, Planning, and Project Office.

These are important steps in the development of UZ, but much of them need a detailed plan to achieve further results. To position UZ for more growth, we should solve the main questions: 1) real elimination of UZ’s monopoly on traction, not declarative; 2) development of the railway infrastructure, and 3) investments. Public-private partnership (PPP) can be the efficient instrument to achieve these goals, as showed us by European countries, including rolling stock manufacturing and the delivery of freight. For example, France, which took about 20 years to build the first four high-speed rail lines, was able to construct four more in only seven years thanks to PPP arrangements. Other European successful railway PPP projects are: in the UK, Belgium (Locorail NV, Diabolo), Sweden (Stockholm-Arlana), Portuguese High-Speed Network.

#### **PPP in Ukraine and in UZ**

PPP – the equal and mutually beneficial long-term cooperation between the state, municipalities and the private sector within the framework of the implementation of projects aimed at solving important socio-economic needs. In the process of implementation, the resources of the parties are combined with the appropriate distribution of risks, responsibilities, and reimbursements between the parties to mutually beneficial cooperation in the construction and modernization of existing facilities that require investment and use. Using the PPP, the private sector finances the construction of the project, and the reimbursement is made either through a services tax from the authority provided in time or through project revenues or it is a combination of the two concepts. Therefore, it is very important to elaborate an investment analysis (especially, cost-benefit studies) as the initial part of the preparation of a project.

The legal basis of the PPP in Ukraine is determined by the following relevant laws: 1) Law – “On public-private partnership” 2010, which formed the legislative basis for cooperation between the public and private sectors to increase competitiveness and attract investment in the Ukrainian economy. The currently available features of public-private partnership in established this Law are: creation or reconstruction, capital repair of a specified object of public-private partnership or management of this object; long-term relationship, the contract is concluded for a period of 5 to 50 years; the private partner assumes part of the risks during the implementation of the public-private partnership; attraction of investments of a private partner in the object of the contract. Disadvantages of the law on PPPs: no minimum share in the project of a private financial partner is established, there are no clearly defined mechanisms for the practical implementation of projects, there is no clear motivation, and no tax or customs benefits for the private partner, there is no mechanism and motivation for partnership and the involvement of foreign partners. 2) Law- “On Concessions” 2019, which streamlined tender procedures and improved the balance of responsibilities, and increased protections for investors, including the right to select the foreign governing law and to

enter into direct agreements. State support can take different forms, including tax exemption, creation of the supporting infrastructure by the state, facilitation of access to the grid, and granting of preemptive rights to use or own land. 3) Law “On the State Support of Investment Projects with Significant Investments in Ukraine” 2021, providing for state support to projects. The legislation, connected with PPP and required for the decentralization reform was adopted in early 2015. According to the Law of Ukraine “On voluntary amalgamation of territorial communities,” were formed 23 regions. Of course, decentralization in Ukraine has a positive role to transport’s and PPP future that could enable new business models to create and develop.

The form of state support for this moment for the implementation of investment projects, particularly the Budget Code, and the Law of Ukraine on the State Budget is not perfect. In the near term, budget laws have to be changed to provide long-term budget commitments for PPP projects and to prioritize the availability payments. Tax Ukrainian Code also should be changed according to this and has legislative consolidation of preferential tax treatment for a private partner. Special tax and customs regimes are a common practice of attracting investments in foreign investment legislation. Among the most popular is the reduction of the tax rate, the provision of tax benefits, and the exemption from taxation of certain projects. The Tax Code of Ukraine does not establish any benefits for PPP projects, but for the development of PPP and the involvement of private partners to participate in such projects, one can consider the introduction of such tax benefits as reducing customs duties on equipment imports and exemption from income tax at the initial stage of the project implementation.

The draft Innovation Code of Ukraine, which should be adopted, provides for the forms of participation of the territorial community in relations in the innovation sphere, in particular: communal-private partnership, state-communal-private partnership and others, which should ensure the restoration of the main production funds and infrastructure facilities on the latest innovative basis.

It is worth paying attention to the fact that today no mechanism would regulate the interaction between the state and local authorities, a private partner in Ukraine. Thus, the Ministry of Economic Development and Trade is a specially authorized body for public-private cooperation and partnership. At the same time, the National Agency for Investment and Management of State Ukrainian Projects contributes to the implementation of the state’s policy in the field of investment activity, management of state projects within the framework of public-private partnership, local authorities formulate a policy for the development of public-private partnership at the regional level, which causes in some cases duplication of functions and contradictions between authorities.

The forms of such cooperation between the state, municipalities, and private businesses are quite diverse. They depend on the direction of the PPP and on the way of regulating legal relations between partners. Among the forms of PPPs based on contracts, that are represented in Ukraine the following are distinguished: the owner model (service contract), the lease model (lease contract), the leasing model (systematic purchase of the object), and the concession model. Of these forms of PPPs, the concession models the features from other contracts. However, currently, neither the lease agreement, the subcontract, the concession agreement, nor the mixed form of the agreement covers the complex forms of public-private partnership. The Law of Ukraine on Public-Private Partnership in Ukraine does not establish essential contract terms in the field of PPPs. It is expedient to develop, and approve a standard framework agreement called a public-private partnership. It is important to enshrine in the legislation the possibility of participation on the side of the state partner

of several persons in it. However, at the same time, it is necessary to combine in such a contract the goals, tasks, principles, mechanisms and tools of the PPP, the components listed above, to provide for such a type of public-municipal-private partnership that will ensure in the field of construction and operation of the typical infrastructure of the transport industry as a whole and in the railway sector in particular the following: 1) construction (reconstruction) of special objects – transport and their infrastructure; 2) their further operation, 3) transportation, 4) provision of other public interests, 5) creation of new jobs, 6) increase traffic, etc This law should include also other types of PPP: corporate-type economic organizations, the special legal regime for business entities implementing priority investment and innovation projects and has certain and ways of its implementation.

If a contract form is used, relations between partners will be purely contractual, and attracting additional investments to implement a socially necessary project will be significantly complicated (it is possible to invest in the relevant project only by direct partners). Such a contract is not enough for the creation transport hub and it doesn’t cover all relationships between members of it (economic, social, political, legal, and administrative aspects). There is a great corruption part, the absence of consulting center for PPP in Ukraine, plans for a long period during the concession agreement are additionally hard, because Ukraine isn’t a country with a stable economy, risk of default, and hardest question is question of the ownership, because UZ is a strategy object and variants with private ownership even for certain period is not possible.

Other forms of PPP are organizational and legal – the creation of corporate-type economic organizations with the participation of the state and/or territorial community in them, in particular: a) joint-stock companies in the process of corporatization or privatization, in which the participation of the state (territorial community) is preserved (Part 2 article 22, part 3 article 24, part 3 article 5 Contract Code), b) economic associations with the participation of the state and private business entities (consortium) (Resolution of the Cabinet of Ministers of Ukraine, 06.01.1995, and – introduction of a special legal regime for business entities implementing priority investment and innovation projects, including in certain territories (The Law On Innovation Activity, On Priority Directions of Innovation Activity in Ukraine, On Scientific parks, On the Science Park Kyiv Polytechnic, On State Regulation of Activities in the Field of Technology Transfer.

In international practice, there are a huge number of types of forms of public-private partnership and cooperation. For the following development of the transport sphere, in particular railway, we need choose the best variant of PPP for UZ, and pay enough attention to all particulars of it. Public-private partnerships are important for the construction and operation of infrastructure, especially for railways and transport ports. In world practice, there are two common forms of PPP, namely contractual (which is provided for in Ukraine’s legislation) and corporate (not used in Ukraine). The most cost-effective is the organizational and legal form – institutional or corporate. It does not exclude the contractual nature of relations between partners- it is based on an agreement on joint activities/contract of a simple company, which is considered the prototype of modern commercial organizations, primarily economic societies. But, in Ukraine, at this moment, the law of PPP stipulates that projects be only implemented in the form of a contract. At the same time, in certain European countries, there are no such restrictions. In most cases, a special structure is created in the form of a legal entity with the participation of a public and private partner, in some cases also with the participation of third parties – certain financial institutions. Within the framework of this association, it is possible to achieve maximum organizational structure and openness during operations by concluding relevant contracts.



As railways connect with roads, sea (river), air networks, and ports, they create opportunities with important elements how people will be able to use them. The perspective way of the PPP development in infrastructure projects, from the author's point of view, is corporative way – a legal entity based on the institutional nature with the state majority in ownership, according to which the interaction of the public and private sectors takes place within a certain structure, and can realize through creation transport cluster or transport hub. The need is to factor in the network effect, across the whole transport system of any individual addition by connecting different transport and door-to-door connection. It is important to preservative of the right of state ownership of strategic objects of the infrastructure of railway transport because of the presence of regulatory, and immigration bodies in railway complexes and the performance of certain state functions and protection of public interests by railways. Then is important to agree and join this idea with existing Laws and Codes or change them and with international documents. It would be important to implement the following concepts to the legislation of Ukraine: 1) substitution private partner – a legal entity, who undertakes to implement the PPP project on the terms provided for by the founding agreement or joint-stock agreement, if the main partner announces the complete or partial insolvency of the PPP project implementation within the prescribed time; 2) sponsor – economic organization (legal entity), state, municipal and other enterprises established by following with the current legislation of Ukraine, which participate in the financing of a private partner to ensure the fulfillment of obligations arising from the PPP, and also have the right to offer a new private partner under the conditions provided for by the founding agreement or joint-stock agreement within the PPP; 3) The Code of Laws on PPP is a unified normative legal act. Also decided legislation of the attraction of a foreign sponsor and partners.

One such approach for the development would involve a variation on the Australian system, where the publicly-owned Australian Rail Track Corporation (ARTC) controls a majority of the country's standard-gauge lines and charges operator access fees. Applying this system with the use of PPP partnership in the Ukrainian railway system could be something like this model: the infrastructure corporation, formed by

the private sector plus the government and municipalities. Each private partner could invest in the infrastructure projects by buying equity in the infrastructure company. As is the case with ARTC, government investments also could increase government capital. The company would set certain infrastructure access rates to cover the investment costs, make the investment decisions, and of course, infrastructure assets would secure the financing. As the ARTC, it will have the ability to pay out dividends that could increase the attractiveness of investing for private partners. To minimize the risk of monopoly behavior by both the infrastructure company and the private partner, an independent transport regulator should be to ensure a consistent, fair and transparent regulatory environment in the railway transport system in Ukraine. In addition, it is important, that the government must maintain the majority equity position in the infrastructure company and manage it separately from UZ. Barriers to entry to this market should be sufficiently low. Of course, this structure has significant advantage in that it incentivizes operators to invest in infrastructure by offering them the ability to take part in decisions about infrastructure access charges and capital investments. Keeping the government involved helps to ensure the investments continue to meet impartial policy goals, while the existence of an independent regulator will help avoid abuses of market power directed against new entrants and shippers. As a semi-government entity, PPP can be exempted from certain taxes that reduce the significant level of money out of the company. In addition, PPP still recognizes the need for direct subsidies—it just makes these subsidies impartial while inviting private sector participation.

PPP is so interesting for the Ukrainian railway, especially when the Ukrainian government hasn't already subsidized the rail infrastructure directly. By creating the open-access infrastructure PPP Corporation with representation from the government, municipalities and rail operators, Ukraine can agree on the motivation of the public and private sectors and improve the investment environment.

PPP can be an effective way to recover and rebuild transport infrastructure. It can be a transparency and real beneficial way to solve transportation and economic problems. It is so important to make rethink to approaches the investment instruments, in particular PPP.

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