



## Possibility to use and enforce lender's step-in rights in Baltic PPP projects: part three — Latvia

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Latvia adopted a new Public Private Partnership Law in 2009, following more than a year of preparatory work. Although the law is quite long, and overly prescriptive in certain respects, it does serve the main purpose of establishing a legal framework for launching public-private partnership projects (PPPs) in Latvia.

First, it recognises and defines the concept of PPP in more detail. Although the Public Procurement Law, which regulates procurements by the public sector in general, did have one article recognising the right to conclude PPP contracts for a duration in excess of five years, that would not have been sufficient to trigger a broader PPP programme for the public sector due to lack of knowledge and expertise by public officials. Secondly, it establishes a set of procedures that must be observed before launching any PPP project, including financial and economic appraisal (essentially involving a cost-benefit analysis and a value-for-money calculation) and governmental consents.

Thirdly, it establishes important rights for parties to a PPP project, which are necessary given international practice in PPPs, especially a flexible right to amend a PPP contract and step-in rights for lenders. Fourthly, it establishes a supervisory institution for PPPs in Latvia, which would act as a competence centre and supervise PPP projects and contracts throughout their life.

### Public procurement issues

The PPP Law provides that the public partner and lenders may enter into an "information exchange agreement", which is basically a direct agreement in the meaning of international PPP practice. The information exchange agreement regulates how the public partner informs the lender of defaults under the PPP contract that entitles the public partner to termination and how the lenders may exercise their step-in rights, albeit within the framework of prescriptive provisions of the PPP Law on step-in.

Essentially, the lenders can exercise step-in rights in the following ways:

- a. By proposing to the public partner a new private partner (i.e., new consortium or new project company) in cases where the public partner uses its contractual right to terminate, or if the private partner has decided to commence voluntary liquidation, or insolvency proceedings of the private partner have been declared.
- b. By proposing to the public partner a new shareholder for the private partner (project company) if the sole existing shareholder has decided to commence voluntary liquidation, or insolvency proceedings of the shareholder have been declared.
- c. By taking over the performance of the PPP contract until the conclusion of a new PPP contract with the new proposed private partner ((a) above), if this has been agreed in the information exchange agreement.

The PPP Law also provides a possibility to exercise step-in rights in case the shareholders of the project company change, if such right is provided for in the information exchange agreement. In such case, the information exchange agreement must provide for the procedure according to which the representative of the public partner gives its consent to the change of the shareholder.

Any new party (new private partner or new sole shareholder) has to comply with the same criteria that were present in the initial tender, with deviations permitted only to reflect the current stage of the PPP project. The public partner must inform the lenders of the full set of criteria when notifying the lenders of the right to terminate the PPP contract. The proposed new candidate must receive the public partner's consent, although under the law consent may be refused only if the candidate does not comply with the criteria.

## Contract law issues

General Latvian contract law would recognise the right of the lenders to "step in" under the PPP contract in the manner described above, provided that all the contracts concerned, i.e., the PPP contract, the information exchange agreement between the lenders and the public partner and the direct agreement between the lenders and the private partner, contain appropriate provisions to cater for such a unilateral transfer or novation of the PPP contract. Given that the PPP Law expressly recognises the concept of step-in, this should remove any doubt as to the validity of such contract clauses.

## Corporate law issues

Replacement of a sole shareholder of the private partner will entail registration of the transfer of the shareholding (i.e., transfer of ownership of the shares of the project company) to the new sole shareholder that the lenders have proposed. Generally, the shareholders' ledger, which under Latvian corporate law is the decisive evidence of shareholding for all non-listed private companies, is kept by the management board of the company and, therefore, its cooperation would be required to record a change of ownership.

If such cooperation is not forthcoming, it will be much harder to replace the shareholder. Lenders should, therefore, consider in advance appropriate corporate mechanics to make sure that the cooperation of the management board is achieved and the lenders have adequate control over the corporate affairs of the project company when it comes to exercising step-in rights on the shareholder level, for example, by retaining special rights under the articles of association of the company and holding a "golden share" in the company.

## Insolvency law issues

Like any company, the project company can, theoretically, become insolvent. This would lead to the court appointing an insolvency administrator to take over the management of the company. Latvian insolvency law has not been tailored to comply with the use of step-in rights by the lenders, so that in any PPP financing, the lenders need to consider the risks that relate to the insolvency regime becoming applicable to the project company.

Although under insolvency law the body of creditors has limited competence, it does have rights to dismiss the administrator if the administrator is conducting insolvency proceedings in an inefficient manner. Lenders should, therefore, make sure they have enough debt (either secured or unsecured) to guarantee the controlling majority in the creditors' meeting.

The insolvency administrator could in theory attempt to challenge transactions concluded up to three years prior to the date on which the insolvency proceedings of the project company were declared, if such transactions have caused damages to the project company and the counterparty knew or should have known about it. Although in a typical project financing or arm's length basis such a possibility would be remote, lenders would still be advised to consider the risks involved. Ultimately, the best protection is close control of the finances of the company to make sure that lenders step in to sort out any defaults before insolvency of the project company becomes acute.

Apart from the insolvency proceedings, the Insolvency Law also provides that legal protection proceedings or out-of-court legal protection proceedings may be initiated in court in case the project company encounters financial difficulties. The purpose of these proceedings is to avoid potential insolvency of the company. In practice, this may affect creditors because in such proceedings the legal protection measures plan is approved by the majority of creditors (both secured and non-secured), which becomes binding on the company itself and all its creditors after approval.

The Latvian government has committed to the international lenders (predominantly, the International Monetary Fund (IMF), the World Bank and the European Commission) that the launch of new PPPs (unless they are concession-type) is possible only if there is an offset by savings in other areas.



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