Possibility to use and enforce lender's step-in rights in Baltic PPP projects: part two — Lithuania

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In Lithuania the main rules that regulate the conduct of investment projects as public-private partnerships (PPPs) are set out in the Lithuanian Investments Law, the Lithuanian Concessions Law, the Lithuanian Public Procurement Law and Resolution No. 1480 of the Government of the Republic of Lithuania on the Partnerships of Public and Private Sector. There are two main types of PPP projects: investment projects conducted as concessions, which are regulated by the Lithuanian Concessions Law; and government authority and private partnerships, which are regulated by the Lithuanian Investments Law and the Lithuanian Public Procurement Law

Public procurement issues

The Lithuanian Concessions Law, which regulates the main terms of the concessions contract and the procedure for selecting the concessionaire, provides that a concessions contract should consider the circumstances on the basis of which the contracting authority or a third person may (temporarily or otherwise) take over the performance of any obligation of the concessionaire, to ensure effective and uninterrupted provision of the services in cases when the concessionaire materially defaults on the performance of its obligations under the concessions contract.

The Lithuanian Concessions Law also provides that a concessions contract should, *inter alia*, include the provisions on: (a) limitations and terms applicable to cases of change of control of the concessionaire; (b) the right of the parties to transfer their obligations under the concessions contract for security or any other purposes, and the terms of such transfer; and (c) the consequences of force majeure, change in laws or the occurrence of other changes and circumstances described in the contract, including the parties' right to demand amendment or termination of the concessions contract or compensation for the resulting losses (if provided in the concessions contract). The exercise of step-in rights by taking over the performance of the rights of the original concessionaire is, therefore, permitted under Lithuanian law and could be exercised in accordance with the terms of the contract, provided that such possibility was provided for in the respective concessions contract.

It is questionable whether the exercise of step-in rights by taking over the title to the shares of the concessionaire (or more precisely, its special purpose vehicle (SPV)) is permitted, as the Lithuanian Concessions Law provides that if a concession agreement is signed with an SPV which the concessionaire has established, then the concessionaire must control that SPV as long as the concessions contract is valid.

The situation is a little different with investment projects conducted as government authority and private partnerships, i.e., where the private partner provides a public service and receives payment for this service exclusively from the public sector partner. The Lithuanian Investment Law governs the main issues of this type of projects. It provides that a government authority and private partnership contract must, *inter alia*, cover: (a) the circumstances and terms under which the government authority, to ensure uninterrupted provision of services and/or performance of work, is entitled temporarily to take over itself or to transfer to a third party the performance of the obligations of the private partner, if the private partner is temporarily unable to perform its contractual obligation(s); (b) the procedure for solving unforeseen issues that have arisen during the term of the government authority and private partnership contract; and (c) the terms and conditions for amendment of the contract, if such possibility was provided in the tender rules, or termination of the contract.

The Lithuanian Investment Law therefore appears to allow the government authority to step in and temporarily take over the performance of the contract or temporarily to transfer it to a third party. The law does not, however, expressly provide that interested third parties could exercise step-in rights without the involvement of the government authority.

On the other hand, the Lithuanian Investments Law states that a government and private partnership contract is awarded in accordance with the provisions of the Lithuanian Public Procurement Law. Under this law, the terms of the public procurement contract may not be amended during the validity of the public procurement contract, except those terms which, if they were to be amended, would not infringe the principles and aims of equality, non-discrimination, mutual recognition, proportionality and transparency, and where the Lithuanian Public Procurement Office has approved such amendments in advance.

There seems, therefore, to be a contradiction between the respective provisions of the Lithuanian Investments Law and the Lithuanian Public Procurement Law about whether a party to the government authority and private partnership contract, awarded in accordance with the Lithuanian Public Procurement Law, may be changed (i.e., whether the contract may be amended). As the PPP provisions in the Lithuanian Investments Law are so new (amendments introducing PPP provisions came into force on January 1, 2010), there is no certainty yet as to which provisions of which law should prevail, although the new provisions do appear to entitle the government authority to step in if the private partner defaults should prevail. It remains to be seen which way the practice will turn.

The standardisation of PPP project documents was initiated by the government of Lithuania last year. A package of standard PPP documents is being prepared at the moment by external legal advisors. It is understood that a draft direct agreement providing for a lender's step-in rights will be included in the package of standard documents, although certain legislative changes in the Lithuanian Public Procurement Law and the Lithuanian Investments Law, as well as in other sub-legislative regulations, still need to be made to avoid ambiguities and misconstructions and to attain the objective of the direct agreement, i.e., to provide step-in rights for the lenders.

Contract law issues

Contract law issues become relevant in cases where the lender wishes to use step-in rights to replace the defaulting private partner in contracts with another private partner. Lithuanian contract law provides that the contract (i.e., the obligations it contains) may be transferred to another person if the counterparty to which such obligations are owed agrees to such a transfer. It is possible, and advisable, to obtain such consent in advance; indeed, such consent can be included in the initial contract.

If the transfer of the contract amounts to the transfer of all or a material part of the transferring entity's business (i.e., all/part of the entity's contracts, employees, etc.), however, it may be deemed to constitute a business, and not merely a contract, transfer. The Lithuanian Civil Code requires that business transfers are made in accordance with the specific procedure which, *inter alia*, includes specific form and content requirements of business transfer contracts and specific requirements for the treatment of other creditors.

Corporate law issues

If step-in rights are exercised in the form of taking over the title to the defaulting private partner's shares, corporate law issues may become relevant. Under Lithuanian corporate law, the title to non-tangible shares is evidenced by entries in the securities accounts of each shareholder. The manager of a private limited liability company is usually responsible for conducting the securities accounting. Recording the transfer of the title to shares may, therefore, be hindered if the manager of the concessionaire that is handling the company's securities accounting refuses to cooperate. There are, however, ways to mitigate this risk, e.g., by transferring the securities accounting task to a competent third party.

If the sponsor exercises control of the private partner, not through holding all the shares of the private partner but through shareholding coupled with rights granted through the shareholders' contract, then the rights under the shareholders' contract should also be transferred to the lender. It should also be noted that if the title to the shares is taken over through security enforcement procedures, specific enforcement procedures provided in the Lithuanian laws should be followed, i.e., 10-20 days' advance notice to the debtor through the Hypothecation Register.

Insolvency law issues

If a Lithuanian private partner were to be declared bankrupt, a bankruptcy trustee, who is an independent official appointed by the court, would gain control of the property and the affairs of the insolvent private partner. If the private partner has other creditors, lenders under the PPP project would not have the ability to direct the bankruptcy trustee fully to their desired course of action as the bankruptcy trustee would have to act for the benefit of all creditors.

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