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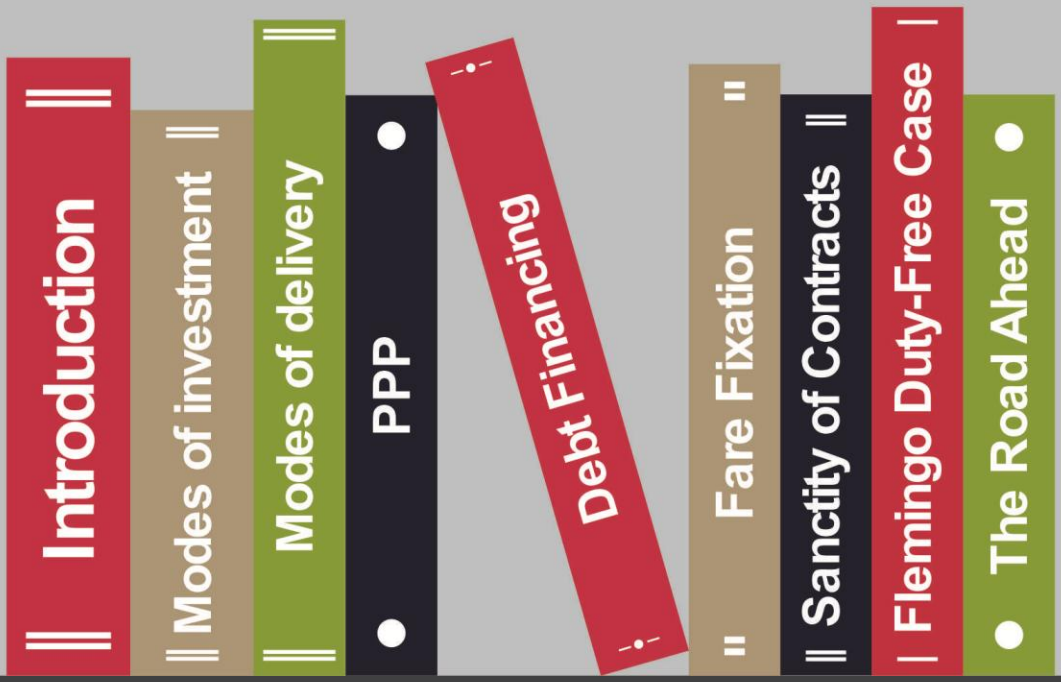

Infrastructure in India

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Preface

Dear Reader,

The need for Infrastructure in India is essential on all three fronts: social, economic and political. In the first of the series of booklets, we are pleased to encapsulate some of the principles that are common to all sectors in Infrastructure, be it energy, water, ports, airports and railways.

At ELP, over the last fifteen years, we have seen cycles of activity in the Infrastructure Sector, varying from greenfield projects to voluntary and involuntary disposal of projects through acquisitions and mergers. Through thick and thin, ELP has firmly believed that the legal work involved in the Infrastructure Sector is utmost complex and unwinding but also something that gives us a lot of satisfaction.

We hope that you enjoy reading these few chapters. If you wish to know anything more, do connect with your usual contacts in ELP or myself.

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I. A Brief introduction to Infrastructure in India

Infrastructure is a key driver for the Indian economy. It is this sector that is responsible for spearheading India's overall development and enjoys intense focus from the Government of India. The latter have initiated policies that would ensure time-bound creation of world-class infrastructure in the country.

Mr. Nitin Gadkari, the Minister of Road Transport, Highways, and Shipping has announced the government's target of approx. USD 377 billion of investment in infrastructure over a period of three years, starting 2017. This will include approx. USD 121 billion for developing 27 industrial clusters, and an additional approx. USD 75 billion for road, railway, and port connectivity projects.

A total of 6,604 km out of the 15,000 km of target set for national highways in 2016-17 has been constructed by the end of February 2017, according to the Minister of State for Road, Transport & Highways, Government of India.

The infrastructure in India includes power, bridges, dams, roads and urban infrastructure development. In 2016, India jumped 19 places in the World Bank's Logistics Performance Index (LPI) 2016, to rank 35th among 160 countries.

Total infrastructure spending was about 10 percent of GDP during the 12th Five Year Plan (2012-2017), which was up from about 7.6 percent in the previous plan (2007-2012). The increased impetus to develop infrastructure in the country is attracting both domestic and international players.

The private sector is emerging as a key player across various infrastructure segments, including but not limited to roads, communications, power, and airports. In order to boost the construction of buildings in the country, the Government of India has come up with a single-window clearance facility for speedy approval of construction projects. On the heels of several initiatives such as 'Housing for All'[1] and 'Smart Cities,'[2] the government has been working on reducing the bottlenecks that impede growth in the infrastructure sector. The latest budgetary outlay for infrastructure spending has been increased to USD 61.51 billion for various projects including housing, railways, ports and irrigation.

With an investment requirement of USD 1 trillion over the next five years, the infrastructure sector in India presents a huge investment opportunity for both domestic and international players. A large number of private players will enter the infrastructure sector, especially roads, through the PPP model. During the next five years, the investment through PPP is expected to touch about USD 31 billion.

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[1] Housing for All or Pradhan Mantri Awaas Yojana was launched in June 2015 with an aim to provide affordable housing to the urban poor.

[2] The Government of India announced its Smart Cities Mission on 25 June 2015 with an objective to promote sustainable and inclusive cities that provide core infrastructure and give a decent quality of life to its citizens, a clean and sustainable environment and application of 'Smart' solutions.

Thanks to initiatives such as the UDAY scheme[3], the power sector has been clocking fast growth. Through this scheme, the government has taken steps to improve operational and financial parameters and increase tariff to help distribution companies (discoms) reduce mounting losses and debt. It has thus far laid out a visionary target for India—providing 24x7 power. For this target, the government plans to spend USD 50 billion on transmission infrastructure. It also aims for 1 billion tonnes of domestic coal production.

The projected spending on infrastructure projects from FY07 to FY12 was as follows:

- Electricity: USD 167 billion
- Railways: USD 65 billion
- Road and highways: USD 92 billion
- Ports: USD 22 billion
- Airports: USD 8 billion

This spending is expected to increase significantly from 2017 to 2022.

Given the focus of the Government on providing the much needed impetus to the infrastructure sector, combined with a concerted effort from domestic players, infrastructure in India is set to pick up pace. Foreign investors too, may find that now is the right time to invest in India's infrastructure.

For the various way in which foreign funding may find its way into infrastructure projects in India, please see the chapter titled *Modes of Investment in Infrastructure in India* on page 7.

[3] Ujwal DISCOM Assurance Yojana (UDAY) is the financial turnaround and revival package for electricity distribution companies of India initiated by the Government of India with the intent to find a permanent solution to the financial mess plaguing power distribution.

II. Modes of Investment in Infrastructure in India

With India already being the fourth-largest economy in the world, its infrastructure needs are huge and are only bound to increase. Both public and private players in the infrastructure space are eyeing possible investments in India through varied mechanisms to avail of the huge opportunity that is present in the infrastructure space. It is estimated that India requires USD 454.83 billion to be invested in infrastructure development over the next 5 (five) years, with 70% (seventy percent) of funds needed for power, roads and the urban infrastructure segment. Finance being the lifeblood of any commercial enterprise, it is important for developers to understand the sources of financing and their limitations. Similarly, investors and/or acquirers also need to bear in mind the avenues and regulatory limitations for their investments.

In this chapter, we aim to highlight the various modes of investment in Infrastructure projects in India.

Sources of Funding and Applicable Regulations

I) Domestic Equity

There are no specific provisions applicable to investment through equity by domestic investors or acquirers in infrastructure projects in India. Other than adherence to the provisions of the Companies Act, 2013 (Companies Act) relating to subscription or purchase of equity securities, there are no requirements that need compliance. Where equity transactions involve acquisition of listed Indian entities, investments and acquisitions over the prescribed threshold of 25% (twenty five percent) or acquisitions of control (which may not involve acquisitions over 25% (twenty five percent) of the share capital of the target) would trigger open offer provisions of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeover) Regulations, 2011 (SEBI Takeover Regulations) issued by the Securities and Exchange Board of India (SEBI). Even where the aforesaid threshold is not breached or control is not acquired, there are disclosure requirements for acquisitions at different thresholds. Indirect transfers are also covered by the SEBI Takeover Regulations.

II) Foreign Equity

During the 1990s, the 'ceilings' on FDI in different sectors were progressively raised. From 2001, 100 per cent foreign investments were allowed in several industrial sectors. Currently, 100 per cent Foreign Direct Investment is allowed in almost all the infrastructure sectors. The table below lists the different FDI ceilings under the automatic route.

Sectors	Percentage of permissible FDI
Telecom	49
Electricity generation, transmission, and distribution	100
Roads and Highways	100
Ports and Harbours	100
Civil Aviation (in Greenfield airport ventures)	100

Railway projects[4]	100
Construction Development[5]	100

It is important to note, however, that FDI is not permissible in any real estate business, construction of farm houses and trading in transferable development rights (TDRs).

In terms of exit as regards construction development, the foreign investor will be permitted to do so and repatriate foreign investment before the completion of the project under the automatic route, provided that a lock-in-period of 3 (three) years, calculated with reference to each tranche of foreign investment has been completed. Nonetheless, exit is permitted at any time if project or trunk infrastructure is completed before the lock-in-period. The aforesaid lock-in restrictions are not applicable to hotels and tourist resorts, hospitals, special economic zones (SEZs), educational institutions, old age homes and investment by non-resident Indians. However, the terms of the project agreement and bidding conditions are also to be adhered to.

The Department of Industrial Policy and Promotion (DIPP) has allowed 100% (one hundred percent) FDI in asset reconstruction companies (ARC) under the automatic route, which is aimed at helping to tackle the issue of declining asset quality of banks.

Apart from the FDI route, foreign investors that are registered as foreign institutional investors (FIIs) or foreign portfolio investors (FPIs) may invest through the Portfolio Investment Scheme ("PIS") route. Under PIS, the individual holding of an FII and/or FPI cannot exceed 10% (ten percent) of the capital of the company and the aggregate limit for FII and/or FPI investment cannot exceed 24% (twenty four percent) of the capital of the company (which may be increased to the sectoral cap subject to the approval of the Reserve Bank of India (RBI). Only registered FIIs and FPIs can trade and invest in securities through a registered broker on stock exchanges in India. Additionally, foreign investors may acquire securities of unlisted companies through off-market transactions.

In any case, acquisitions by foreign investors would always be subject to the provisions of the SEBI Takeover Regulations, which require disclosure and open offer to be made beyond a certain threshold.

In a bid to encourage foreign investment in infrastructure projects, the Union Cabinet has approved a scheme allowing the grant of Permanent Residency Status (PRS)[6] to foreign investors based on a minimum investment of USD 1.5 million within 18 months or USD 3.6 million within 36 months.

[4] 100% FDI is permissible in construction, operation and maintenance of (i) Suburban corridor projects through PPP, (ii) High speed train projects, (iii) Dedicated freight lines, (iv) Rolling stock including train sets, and locomotives/coaches manufacturing and maintenance facilities, (v) Railway Electrification, (vi) Signaling systems, (vii) Freight terminals, (viii) Passenger terminals, (ix) Infrastructure in industrial park pertaining to railway line/sidings including electrified railway lines and connectivity to main railway line and (x) Mass Rapid Transport Systems. Any foreign investment in to railway projects would be subject to the sectoral guidelines of the Railways Ministry.

[5] This includes development of townships, construction of residential/commercial premises, roads or bridges, hotels, resorts, hospitals, educations institutions, recreational facilities, city and regional level infrastructure, townships.

[6] PRS serves as a multiple entry visa without any stay stipulation and holders will be exempted from registration requirements. They will be allowed to purchase one residential property for dwelling purpose. Spouse and dependents will be allowed to take up employment in private sector (in relaxation to salary stipulations for employment visa) and undertake studies in India.

III) Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs)

Over the last decade, REITs and InvITs have developed into a mature market, providing easy access to high-quality assets and enabling a stable return on investments. To illustrate this, as of 2012, there have been over 500 REITs across 22 countries, with a total market capitalisation of more than US$ 850 billion. Countries such as the US, Australia, France, Japan and the UK were the top five markets for REITs in the world. Taking a leaf out of the global book and to encourage investments in the real estate and infrastructure sectors, SEBI introduced REITs and InvITs as alternate investment structures to be set up as registered trusts through the Real Estate Investment Trust Regulations, 2014 (REITs Regulations) and the Infrastructure Investment Trust Regulations, 2014 (InvITs Regulations) respectively.

InvITs

InvITs are mutual fund-like institutions that enable investments into the infrastructure sector in India by pooling small sums of money from multiple individual investors. This money is directly invested in infrastructure, so as to return a portion of the income (after deducting expenditures) to unit holders of InvITs who pooled in the money.

InvITs can invest in infrastructure projects either directly, or through a Special Purpose Vehicle (SPV). In case of PPP projects, such investments can only be through SPV. InvITs are regulated by SEBI.

There are two types of InvITs that have been allowed. One is allowed to invest mainly in completed and revenue-generating infrastructure projects, and the other has the flexibility to invest in completed or under-construction projects. While the former has to undertake a public offer of its units, the latter has to opt for a private placement of its units. Both the structures are required to be listed.

Structure of InvITs

InvITs are set up as a trust and registered with SEBI. An InvIT has four parties: A Trustee, Sponsor(s), Investment Manager, and Project Manager.

The trustee, who oversees the role of an InvIT is a SEBI-registered debenture trustee and cannot be an associate of the Sponsor or Manager.

“Sponsor” means promoter(s) and refers to any company or Limited Liability Partnership (LLP) or body corporate with a net worth of USD 15.53 million which sets up the InvIT and is designated as such at the time of application made to the SEBI. In case of PPP projects, it refers to the infrastructure developer or a special purpose vehicle (with the net worth as specified in the PPP contract) holding a concession agreement.

Promoters or Sponsor(s), collectively, have to hold at least 15% in the InvIT for at least 3 years, except in cases where a regulatory requirement/ concession agreement requires the sponsor to hold a certain minimum percent in the underlying SPV. In such cases the consolidated value of such sponsor holding in the underlying SPV and in the InvIT cannot be less than 15% of the value of units of InvIT on post-issue basis.

Investment Manager is a company or a Limited Liability Partnership (LLP) or body corporate, which manages assets and investments of the InvIT and undertakes activities of the InvIT.

Project manager means the person designated as the project manager by the InvIT, responsible for achieving execution of the project and in case of PPP projects, it refers to the entity responsible for such execution and achievement of project milestones in accordance with the concession agreement or any other relevant project document.

If the investment is done through an SPV, then InvIT has to hold a controlling interest with not less than 50% of the equity share capital or interest in SPV, except where this is not possible because of a regulatory requirement/ requirement resulting from the concession agreement.

In such cases, the sponsor has to enter into an agreement with the InvIT, to ensure that no decision taken by the sponsor, including voting decisions with respect to the SPV, are against the interest of the InvIT and its unit holders. The Union Budget 2016-17 has withdrawn the 17% Dividend Distribution Tax that is applicable on any distribution made out of income of SPV to the REITs and InvITs, having specified shareholding. An InvIT has to be listed on a stock exchange.

Operational aspects of the InvIT

The value of the assets owned or proposed to be owned by the InvIT should be at least USD 77.66 million. The minimum issue size for an initial offer is USD 38.83 million. InvITs are allowed to add projects in the same vehicle in the future, so that investors can benefit from diversification as well as growth in their portfolio.

The maximum borrowing permitted is 49% (forty-nine percent) of the value of the InvIT assets. Also, post 25% (twenty-five percent) unit holders' approval and credit rating is mandatory for borrowing. InvITs which propose to invest at least 80% (eighty percent) of the value of the assets in the completed and revenue generating Infrastructure assets, shall:

- Raise funds only through public issue of units
- Have a minimum 25% (twenty-five percent) public float and at least 20 investors
- Have minimum subscription size and trading lot of USD 15532 and USD 7766 respectively
- Distribute not less than 90% (ninety percent) of the net distributable cash flows, subject to applicable laws, to the investors
- Undertake full valuation of invested assets at least once a year, with half yearly updating of the same
- May invest the remaining 20% (twenty percent) in under-construction infrastructure projects and certain other permissible investments. However, the investments in under-construction infrastructure projects shall not be more than 10% (ten percent) of the value of the assets

InvITs which propose to invest more than 10% (ten percent) of the value of their assets in under construction infrastructure projects:

- Can raise funds only through private placement from Qualified Institutional Buyers and body corporates
- Have minimum investment and trading lot of USD 0.1553 million
- Have a minimum of 5 investors with each holding not more than 25% (twenty-five percent) of the units

- Distribute not less than 90% (ninety percent) of the net distributable cash flows, subject to applicable laws, to the investors
- Undertake full valuation on a yearly basis

It is important to note that listing is mandatory for both publicly offered and privately placed InvITs.

REITs

REITs are set up as a trust under the provisions of the Indian Trusts Act, 1882 and are registered with SEBI. Like a mutual fund, it has three parties - Trustee, Sponsor(s) and Manager - to avoid any conflict of interest issues. The Trustee generally has an overseeing role on the activities of the REIT. Sponsor(s), must collectively hold at least 25% (twenty-five percent) in the REIT for at least 3 years and 15% (fifteen percent) thereafter. Sponsor's responsibilities are to set up the REIT and appointment of the Trustee. Manager, a company or LLP or body corporate incorporated in India, is to manage assets and investments of the REIT and undertakes operational activities of the REIT. In short, the manager assumes the operational responsibilities pertaining to the REIT. A manager needs to have at least 5 years of related experience coupled with other requirements such as minimum net worth, manpower with sufficient relevant experience, and so on.

REIT can invest in commercial real estate assets, either directly or through Special Purpose Vehicle (SPVs) which invests more than 80% (eighty percent) of its assets in properties. If REIT is investing through an SPV, REIT has to hold controlling interest with not less than 50% (fifty percent) of the equity share capital or interest in SPV.

Here "real estate" refers to land and any permanently attached improvements to it, whether on leasehold or freehold, and includes buildings, sheds, garages, fences, fittings, fixtures, warehouses, car parks, and so on, and any other assets incidental to the ownership of real estate. But the definition does not include mortgage and any asset falling under the purview of 'infrastructure' as defined vide Notification of Ministry of Finance dated October 07, 2013.

This is because a modified REITs type structure for infrastructure projects is done through InvITs for PPP and other infrastructure projects.

Offer of units, listing, investments and distribution

- Value of the assets owned/proposed to be owned by REIT should be at least USD 77.66 million
- The REIT can raise funds initially through an initial offer and once listed, may subsequently raise funds through follow-on offers
- Minimum issue size for initial offer is USD 38.83 million with a minimum public float of 25%
- Listing of units in a stock exchange is mandatory in India
- The minimum subscription size for units of REIT is USD 3107 and the trading lot is specified at USD 1553 so as to allow only reasonably informed investors into this market

    - Permitted Investments by REIT are:
    - At least 80% (eighty percent) in completed and revenue generating properties.

- Not more than 20% (twenty percent) in developmental properties and other eligible investments. Provided, investment in developmental assets is not more than 10% (ten percent) of the value of REIT assets.
- REIT to invest in at least 2 projects with not more than 60% (sixty percent) of value of assets invested in one project. Related party transactions are subject to strict scrutiny.
- REIT to distribute not less than 90% (ninety percent) of the net distributable cash flows, subject to applicable laws, to its investors.
- Maximum borrowing permitted is 49% (forty-nine percent) of the value of the REIT assets. Further, credit rating and post 25% (twenty-five percent) unit holders approval are mandatory to raise debt.

Full valuation to be carried out at least once a year and half yearly updating of the same has to be carried out.

IV) Taxation Regime of REITs and InvITs

Taxation regime was introduced in the provisions of the Income-tax Act, 1961 (IT Act) by the Finance Act, 2014 (subsequently there have been amendments by the Finance Act, 2015 and Finance Act, 2016) with respect to REITs and InvITs.

Section 2(13A) of the IT Act defines the term 'business trust' as follows:

2(13A) "business trust" means a trust registered as-

i. an Infrastructure Investment Trust under the Securities and Exchange Board of India (Infrastructure Investment Trusts) Regulations, 2014 made under the Securities and Exchange Board of India Act, 1992 (15 of 1992); or

ii. a Real Estate Investment Trust under the Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014 made under

the Securities and Exchange Board of India Act, 1992 (15 of 1992), and the units of which are required to be listed on recognized stock exchange in accordance with the aforesaid regulations

1. The taxation regime of REITs/INvITs, Investors and Sponsor and Investors is set out below:

Nature of income	Provision of the IT Act	Taxation of REITS/InvITs	Taxation of Unit holders
Interest received from Special Purpose Vehicle[7]	Section 10(23FC)/115UA	Exempt from tax	Taxable as Interest income[8]

[7] "special purpose vehicle" means an Indian company in which the business trust holds controlling interest and any specific percentage of shareholding or interest, as may be required by the regulations under which such trust is granted registration;

[8] 115UA. (1) Notwithstanding anything contained in any other provisions of this Act, any income distributed by a business trust to its unit holders shall be deemed to be of the same nature and in the same proportion in the hands of the unit holder as it had been received by, or accrued to, the business trust.
(2) Subject to the provisions of section 111A and section 112, the total income of a business trust shall be charged to tax at the maximum marginal rate.

Rental income – applicable only in relation to REITs – by way of renting or leasing or letting out any real estate asset owned directly by such business trust	Section 10(23FCA)	Exempt from tax	Taxable as rental income
Withholding tax on interest and rental income payable by a business trust to its units holders	Section 194LBA	- **Residents**: Withholding at the rate of 10%; - **Non-residents**: a) *Interest income*: Withholding at the rate of 5%; b) *Rental income*: Withholding at the rates in force.	
Capital gains earned on sale of shares of SPV by REITs/InvITs	Section 115UA/Section 10(23FD)	Taxable in the hands of REITs/InvITs at the applicable rate i.e. as per the provisions of Section 111A and 112 depending upon the period of holding	Exempt from tax as per the provisions of Section 10(23FD)
Capital gains earned on sale of units of business trust by a Unit holder	Section 111A, 10(38)	Not relevant/applicable	- Short Term Capital gains: Taxed at the of 15% (as per Section 111A) - Long term Capital Gains: Exempt from tax (as per Section 10(38)
Other income of REITs/InvITs	Section 115UA/Section 10(23FD)	Taxed at maximum marginal rate	Exempt from tax
Dividends	Section 10(23FC)	Exempt from tax	Exempt from tax

2. Taxation of Sponsor – Swap of shares for units of business trust

- As per Section 47(xvii) of the IT Act, *'any transfer of a capital asset, being share of special purpose vehicle to a business trust in exchange of units allotted by that trust to the transferor'* shall not be regarded as a transfer and accordingly will not be liable to capital gains tax.

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(3) If in any previous year, the distributed income or any part thereof, received by a unit holder from the business trust is of the nature as referred to in *sub-clause (a) of* clause (*23FC*) or clause (*23FCA*) of section 10, then, such distributed income or part thereof shall be deemed to be income of such unit holder and shall be charged to tax as income of the previous year.

- Thus, when there is a swap of shares for the units of the business trust by a Sponsor, such swap will not be regarded as a transfer. However, on the sale of units by the Sponsor, taxation as applicable to other investors will be applicable (Section 111A – at the rate of 15%/Section 10(38) exempt from tax)[9].

3. Special purpose vehicle – distribution of dividends

As per Section 115-O(7), no tax shall be levied on distributed profits in respect of the amount declared, distributed or paid by a special purpose vehicle (SPV) to a business trust i.e. SPV is not required to pay dividend distribution tax (DDT) on the amount of dividend paid to a business trust, provided the following conditions are fulfilled:

a) Exemption from levy of DDT would only be in the cases where business trust either holds 100% (hundred percent) of the share capital of the SPV or holds all of the share capital other than that which is required to be held by any other entity as part of any direction of any Government or specific requirement of any law to this effect or which is held by Government or Government bodies; and
b) Exemption from the levy of DDT would only be in respect of dividends paid out of current income after the date when the business trust acquires the shareholding in SPV as referred above. The dividends paid out of accumulated and current profits up to this date shall be liable for levy of DDT as and when any dividend out of these profits is distributed by the company either to the business trust or any other shareholder.

[9] Prior to the amendment by the Finance Act, 2015, Sponsor was liable to tax at the normal capital gain rates, the preferential regime was not applicable.

III. Modes of delivery of Infrastructure through private participation

An Overview

While the Government of India can participate in Infrastructure projects through PPPs, there are also infrastructure projects that are dependent on private participation of different sorts. There are various acronyms used to describe the nature of private participation in infrastructure projects in India. These projects are dependent upon the scope and extent of private participation in the implementation of an infrastructure project and define not only the nature of private participation but the nature and structure of the project as well.

The scope and extent of private participation is determined by the government and can be of varying degrees. The degree of participation by the private enterprise determines the structure of implementation of the project, the nature of documentation, the risks involved, the legal framework and other relevant issues.

The grants of rights to private developers regarding an infrastructure project can be either through a license granted under a governing statute or through a contractual agreement. The governing contract in a contractual arrangement that vests the rights of development and implementation of the project with a private body, is common known as the Concession Agreement.

Schemes for Private Participation

Broadly speaking, the schemes for private participation in infrastructure can be categorised as below:

1) **Build Own and Operate (BOO)**: BOO is a contractual agreement, whereby a project developer is authorised to finance, construct, own, operate, and maintain an infrastructure or development facility, from which the developer is allowed to recover the total investment, operating and maintenance costs, plus a reasonable return thereon, by collecting tolls, fees, rentals or other charges from facility users. Under the project, the developer who owns the assets of the facility may assign its operation and maintenance to a facility operator.
2) **Build Operate and Transfer (BOT)**: BOT is a contractual arrangement whereby the project developer undertakes the construction (including financing) of a given infrastructure facility, and the operation and maintenance thereof. The project developer operates the facility over a fixed term during which one is allowed to charge facility users appropriate tolls, fees, rentals, and charges not exceeding those proposed in its bid, or, as negotiated and incorporated in the contract to enable the project developer to recover the investment, and operating and maintenance expenses in the project. The project developer transfers the facility to the government agency or local government unit concerned at the end of a fixed term. This may include a supply-and-operate situation which is a contractual arrangement, whereby the supplier of equipment and machinery for a given infrastructure facility, is the interest of the government so requires, operates the facility.
3) **Build Lease and Transfer (BLT):** BLT is a contractual arrangement whereby a project developer is authorised to finance and construct an infrastructure or development facility. Upon its completion, the developer turns it over to the government agency or the concerned local government on a lease arrangement for a fixed

period, after which the ownership of the facility is automatically transferred to the government agency or the concerned local government.

4) **Build Transfer and Operate (BTO)**: BTO is a contractual arrangement whereby the government contracts out the construction of an infrastructure facility to a private entity such that the contractor builds the facility on a turn-key basis, assuming cost overruns, delays, and specified performance risks. Once the facility is commissioned satisfactorily, the title is transferred to the implementing agency. The private entity, however, operates the facility on behalf of the implementing agency under an agreement.
5) **Contract Add and Operate (CAO)**: CAO is a contractual arrangement whereby the project developer adds to an existing infrastructure facility which it rents from the government and operates the expanded project over an agreed period as a franchisee. There may or may not be a transfer arrangement with regard to the added facility provided by the project developer.
6) **Develop Operate and Transfer (DOT)**: DOT is a contractual arrangement whereby favourable conditions external to the new infrastructure project which is to be built by a private developer are integrated into the arrangement by giving that entity the right to develop an adjoining property, and thus, enjoy some of the benefits created by the investment such as higher property or rent values.
7) **Rehabilitate Operate and Transfer (ROT)**: ROT is a contractual arrangement whereby an existing facility is turned over to a private entity to refurbish, operate and maintain for a specified period as a franchisee, on the expiry of which the legal title to the facility is turned over to the government. The term is also used to describe the purchase of an existing facility from abroad, and refurbishing, erecting and consuming it within the host country.
8) **Rehabilitate Own and Operate (ROO):** ROO is a contractual arrangement whereby an existing facility is turned over to the private sector for refurbishing and operation with no time limit on ownership. As long as the operator has not violated the franchise, it can continue to operate the facility in perpetuity.
9) **Lease Renovate Operate and Transfer (LROT):** LROT is a contractual arrangement whereby an existing infrastructure facility is handed over to private parties on lease, for a particular period of time for the specific purpose of renovating the facility and operating it for a specific period of time, on such terms and condition as may be agreed to with the government for recovering the costs with an agreed return and thereafter, transferring the facility to the government. The Ministry of Power has adopted this route for the renovation of existing power plants.
10) **Hybrid Annuity Model:** This model has been approved by the Cabinet Committee on Economic Affairs. This model is one of the modes of delivery for implementing Highway projects. Adopting such a model for projects not found viable on BOT (Toll) mode shall be more effective in terms of maximizing the quantum of kilometres implemented within the available financial resources of the Government. The main object of the approval is to revive highway projects in the country by making one more mode of delivery for highway projects.

    By adopting this Hybrid Annuity model as the mode of delivery, all major stakeholders in the PPP arrangement - the Authority, lender and the developer, and concessionaire, would have an increased comfort level resulting in revival of the sector through renewed interest of private developers/investors in highway projects and this will bring relief thereby to citizens/ travellers in the area of a respective project.

    It will facilitate uplifting the socio-economic condition of the entire nation due to increased connectivity across the length and breadth of the country leading to enhanced economic activity.

Conclusion

These modes of delivery for private participation in infrastructure projects in India offer a wide range of options for private players interested in investing in the infrastructure sector in India. These modes of delivery augurs well for a win-win solution for both the Government of India and for private players.

IV. Public Private Partnerships (PPP) in Indian Infrastructure

World History of Public-Private-Partnerships (PPPs)

It was Margaret Thatcher's government who introduced the privatisation of infrastructure projects in the 1980s. They faced great criticism. However, it was the Conservative Government led by John Major in the UK that introduced the concept of PPPs in 1992. It was then named the Private Finance Initiative (PFI).

The Labour Government that came into power in 1997 also continued the PFI policy. With serious opposition from labour unions, PFI has become a key method for successive UK governments to procure value for money for public services and infrastructure in times when they could not afford to do so otherwise.

Initially, in the UK, roads and prisons were the sectors toward which PFI was directed. After 1997, priorities moved to education and health, with enormous investments being made in UK infrastructure over the subsequent decade. Currently, the term PPP is used more than PFI to refer to such projects.

Along with the UK, the Australian Government also commenced and implemented a robust PPP programme. Over the last decade, governments across the globe have become aware of PPP and its advantages. Therefore, PPP policies have been implemented in countries throughout Europe, the Middle East, the Americans, Australasia and Asia.

The development and use of PPPs for delivering infrastructure services has now at least 15 years of precedence in India. The Indian Government has made great efforts to promote PPPs in India and is being supported in their efforts by multilateral agencies, such as the World Bank and the Asia Development Bank.

Introduction to PPPs in India

A Public-Private-Partnership (PPP) is a commercial legal relationship defined by the Government of India in 2011. It can be defined as, "*an arrangement between a government or statutory entity or government-owned entity on one side and a private sector entity on the other, for the provision of public assets and/or related services for public benefit, through investments being made by and/or management undertaken by the private sector entity for a specified time period, where there is a substantial risk sharing with the private sector and the private sector receives performance-linked payments that conform (or are benchmarked) to specified, predetermined and measurable performance standards.*".

PPPs are long-term contractual partnerships between the public and private sector agencies, specifically targeted towards financing, designing, implementing, and operating infrastructure facilities and services that were traditionally provided by the public sector.

The Government of India recognizes several types of PPPs, including: User-fee based BOT models, Performance based management/maintenance contracts and Modified design-build (turnkey) contracts. Today, there are hundreds of PPP projects in various stages of implementation throughout the country.

As outlined in its XII Five Year Plan (2012–2017), India has an ambitious target of infrastructure investment (estimated at US$1 trillion). In the face of such an enormous investment requirement, the Government of India is actively promoting PPPs in many sectors of the economy.

Infrastructure in India is poor when compared to similarly developed nations. The Government of India identified PPP as a way of developing the country's infrastructure. In the 1990s, during India's first liberalization wave, there were various attempts to promote PPPs. However, in some sectors – such as water and sanitation – it failed. India was perceived as too risky and there was significant opposition to private sector involvement. It is only in the first half of the 2000s that the first PPPs were signed and implemented. Construction of infrastructure in India requires large capital outlays and there is a deficit in supply. Over 50% (fifty percent) of major infrastructure development projects in Maharashtra state are based on PPP. Projects using the PPP model have also proceeded in Karnataka, Madhya Pradesh, Gujarat, and Tamil Nadu state.

In August 2012, the then Prime Minister of India, Manmohan Singh, lifted the ban on the transfer of government-owned land, relaxed land transfer policy and did away with the need for Cabinet approval for PPP projects in order to accelerate the building of infrastructure.

An Overview of PPPs in Indian Infrastructure

India, today has one of the largest PPPs in Infrastructure in the world. With close to 1300 PPP projects, in various stages of implementation, India is one of the leading countries in terms of readiness for PPPs. According to the 2015 Infrascope Report of the Economist Intelligence Unit, India ranks first in the world in “Operational Maturity” for PPP projects, third for sub-national PPP, and fifth overall for having an ideal environment for PPP projects.

In 2006, the Department of Economic Affairs (DEA) set up the PPP cell. The PPP Cell is responsible for policy level matters concerning PPPs, including Policies, Schemes, Programmes, Model Concession Agreements and Capacity Building. The PPP Cell is also responsible for matters and proposals relating to clearance by PPPAC, Scheme for Financial Support to PPPs in Infrastructure (VGF Scheme) and India Infrastructure Project Development Fund (IIPDF).

With India expected to grow at 8 to 9 percent annually in the years to come, the creation of world-class infrastructure would require large investments in addressing the deficit in both quality and quantity. Therefore, it is necessary to plug this deficit through PPPs in all areas of infrastructure, such as roads, ports, energy, and so on.

Recently, legal and regulatory changes have been made to enable PPPs in the infrastructure sector, across power, transport, and urban infrastructure. For example, the Electricity Act has allowed for private sector participation in the distribution of electricity in specified areas, as a “franchisee.” This recognition of the “franchisee” role is an important step in fostering PPP in the distribution of electricity.

In some cases, another model of PPP has been adopted, the benefits of which have been felt almost immediately. A case in point would be the initial Build-Operate-Transfer (BOT) experience at the Jawaharlal Nehru Port. As far as the latter is concerned, the Minimum Guaranteed Traffic requirement was met in just 2

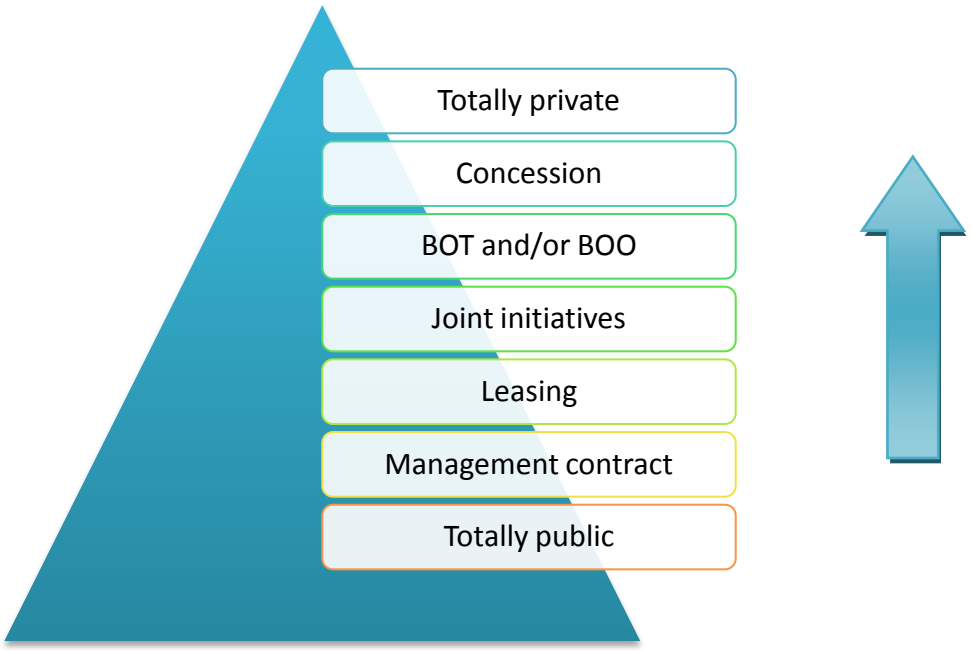
years, as opposed to the 15 years in the Agreement. Therefore, this experiment is being replicated in other major ports as well.

The roads sector in India has been the most proactive in attracting private participation, with the National Highways Development Project (NHDP) being the biggest PPP initiative to date. The roads sector accounts for about 75% (seventy-five percent) of completed projects. Other than the roads sector, the ports sector has seen a lot of private participation.

While the PPP model has met with great success in India, there is still a need to refine and evolve it further to make it an even more successful proposition. One of the key issues is the need to address the conflicting interests of multiple stakeholders. The latter include the government, private players, users, financial institutions and so on.

In a subsequent section, we shall talk about certain approaches that will enable private sector players to secure a reasonable return at manageable levels of risk, provide the user with adequate service quality at an affordable cost, and facilitate the government in procuring value for public money.

Public-Private Modalities and Trends



Note: BOO = Build-Own-Operate and BOT = Build-Operate-Transfer

The Role of Partners in PPP Projects

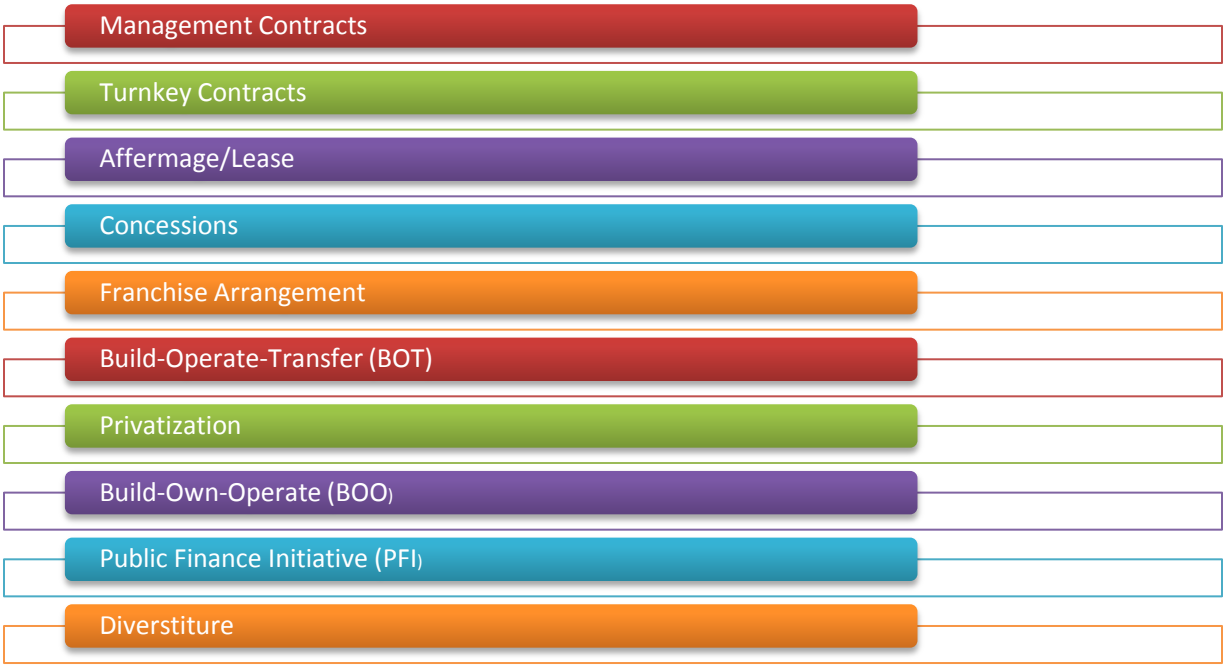
PPPs aim to combine the skills, expertise, and experience of both the public and private sectors to deliver higher standard of services to customers or citizens. PPPs do not mean reduced responsibility and accountability of the government. The government remains accountable for service quality, price certainty, and cost effectiveness (value for money) of the partnership.

Under the PPP format, the government role gets redefined as one of facilitator and enabler, while the private partner plays the role of financier, builder, and operator of the service or facility.

Contribution of Public Sector	Contribution of Private Sector
Stable governance	Operational efficiencies
Ensuring citizens' support	Innovative technologies
Financing	Managerial effectiveness
Assuming social, environmental and political risks	Access to additional finances and Construction and commercial risk sharing

Types of involvement of the private sector in PPP projects

There are different ways that the private sector can get involved in PPP projects. Given below are some of the ways with their explanation.



1) **Management Contracts:** Contractual arrangement for the management of a part of whole of a public enterprise by the private sector for a fee. The private sector is provided specified responsibilities concerning a service and is generally not asked to assume commercial risk. These include supply or service contract, maintenance management and operational management.
2) **Turnkey Contracts**: A private contractor is selected through a bidding process. The private contractor designs and builds a facility for a fixed fee, rate or total cost, which is one of the key criteria in selecting the winning bid. The contractor assumes risks involved in the design and construction phases.
3) **Affermage/Lease**: An operator (the leaseholder) is responsible for operating and maintaining the infrastructure facility and services. This model may be applied in combination with other models such as Build-Rehabilitate-Operate-Transfer. The arrangements in an affermage and a lease are very similar. The difference between them is technical. Under a lease, the operator retains revenue collected from

customers/users of the facility and makes a specified lease fee payment to the contracting authority. Under an affermage, the operator and the contracting authority share revenue from customers/users.

4) **Concessions**: The Government defines and grants specific rights to an entity (usually a private company) to build and operate a facility for a fixed period of time. The Government may retain the ultimate ownership of the facility and/or the right to supply the services. Concessions may be of 2 types[10]:
    a) **Franchise Arrangement**: The Concessionaire provides services that are fully specified by the franchising authority. The private sector carries commercial risk and may be required to make investments. Private sector participation is historically popular in providing urban bus or rail services.
    b) **BOT**: In a Build-Operate-Transfer, or its other variants, namely, Build-Transfer-Operate (BTO), Build-Rehabilitate-Operate-Transfer (BROT), and Build-Lease-Transfer (BLT), the Concessionaire undertakes investments and operates the facility for a fixed period of time, after which the ownership reverts to the public sector. In this type of arrangement, operating and investment risks can be substantially transferred to the Concessionaire.
5) **Privatization**: The private sector remains responsible for the design, construction, and operation of an infrastructure facility and in some cases, the public sector may relinquish the right of ownership of assets to the private sector. This may take any one of 3 forms:
    a) **BOO**: In the Build-Own-Operate type and its other variants such as Design-Build-Finance-Operate (DBFO), the private sector builds, owns, and operates a facility, and sells the product/service to its users or beneficiaries. This is the most common form of private participation in the power sector in many countries. Licensing is also seen as a type of BOO.
    b) **PFI**: Similar to the BOO, the private entity model builds, owns, and operates a facility. However, the public sector (unlike the users in a BOO model) purchases the services from the private sector through a long-term agreement.
    c) **Divestiture**: The private entity buys an equity stake in a state-owned enterprise. However, the private sector may or may not imply private management of the enterprise. True privatization, however, involves a transfer of deed of title from the public sector to a private undertaking. This may be done either through outright sale or through public flotation of shares of a previously corporatised state enterprise.

Compensation Models for PPP Projects

The main compensation models for PPP projects are:

- **Availability/Performance based payment mechanisms**
    - Public authority grants a private party the right to design, build, (or refurbish or expand), maintain, operate and finance an infrastructure asset owned by the public sector for a fixed term;
    - Public authority makes payments to the private party to make the services from the asset available;
    - Common in power and social infrastructure projects, such as schools, hospitals, and prisons.

[10] The key distinction between a franchise and a BOT type of concession is that, in a franchise the authority is in the lead in specifying the level of service and is prepared to make payments for doing so, while in the BOT type, the authority imposes a few basic requirements and may have no direct financial responsibility.

- **User-fee PPPs**
  - Public authority grants a private party the right to design, build (or refurbish or expand), maintain, operate, and finance an infrastructure asset owned by the public sector for a fixed term;
  - A private party recoups investment by charging members of the public a user fee. Another variant of this is a shadow toll;
  - Common in roads, ports, and airports;
- **Grant funding**
  - The Government provides grants;
  - This is usually mixed with another compensation model

Different Approaches to manage the level of risk in Indian Infrastructure Projects

The following are some of the approaches that can be adopted to manage the level of risk in Indian infrastructure projects.

1) **A competitive dialogue process**: Detailed discussions should be held with pre-qualified bidders to identify solutions that meet the needs of the different stakeholders, before seeking final offers from builders. Such discussions would boost transparency and accountability, contestability of solutions, clarity of roles and responsibilities, and pragmatic optimal risk allocation.
2) **Flexibility and evolving needs during the project lifecycle**: Quite often, the differences in risk and economic consequences during building, stabilization, and completion, are not understood, underestimated, and disregarded. To have a fair, transparent, and successful PPP, these three stages should lead to the independent assessment of risks and returns, mitigation strategies, and so on. This will also help identify the roles and responsibilities of private players, their consortium members, and their public counterparts.
3) **Protection against factors that cannot be controlled by private players**: As the feasibility and economic gains of a PPP project depends on several controllable and uncontrollable factors, it is important to identify these factors. This will help shield private players against factors that are beyond their control. An example of such factors is quite common in the electricity distribution business, with elements such as subsidy and category-wise tariff substantially affecting the project's cash flows and financial risks. These are not regulated by the contract between the public and private parties, but would be controlled by the government or regulator.
4) **Risk allocation in the context of long-term consequences**: During the competitive tendering and negotiation process, builders may accept risks simply to stay in the game. This takes place without adequate consideration on either side as to the sustainability of the position. Another problematic situation arises when political commitments and timetables leave public authorities with no choice, but to assume risks. The latter on the other hand, could have been better borne by the private sector. Hence, risk allocation, management, and pricing should be seen in the context of long-term consequences for both private and public sectors. They should also facilitate ease of integration into delivery of the intended outcome and provider competence, and not political expediency.
5) **Performance standard setting and monitoring**: Ongoing measurement and incentive systems should encourage and motivate consistent long-term stewardship of assets and services. Also, whole life

accountability needs to address any potential failings. All of this can be done through clear identification of levels of service-quality based on benchmarks.

6) **Identification of termination and extension mechanism at the outset**: The principles for termination and extension of the contract should be clearly and objectively defined at the outset, along with the consequences for either. A pre-agreed, objectively defined mechanism, would help plan for exit strategies and avoid any potential dispute.

Conclusion

Given the difficulties faced by the road sector in India, the National Highways Authority of India (NHAI) formulated a new model concession agreement – the Hybrid Annuity Model (HAM). India is one of the only countries using HAM. This type of concession agreement is a mix of the BOT and engineering, procuring and construction (EPC) models. Traditionally, for road projects in India, the EPC model was followed. An important feature of HAM for highways development is the rational approach adopted for allocation of risks between the PPP partners - the Government and the concessionaire. While the private partner continues to bear the construction and maintenance risks as in BOT (Toll) projects, it is required only to partly bear financing risk. Further, the concessionaire is insulated from revenue/traffic risk and the inflation risk, which are not within its control.

In recent years, the Government has also introduced the PPP model in various other sectors besides infrastructure, including the development of schools and urban areas. Under the 'Modern School Scheme', the Government will set up 2,500 modern schools through PPP. The first modern 'anganwadi centre' on PPP model took off in 2015 at Hasanpur village in the Sonepat district of Haryana. In February of this year, the Telecom Regulatory Authority of India has recommended the implementation of rural broadband network by PPP model. Despite various setbacks, PPPs will continue to drive the infrastructure growth in the country. However, in order to maintain the momentum, the big reforms should be taken up on priority basis.

It is through this innovation that the Government can provide an impetus to the PPP regime and incentivise private players to enter the market.

V. Debt Financing of Infrastructure Projects

Background

India has remained one of the fastest growing economies in the world. However, India's story as one of the fastest rising economies hinges on the growth and development of its infrastructure. As India surges ahead, with the burden of an ever increasing population, the need for better and, more so, necessary infrastructure has become more important than ever.

The Executive has invariably realised the urgency and the need. In the Twelfth Five Year Plan investment in the infrastructure sector is expected to reach US$ 48 billion (approx.)[11] which would be about 5.7% of the GDP in the Tenth Five Year Plan.

However, as much as one realises the need for infrastructure development, one also has to realise that infrastructure projects are highly capital intensive and funding has been one of the major impediments in achieving the infrastructure goals. Along with the change of regime in India in 2013, came a new style of governance with new measures and legislations. Some were much needed reforms while others muddled the picture even more. Initiatives of Smart Cities[12], new legislation on land acquisition, better incentives to the renewable energy sector, and greater investment by government were commendable. However, all this viewed at the backdrop of an ever increasing portfolio of non-performing assets of Indian banks/financial institution, a new Good and Services Tax (GST) regime (in the process of being implemented), fading participation of the private sector in PPP arrangements, delays in existing projects due to delays in acquiring approvals leading to cost escalation have led the funding institutions to stray on the side of caution. The increasing issues being faced by the infrastructure sector has led financial institutions to look away from traditional project financing structures and relook/ re-analyse the business models for such projects.

In this chapter we would be giving a brief insight into project financing in India, highlighting the unique features of project financing in India as it stands today and also pointing out the issues that go along with it.

Traditional Concepts

Funding/investment in any form is linked or rather incentivised by the returns it promises. Project financing is no different from the rest when it comes to seeking returns from such funding. But what makes project financing unique is the limited recourse available to the lender. Traditionally and as a concept, project finance essentially is funding of a project on a non-recourse or limited recourse basis, in which project debt and equity used to finance the project are paid back from the cash flow generated by the project. Lenders rely more on the viability of the project and on the cash flows to be generated from the project rather than on the name and credibility of the promoters/owners of such projects. Almost all infrastructure projects have the mandatory

[11] Report by the High-level government committee on infrastructure headed by Deepak Parekh.
[12] Smart Cities Mission, Government of India.

debt component along with the equity component that is used to fund. This is merely because a long term, limited/no recourse project debt makes more economic sense that complete infusion of the entire capital.

The majority of the debt funding for the infrastructure sector is in Indian Rupees. This is primarily because the majority expenditure is in Indian Rupees. However, for certain projects there are some costs (like import of goods and so on), which may be incurred in foreign currency. In such cases, the projects are also able to access foreign currency funding in the form of external commercial borrowings (ECBs). It is important to note that the extant foreign exchange regulations in India will be required to be followed for any foreign currency funding and any security creation in favour of a foreign entity.

In India, there have been various models of concessions that have been followed by the various authorities. Some of the commonly adopted forms of public private partnerships (PPP) include build-operate-transfer (BOT) and its variants, build-lease-transfer (BLT), design-build-operate-transfer (DBFOT), operate-maintain-transfer (OMT), and so on. As far as funding by the government is concerned, projects have seen the traditional 'annuity models' as well as the newly introduced 'hybrid annuity models'. Apart from considering the promoter group, financiers in India analyse risk on the basis of the infrastructure sector, the regulatory and concessioning authority, the region in which the project is being proposed, the revenue generation possibilities and the type of concession granted.

Traditional Security Packages

Based on the risks analysed, as mentioned above, traditionally, security packages for project financing would include the following:

- **Charge over receivables**: With the lending done primarily on the strength of the cash flows generated from the project, the most important asset over which security is sought by the lenders is the cash flows from the project. Such charge is generally created by way of hypothecation[13] of the receivables generated from the project. To exercise greater control over such receivables, lenders would seek the deposit of the receivables into a specified account over which the lenders would have a specific charge.

- **Monitoring the bank account**: Cash flows/ receivable being the key for lenders, all of them ensure that they have a clear control over the relevant bank accounts for the project. Some of the lenders monitor the expenditure for the project along with the receivables. The money is expected to be routed through specific restricted accounts, which are in the form of escrow accounts or trust and retention accounts.

  In a trust and retention account, the borrower settles a trust, which has the account. The account bank acts as the trustees and holds the account. The lenders are beneficiaries to such a trust. This arrangement is primarily used to create the account as a trust property and thereby ring fence the same from being assets of the project company.

  Banks have developed advanced processes including creation of sub-accounts with separate instructions, which are used to monitor and operate the escrow accounts and the trust and retention accounts.

[13] In India security over movable assets are done by way of hypothecation of such assets.

- **Charge over other movable assets**: In addition to the charge over the receivables, a charge over other moveable assets are also created by way of hypothecation. This would include moveable fixed assets as well as current assets. The usual market trend being that the working capital lenders would have a first ranking charge over the current assets with the term lenders having a second charge over the same.

- **Mortgage of immoveable properties**: Depending on the nature of the project, lenders would also seek mortgage over the immoveable properties forming part of the project. With most of the projects being conducted on a concession basis, the project company does not usually own any immovable property.

  In certain situations the project company receives the lease hold rights over the property over which the plant/ project is to be set up. The lenders are happy to create a mortgage over such lease hold rights to the land.

- **Assignment by way of security of project contracts**: In addition to the security as stated above, lenders also seek assignment by way of security over the rights of the project company under various project contracts. In case of an event of default, the lenders have the ability to take over the project and continue with the project contracts. Under certain arrangements like the concession agreement of the National Highways Authority of India Limited, there are substitution arrangements incorporated in the concession agreement for the benefit of the lenders. In a substitution arrangement, the lenders have the ability of stepping into the shoes of the project company and run the project.

  It has been observed that the lending community and stressed asset funds are increasingly exploring opportunities to use substitution arrangements to replace the project companies that are in financial difficulty from infrastructure projects.

Deviation from the Norm

Over the years one has seen that there has been a paradigm shift in the manner project funding is done. Some of the important changes and the reasons for such changes are as discussed below.

- **Moving towards corporate finance**: With delays in existing projects leading to cost overruns and cash flow mismatch, lenders are viewing project funding akin to corporate financing. Lenders are relying more on the credibility of the promoters of the project companies than on the prospects of cash flow generation from the projects.

- **Security Packages:** In addition to the traditional form of securities as mentioned above, lenders are tweaking the traditional security structures and seeking the promoters/stakeholders to have more 'skin in the game'. In light of the same, one has witnessed the following:

  - Guarantees - Corporate guarantees of promoter companies and personal guarantees of promoters have become the norm rather than an anomaly in the recent years. Experience has taught lenders that in spite of failing projects and loan defaults, promoters/stakeholders have remained immune to lenders' actions leading to much frustration among the lenders. To reduce the recurrence of such

situations, lenders are negotiating to have direct access to promoters' assets in addition to the guarantees.

- Promoter undertakings – The lenders are seeking specific undertakings from promoters/sponsors including but not limited to:

  - undertakings of non-disposal of shares and maintaining of management control;
  - funding obligations in the event of cost overrun of the project;
  - equity contribution obligations;
  - restrictions in the amount of borrowings or contingent liabilities of the promoters; and
  - performance guarantee obligations.

  The consequence of such undertakings is that lenders to project companies are able to impose contractual restrictions on the promoter entities as well.

- Third party securities - Looking for a better fixed asset security coverage ratio, especially in relation to projects which are not asset heavy, lenders are seeking charge over assets of promoter/group companies.

- Pledge – Increasingly we are witnessing lenders seeking pledge over the shares of the project company as security. This is done primarily to ensure that in the event of default by the project company the lender would have the ability to take control of the company. Usually such pledges are created over at least 51% (fifty-one percent) of the shares of the project company. It is pertinent to note here that banks in India are restricted to hold not more than 30% (thirty percent) of shareholding as pledge, in pursuance to the Banking Regulation Act, 1949. In view of this Act, banks seek a non-disposal arrangement over additional shares of the project company, in addition to the pledges shares.

- **Risk participation:** Lenders are now looking more and more towards hedging their risks in infrastructure funding. This has led to greater number of syndication and multi/consortium lending arrangements on project financing transactions, especially during the construction stage of the projects.

- **Diligence:** Although conducting due diligence on the projects and the project companies prior to investing/extending loans has always been a part of project finance, the nature and depth of such diligences have undergone a dramatic change. One is witnessing greater awareness among lenders about the importance of such due diligence and the lenders are employing experts to conduct such diligences on the projects, project companies and their promoters. Lenders' legal counsels are now being requested to specifically review project documents to understand:

  - implications of delay in projects under the concession agreements;
  - whether the project contracts can be assigned or is the consent of the counterparty required;
  - restrictions, if any, on creation of security over project assets;
  - the existence, if any, of any expiry or revocation or termination provision in relevant approvals and concession agreements; and
  - the impact of the liquidated damages clauses in the project contracts.

- **Advent of GST:** There has been mixed reactions to the new GST regime. Some have welcomed the move while others seem to have a 'wait and watch' stance. Depending on the specific sector and the specific player within the sector, the lenders are now actively looking to analyse whether the introduction of GST will alter or adversely impact the cashflows of project companies.

  The lenders are majorly concerned about:

  - Pricing of bids made pre the GST regime were based on the erstwhile tax regime. Project developers are now worried about the impact of GST on the pricing which invariably may impact the cash flows to be generated from these projects.

  - Although, under the GST regime tax credit may be availed of by the stakeholders in the supply chain, project developers are concerned about the impact on immediate liquidity. Lenders are worried that with limited liquidity, the ability to repay loans may get affected.

- **Sector specific:** Over the years one has witnessed that infrastructure development in certain specific sectors have been significantly adversely affected than others leading to growing stress on the books of the lenders. The steel and power sector are the worst affected. However, with issues being faced with the cost of coal, saturation in the renewable energy (especially solar power) sector, and delays in approvals/clearances, cash flow mismatch has deeply affected the status of power projects in India.

  Government is taking several steps to clear relevant obstacles from the authorities in the road sector and thereby provide adequate resolution to the issues. Several delays being faced from the authorities have impeded completion of projects and thereby severely affected project lenders.

'Boiler Plate Clauses' or Necessary Covenants

To ensure greater control over the affairs of the project companies and to enable the lenders to take pre-emptive action, lenders are incorporating specific restrictive covenants in the loan documents. The covenants which lenders would usually like to incorporate in loan documents in relation to project financing can be broadly classified into the followings types:

- Financial Covenants
- Change of control covenants
- Information covenants
- Other covenants

- **Financial Covenants:** Every project finance loan would have certain specific financial covenants including but not limited to maintenance of a specific debt to equity ratio and debt service coverage ratio. Usually, these financial ratios are eased as the project becomes operational. Lenders sometimes suggest variation in financial covenants from the construction phase till the operational phase.

Lenders usually treat all contributions from the promoters/shareholders (whether as equity, quasi-equity or debt) under the head of 'equity' while calculating the debt to equity ratio.

A breach of such financial covenants acts as a trigger for the "*Event of Default*" clause and is seen as a primary indicator of the ability of the project company to perform its obligations under the loan documents.

- **Change of control covenants:** With greater reliance on the promoter's credit worthiness in assessing the viability of projects, restrictive covenants on change of shareholding and change of management control have become increasingly relevant. There are instances where carve outs for transfer of shareholding within group companies without any prior approval are provided by lenders.

  There are various sectors wherein creation of security and enforcement of security (whether over pledge of shares or otherwise) is subject to approval of the relevant concessioning authorities

- **Information covenants:** Information covenants usually cover the following obligations:

  - Provision of annual audited and quarterly or half yearly unaudited financial statements of the project companies. In some instances, where the lending is primarily on the strength of the promoter companies then such financial statements of the promoter companies are also sought. The annual reports provide a clear understanding of the financial wellbeing of the project companies/promoter companies and assist the lenders from taking pre-emptive actions.

  - Information about litigations and other judicial proceedings against the project companies and/or the promoter companies are being made mandatory by lenders. Especially, in light of the newly legislated Insolvency and Bankruptcy Code, 2016 (the "**Code**") (*dealt with in detail in a later part of the article*), requiring the project companies to report about initiation of such proceedings has become extremely important.

  - Supplying of other information as may be sought by the lenders from to time including but not limited to submission of project progress reports and lenders' independent engineer reports.

- <u>Other Covenants</u>

  In addition to the above, depending on the sector there would be certain specific covenants incorporated in the loan documents:

  - Restriction of sale of assets other than in the ordinary course of business. Project companies have in certain instances been able to negotiate sale of assets up to a particular threshold without lender's approval.

  - Restrictions on additional borrowing and/or taking of any guarantee obligations during the tenure of the loan to ensure that the project company does not take additional financial burden upon itself.

- Obligations to procure adequate insurance to ensure the project assets. It is interesting to note here that in the renewable energy sector, with the cost of raw materials falling considerable over the last few years (and promising to do so in the near future) there is a dilemma as to extent of insurance required as the replacement cost of the materials is lesser than the price at which they were procured.

- Environmental covenants have become increasingly important, especially with banks in India having lines of credit from international financial institutions which have stricter compliances.

- Any form of alteration or default to project documents either triggers an event of default or has to be approved by the lenders.

➢ **Stamp Duty:** It is important to note that stamp duty is payable on an instrument in India as per the rates applicable in each respective state. The rates of stamp duty are a state subject and are an important driver for structuring of project financing transactions. This is because several instruments are stamped at an *'ad valorem'* duty and accordingly, this may alter the economics of a transaction. Most financing documents are instruments and therefore required to be stamped. It is important to note that an un-stamped or an under stamped document will not be admissible as evidence in court. Additionally, in certain states like Maharashtra, the liability of non-payment or under payment of stamp duty is that of the lender and therefore lenders are extremely cautious over the stamp duty being paid.

Restructuring of Project Finance Debt

Commercial banks continue to remain cautious to lend. The problem of non-performing assets for commercial banks has exacerbated in recent times, lowering their appetite for extending fresh loans. India's banking sector continues to be troubled by a high level of stressed assets. About one-fifth of these stressed loans are on account of the infrastructure sector, particularly the power, road and steel segments. The primary factors leading to stress have been excessive leverage and over investment during earlier strong economic phases and regulatory delays in the infrastructure sector. Some steps have been taken by RBI and the finance ministry to address the issue of stressed assets.

➢ **Joint lenders' forum and corrective action plan:** Through this framework, the RBI tried to concentrate more on early recognition of stressed assets as it requires the banks and financial institutions to route the assets through three classes of special mention accounts (SMA), i.e., SMA-0, SMA-1 and SMA-2, before finally classifying it as an NPA. It also requires all lenders of an SMA-2 account to form a joint lenders forum (JLF) whereby they are to formulate a corrective action plan. Through this corrective action plan, in relation to the loans, the lenders are expected to rectify, restructure or recover. In case the regulations under this JLF scheme is not being duly followed then the lenders are subject to accelerated provisioning. The primary road block witnessed under this JLF scheme is that the group of lenders that are part of the JLF are finding it difficult to reach an agreement over the corrective action place.

➢ **Corporate debt restructuring:** The corporate debt restructuring (CDR) mechanism is a voluntary non-statutory system which allows the banks to restructure assets while retaining their standard classification and without any additional provisions based on the principle of approvals by a majority of 75% (seventy-five percent) creditors (by value) which makes it binding on the remaining 25% (twenty-five percent) to fall in line with the majority decision. The CDR mechanism covers only multiple banking accounts, syndication/consortium accounts, where all banks and institutions together have an outstanding aggregate

exposure of US$ 1.5 million (approx.) and above. There is a CDR board, which approves the proposals and the revival structures proposed. India has seen that there has been a huge delay of approval over such CDR cases. Additionally, there have also been several cases where there has been a failure of implementation of the CDR package.

- **Strategic debt restructuring (SDR):** The scheme was enacted with a view to revive stressed companies and provide lending institutions with a way to initiate change of management in companies which fail to achieve the milestones. Under this scheme, JLF has been given the option to convert a part of their loan in an ailing company into equity, with the consortium of lenders owning at least 51% (fifty-one percent) stake. The JLF must divest their holdings in the equity of the company and on such divestment; the loan will be upgraded to 'standard', without any reversal in the quantum of provisions held by the lenders. The SDR gives banks more power in the management of the company who has taken the loan and has defaulted. However, the SDR scheme also mandates that banks and financial institutions will have to sell of their interest to a new promoter (absolutely unrelated to the existing promoters) within a particular period. The banks are finding it next to impossible to sell the shares to a new buyer. Buyers for stressed assets are few and some of them are unable to finalise commercials around the purchase. The primary deterrent for the promoters of project companies is that under this scheme the existing promoters get removed entirely from controlling the company.

- **Scheme for sustainable structuring of stressed assets:** The RBI announced the Scheme for Sustainable Structuring of Stressed Assets (S4A Scheme) in June, 2016. Under the S4A Scheme, banks can classify the existing debt of a company into sustainable and unsustainable portions, based on its cash flow. Banks are permitted to continue loans for the sustainable portion of the debt, while the unsustainable portion can be converted into equity or a convertible security. The scheme, therefore, allows the incumbent management to continue as long as the default isn't wilful. The S4A Scheme aims at deep financial restructuring of projects having large debt, by allowing lender (bank) to acquire equity of the stressed project.

- **Flexible Structuring of Long Term Project Loans to Infrastructure and Core Industries:** This initiative by the RBI is generally referred to as the 5:25 scheme. The 5:25 scheme allows banks to extend long-term loans of 20-25 years to match the cash flow of projects, while refinancing them every 5 or 7 years. It aims to increase long term viability of such projects, reduce asset liability management issues, reduce repayment stress, encourage efficient sharing of exposures by banks and non-banking financial companies at various stages of the economic life of the projects and improve the credit ratings of such projects.

Insolvency and Bankruptcy Code, 2016

Prior to the enactment of a bankruptcy regime, the recovery proceedings by creditors in India, under the existing frameworks, had failed to yield the desired results and India continued to have a considerable amount of stressed assets. The Code lays down an institutional mechanism for insolvency resolution process either by coming up with a viable survival mechanism or by ensuring their prompt liquidation. The Code makes a clear distinction between insolvency and bankruptcy - the former is a short-term inability to meet liabilities during the normal course of business, while the latter is a longer term view on the business. As all businesses cannot succeed, it is perfectly normal for some businesses to fail, making it important to emphasize on corrective action. The Code amply clarifies that insolvency or bankruptcy is a commercial issue, backed by law to enforce transparency and objectivity. It is not another law behind which the inevitable can be delayed. Such a framework can incentivize all stakeholders to behave rationally in negotiations towards determination of

viability, or in bankruptcy resolution. In turn, this will result in shorter recovery timeframes and better recovery, and greater certainty on lenders' rights leading to the development of a robust corporate debt market and unlocking the flow of capital, an impending requirement of the infrastructure sector.

The Code prescribes an insolvency resolution process for corporates with a strict timeline of 180 days, and a one-time extension of 90 days. During this process, creditors and the debtor are required to deliberate on viability of the business of the debtor, and formulate a plan if the business is found to be viable. Each decision of the creditors committee requires a 75% (seventy-five percent) majority vote and is binding on the corporate debtor and all its creditors. Once application for Insolvency Resolution Professional (IRP) is admitted, the adjudicating authority will order a moratorium for the period of the IRP during which no judicial proceedings for recovery, enforcement of security interest, sale or transfer of assets, or termination of essential contracts can take place against the debtor. An insolvency professional is appointed for the corporate debtor, whose primary function is to take over the management of the company and operate its business as a going concern under the broad directions of a committee of creditors. The creditors' committee has been empowered to replace the resolution professional. In the event, no resolution plan is agreed upon, an order for liquidation of the debtor is passed.

However, it is important to note that initiation of the insolvency resolution process in a project company may be futile in a situation where either the project is under construction or the operational asset is not generating cash flows. In both cases, the chances of revival of the company would be minimal. Fresh investors may not be interested in the asset in the construction stage and low revenues will also not interest them in the operation stage. Accordingly, in such situations the project company may be pushed to liquidation and the minimal assets of the company will not help in paying out the lenders. In such situations, the lenders try to substitute the project companies.

Emerging Options for Project Financing

New financial options and sources are now available to infrastructure projects, and the RBI has also taken various steps to facilitate more investment in the sector, through new investment structures as well as through changes in the existing project lending guidelines.

- **Infrastructure Debt Funds (IDFs)/Infrastructure Investment Trusts (InvITs):** These are two long term funding options which were introduced by the RBI to address the asset liability management (ALM) related concerns of banks and provide an additional source of funds, domestic & foreign, are being tried out in the infrastructure financing space. IDFs are investment vehicles, which can be set up as trusts or as NBFCs, and are used for investments in infrastructure projects. Foreign and domestic institutional investors, typically long term investors, are permitted to invest in IDFs through units or bonds issued by them. The IDFs in turn invest in infrastructure projects. InvITs are collective investment schemes, like mutual funds, that enable pooling of money from multitude of individual investors for directly investing in infrastructure. Infrastructure companies have been slow to respond to IDFs and InvITs. Easing of regulatory norms with respect to these sources is expected to increase their offtake in times ahead.

- **National Investment and Infrastructure Fund (NIIF):** A significant step to facilitate infrastructure financing has been the development of the National Investment and Infrastructure Fund as a category II alternative investment fund. The NIIF has recently garnered interest from entities such as Rusnano (Russia), the Abu

Dhabi Investment Authority and the Qatar Investment Authority (QIA). It is further expected that new financing sources such as the New Development Bank and the Asian Infrastructure Investment Bank (AIIB) will play a crucial role in bridging the financing gap.

- **External commercial borrowing:** The infrastructure sector is one of the five sectors that contribute to around 53% (fifty-three percent) of the stressed assets in India today. There is no doubt that the infrastructure sector is also the sector in need of maximum funding in India. Keeping this in mind, the RBI has taken various steps in the past year in relation to the regulations with respect to external commercial borrowings (ECB). The companies in the infrastructure sector, Non-Banking Financial Companies-Infrastructure Finance Companies (NBFC-IFCs), NBFCs-Asset Finance Companies (NBFC-AFCs), Holding Companies and Core Investment Companies (CICs) are now permitted to raise ECB for an average maturity period of 5 years, thus allowing infrastructure companies to secure debt funding for both short and long term perspectives. This broadens the option for project companies to seek funding from varied sources and aims to complement the government's focus on the infrastructure sector, by making it easier for Indian corporates to access foreign debt. However, such short term ECBs to be availed of by the infrastructure sector are required to be entirely hedged. While hedging is fundamentally important, the cost of it erodes the advantage of lower interest rates commonly seen in the international market and it remains to be seen whether all-in-costs will be substantially different to the local market. In addition, the entities operating in the "Exploration, Mining and Refinery" sectors have now been allowed to raise ECB. Mining is another one of the five sectors that contribute to around 53% (fifty-three percent) of the stressed assets in India today.

- **The Bonds market and Masala Bonds:** While globally, pension and insurance funds have are the primary sources of long term finance for long gestation infrastructure projects, regulatory / credit hurdles have prevented this from happening in the Indian context. Indirectly, the bond market has been supporting the infrastructure investments through investments in entities such as NHAI, Power Finance Corporation, Rural Electrification Corporation and most recently the railways.

  However, corporate bond issuances, especially for infrastructure projects have yet to make a mark in the segment.

  The RBI permitted any Indian corporate to issue rupee bonds in overseas centres in September 2015 and introduced the concept of issuance of rupee denominated bonds overseas (RDBs) within the overarching ECB framework, thereby opening a new avenue of funding for Indian entities. The added benefit to Indian entities in relation to such a form of funding is that their currency risk is obviated which could possibly bring down the costs as well.

  Any corporate, body corporate, real estate investment trust (REIT) or InvIT can issue RDBs. Any investor from a financial action task force (FATF) compliant jurisdiction can invest in RDBs. However, banks incorporated in India cannot access these bonds in any manner, except as arrangers or underwriters. RDBs can only be 'plain vanilla' bonds issued in FATF compliant financial centres and can either be privately placed or listed on exchanges as per host country regulations. RDBs are to have a minimum maturity period of 5 years. In the event, the RDBs have an in-built call or put option, the same cannot be exercised prior to the completion of the 5 year period.

  One of the major advantages to Indian entities availing funding via RDBs is that they are not required to hedge their currency risk. The overseas investors who want to hedge their exposure in rupees, have been permitted to do so through permitted derivative products with authorised dealer category – I banks in India. Investors can also access the domestic market through foreign branches or subsidiaries of Indian banks or

through branches of foreign banks with an Indian presence, thus ensuring that there is enough impetus to the overseas investors to invest in such RDBs. Companies such as National Thermal Power Corporation and Adani Transmission Limited have raised funds through the issuance of masala bonds.

- **Pension Funds:** The Canada Pension Plan Investment Board (CPPIB) has made various investments in India including raising its stake in Kotak Mahindra Bank, which is the fourth-biggest Indian private sector lender in terms of assets and participation in a strategic investment platform with The Phoenix Mills Limited Announce Strategic Investment Platform for development and operation of retail real estate properties in India. CPPIB is exploring further opportunities in India's financial services, telecoms and logistics sectors.

- **Partial Credit Guarantee Scheme:** The partial credit guarantee scheme developed jointly by the Asian Development Bank and the India Infrastructure Finance Company Ltd., has been opted for by several borrowers in the infrastructure sector to refinance debt of operational projects including conventional energy, renewables and highways. This scheme provides an additional credit support, in the form of a "First Loss" guarantee, which escalates the credit rating of an operational project. The quantum of guarantee is limited to 50% (fifty percent) of the total outstanding debt. The structure enables operational infrastructure projects to reach the required rating category for participation by insurance and pension funds. The choice of the "Partial Guarantee" structure also ensures that the insurance and pension funds, simply do not rely on the guarantee but also understand the overall project risks before investing.

Conclusion

A proactive executive propelled by effective legislations seems to have put India in the driver's seat. If recent developments in the infrastructure space are an indicator of the times ahead, then one may say that things are moving in the right direction and that the future of project financing in India is looking busy and bright.

VI. Fare Fixation

The Supreme Court, upholding the Bombay High Court's decision, in its landmark judgement on March 18, 2015 permitted the Reliance Infrastructure Limited-led Mumbai Metro One Private Limited (MMOPL) to collect the fares at higher rates than those agreed with the Government of Maharashtra (GoM) until the fixation of fares by the statutorily appointed fare fixation committee (FFC). Subsequent to the decision of the Supreme Court, in 2015, the FFC recommended the minimum fare be retained at INR 10/- but proposed the maximum fare be substantially increased to INR 110/-from the original maximum of INR 70.

The genesis of the fare dispute was the MMRDA's arbitration petition to the Bombay High Court against MMOPL, filed in June 2014, challenging MMOPL's decision to fix the initial fares higher than the fares agreed upon in a concession agreement dated March 7, 2007 (Concession Agreement) entered into between them.

The Original Concession

The GoM, under the Indian Tramways Act, 1886, had authorised the MMRDA as the project implementation agency for the implementation of a rail based Mass Rapid Transit System or Mumbai Metro Line -1 along the 11.40 kilometres long Versova – Andheri – Ghatkopar corridor on aPPP basis. In the month of June 2006, the Government of Maharashtra awarded the Project to MMOPL, a special purpose vehicle formed by a consortium of Reliance Infrastructure Limited, the MMRDA and Veolia Transport SA.. The parties executed the Concession Agreement under which MMOPL was granted the right to develop, implement, operate and maintain of the metro on a Build, Own, Operate, and Transfer (BOOT) basis to MMOPL for a period of 35 years.

Subsequently, in 2009, the Central Government extended the central legislation governing the construction and operation of metro railways i.e. the Metro Railways (Construction of Works) Act, 1978 (Metro Construction Act) and the Metro Railways (Operation and Maintenance) Act, 2002 (Metro O&M Act) to the Mumbai Metropolitan area amongst others [14]. These Acts govern various aspects of construction, safety, operation and maintenance of metro railways, and in some cases conflict with various metro concession agreements executed prior to their coming into force, including the Concession Agreement. Without having regard to the provisions of the Acts, the GoM, on September 3, 2013, issued an order (Order) according approval to the fare schedule appended to the Concession Agreement. As per the Order, the fare for the year 2014-15 ranged from Rs. 9/- to Rs. 13/-.

On the other hand, in late 2013, MMOPL through various letters to the Central Government sought constitution of an FFC for fixation of fares. The Metro O&M Act provides for the constitution of an FFC to make recommendations to a metro railway administration (MRA) for fixation of fares under Section 33 thereof. MMOPL contended that the original fares had lost their relevance due to abnormal increases in applicable economic indices. In response, the Central Government clarified that MMOPL was free to fix the initial fares for the project as the first proviso to Section 33 of the Metro O&M Act permitted an MRA to fix fares at the opening of a metro without a recommendation from the FFC, but subsequent fare revisions would be subject to the FFC's recommendation.

[14] The Metro Construction Act and the Metro O&M Act are collectively referred to as the "Acts"

Consequently, on May 29, 2014, MMOPL passed a resolution fixing the initial fares at Rs. 10/- to Rs. 40/- despite the Order, causing the MMRDA to seeking an injunction against MMOPL from revising fares exceeding those in the Concession Agreement and the Order.

The Bombay High Court's Decision

A single judge of the Bombay High Court, however, negated the MMRDA's contentions in 2014 and dismissed the arbitration petition.

The principal questions which the Bombay High Court was concerned with in the arbitration petition were:

Whether MMOPL was entitled to fix the initial fare for the Project?

Whether the right of fixation of fares under the Concession Agreement was inconsistent with Section 33 of the Metro O&M Act and thus, whether section 33 would apply and not the Concession Agreement for fixing of the fares?

The Bombay High Court with respect to the above issues held that fares could be fixed and collected by MMOPL only in accordance with the recommendations made by the FFC constituted under the Metro O&M Act. The Court further clarified that MMOPL was however empowered to fix the initial fare without recommendation of the FFC by virtue of proviso to Section 33 of the Metro O&M Act. Further, considering that the FFC had not been constituted despite several requests made by MMOPL, the initial fare could logically only be fixed by MMOPL.

The Bombay High Court observed that there was a marked inconsistency between the Concession Agreement providing powers to the parties to fix the fares and the powers prescribed under Section 33 of the Metro O&M Act. It may be noted that Section 103 of the Metro O&M Act provides for the overriding effect of the provisions of Metro O&M Act over any other inconsistent enactment or instrument. Therefore the Bombay High Court opined that the provisions for fixing fares under the Concession Agreement would yield to the contrary provisions of Section 33 of the Metro O&M Act.

The Bombay High Court further elucidated that the GoM was not entitled to set fares considering the extension of the Acts to the metro project. Further, the fare for the initial opening of the Project could not have been decided under the Concession Agreement under any circumstances.

Aggrieved by the order, MMRDA filed an appeal against the single judge's order in the Bombay High Court to a division bench thereof. The Division Bench refused to interfere with the above ruling and in its judgement, dated January 8, 2015, recapitulated that on the extensions of the provisions of the Metro O&M Act to Mumbai, the fixation of fares could be carried out by MMOPL on the recommendation of the FFC.

The Supreme Court's Decision and FFC Recommendations

The MMRDA appealed against the Bombay High Court's order to the Supreme Court. The Supreme Court, however, affirmed the Bombay High Court's order and provided *carte blanche* to MMOPL to fix the initial fares. Further, the Supreme Court directed that the FFC be constituted and that rates be determined.

The FFC, in its report dated July 8, 2015, fixed the maximum rate (in respect of the 8 km stretch) to a whopping INR 110/-. However, despite the recommendations of the FFC, MMOPL has adopted a 'commuter friendly approach' by retaining the fares at the current rates of INR 10/- for 1-2 kilometres, INR 20/- for 2-5 kilometres, INR 30/- for 5-8 kilometres and INR 40/- for 8 kilometres and above until further notice. MMOPL will then have the fares reviewed and accordingly increased depending on the response of the GoM to various proposals of fare enhancement. The FFC has also recommended the grant of an operational subsidy to MMOPL by the Government in order to keep the fares affordable so as not to increase the burden on commuters.

The granting of operational subsidies to transportation services is a recognised practice around the world to ensure fare affordability to the mass commuters of such transportation services. Another reason for the putting forth of such a proposition by the FFC appears to stem from the fact that MMOPL does not have the advantage of concessional interest rate and lower power tariff which facility has been made available to other companies running metros in other parts of the country. MMOPL has, as a result, asked the GoM to provide a one-time capital grant of USD 155.32 million, an operational subsidy of USD 3.38 million per month and permission to fully monetize the real estate to keep the fares at the 'desired level'. The GoM, has, as of the date of this booklet, not provided any further funding or any subsidy to the metro project.

The writ petition filed by MMRDA in the Bombay High Court under Article 226 is currently still pending before the Court, and it is for this reason that the Union Ministry of Urban Development has declined to recommend the formation of or appoint a new fare fixation committee.

The entire episode poses some interesting questions from both a legal as well as social perspective such as the sanctity of concession agreements in other states entered into prior to the Acts coming into force, the extent of control of state governments have over metros in their state and of course, the overall objective of public and commuter interest.

Same Court- Dissenting Views?

The decision of the Supreme Court is in stark contrast to the decision of the Court in the *Adani Power Case*, discussed in detail in the Chapter 7 at page 41. While the decision of the Supreme Court in the Mumbai Metro case did not deal with 'change in law' as in the case of Adani Power, the two cases are fairly similar as they deal with the sanctity of concession agreements and the ambit of regulatory authorities to deviate therefrom.

Where in the Mumbai Metro case, the Apex Court permitted the parties to deviate from the provisions of the concession agreement, and have fares recommended by the FFC, in the Adani Power Case, it bolsters the principle of sanctity of contracts, by refusing to interfere in the contractual understanding between the parties.

This disparity in the decisions of various benches of the same Court may be attributed to the peculiarities attached to the two sectors and circumstances surrounding them that lie outside of the purview of law. Even in the Adani case, although the Supreme Court has found that no relief was due under the contract based on the pleadings before it, it left the door open for the regulator to reconsider pricing based on extant commercial realities.

Given that the Mumbai Metro case has still not been entirely determined, and whether the decision to follow the recommendations of the FFC will be upheld by the Bombay High Court, remains to be seen.

*(*1 USD = 64.44 INR as on June 19, 2017)*

VII. Maintaining the Sanctity of Contracts

"The board of Adani Power Ltd. is hiving off its flagship Mundra power station to a new subsidiary and is exploring all options for financial revival, including a potential sale of substantial stake in the new subsidiary in which a Gujarat government entity may take a majority stake.

As a result of the transaction, the company will infuse capital investment which will ultimately help increase working capital and also reduce the losses suffered in the latest quarter. The separate entity will be majorly owned by Gujarat Urja Vikas Nigam Ltd. (GUVNL), which will utilize its maximum capacity, resulting in revenue growth in the near future. This tie-up will enhance the profitability of the business and will help in reducing the cost drivers. The company's D/E stands at 7.2x on FY17. A meeting of the board of directors of the company was held on June 6, 2017 to consider and evaluate the slump sale of its Mundra power generating business to its subsidiary Adani Power (Mundra) Ltd.

Now, as a part of the restructuring exercise, Adani Power wants to separate its investment activity from the generating asset. It has, therefore, proposed to transfer the Mundra plant to a separate subsidiary by way of slump sale and retain the investments in subsidiaries with itself.

Due to the recent Supreme Court judgement, the company is engaged with the stakeholders, including GUVNL, for possible remedial measures for long term sustainability of the Mundra plant and various options are being explored presently. Last month, Adani Power had discontinued 1,250 MW power supply to GUVNL in a phased manner, mainly due to the non-viability of running its Mundra power plant on imported coal. Of the 2,000 MW power provided by Adani Power to GUVN under different power purchase agreements (PPAs), 1,250 MW supply was discontinued.

The company had told the state government that operating Mundra power plant at the tariff specified in the PPA using imported coal (from Indonesia) was not viable after the Supreme Court disallowed raising power tariffs to compensate for rise in the price of coal from Indonesia...."[15]

Dalal Street Investment Journal – June 7, 2017

It all began around 2010 when the Minister of Energy and Mineral Resources (of Indonesia) promulgated 'Regulation 17, 2010' which directed the coal producing licensees, to use the benchmark price determined by the Director General, as the reference coal price for coal sales (Regulation), elevating prices of coal. Back home in India, Adani Power Limited's (APL) Mundra project of 4260 MW, consisting of four units of 330MW and five units of 660 MW, was based on an agreement with its group company, Adani Enterprises Limited, for supply of Indonesian coal. Out of the 4260 MW capacity at Mundra, APL entered into PPAs for 2000 MW with GUVNL and for 1424 MW with Haryana utilities, prior to the Regulation coming into force.

[15] https://www.dsij.in/articledetails/tabid/740/articleid/20379/adani-power-to-hive-off-mundra-power-plant-to-improve-profitability.aspx

With the inability of APL to secure domestic fuel supply agreements, APL (and several other power generating companies relying on Indonesian coal) very soon found itself at the receiving end of exponentially high fuel supply related risks. These risks exposed, inter alia, a fundamental flaw in the regulatory framework, within the power sector. This includes inducing inappropriate procurement processes, where a bid evaluation criteria encouraged (and continues to encourage) the bidders to create a smokescreen of low tariffs, where an individual contracting party is encouraged to take on the inflation and commodity price risk on a long term basis, that are then entrenched in the tariffs and where, finally, the regulator is often called upon to bail out unviable projects, unconsciously encouraging ambiguity and litigation.

Sanctity of contract

When the going got tough, APL first attempted to terminate its PPA with GUVNL, which was challenged by GUVNL at the Gujarat Electricity Regulatory Commission (GERC). The GERC observed[16] that APL cannot be allowed to pay liquidated damages in lieu of specific performance of contract and refused to allow APL to terminate the PPA. This order was upheld by the Appellate Tribunal for Electricity (APTEL)[17]. APL's financial troubles became a reality, with the company posting losses in the first quarter of 2012 to the tune of about USD 123.17 million[18]. APL then sought relief[19] from the Central Electricity Regulatory Commission (CERC) under Section 79 of the Electricity Act, 2013 (Act) – to either discharge APL from the performance of its obligations under the PPA on account of frustration, or evolve a mechanism to restore it to the same economic condition prior to the occurrence of the change in law.

On 2nd April, 2013, the CERC, while dismissing the grounds of force majeure and change in law, held that in exercise of the regulatory powers provided under Section 79 of the Act, it can provide redressal of grievances to generating companies, considering the larger public interest, and hence constituted a committee to look into the alleged difficulties faced by APL and to find an acceptable solution thereto. Based on the committee's report, the CERC proceeded to grant compensatory tariff. This was appealed and cross-appealed in the APTEL and the Supreme Court, and finally, the APTEL in April, 2016, inter alia concluded that force majeure was made out on the facts of these cases and reversed the CERC's decision on this count. It also held that change in law provisions do not apply to foreign law and, therefore, changes in Indonesian law did not come within the scope of the provisions. Accordingly, the APTEL directed the CERC to find out the impact of the force majeure event to grant compensatory tariff. The CERC, by its order dated December 16, 2016 arrived at a certain determination as to compensatory tariff to be granted on account of force majeure.

These decisions were challenged again in the Supreme Court, by Energy Watchdog, Prayas (Energy Group), Punjab State Power Corporation Limited, Ajmer Vidyut Nigam Limited, Maharashtra State Electricity Distribution Company Limited, GRIDCO Limited and Coastal Gujarat Power Limited. On April 11, 2017, the Supreme Court set aside the judgments rendered by APTEL and CERC and held that: (i) For change in law: *"The definitions of laws and Electricity Laws refers only to the law of India, and that it would be unsafe to rely upon the other clauses of the agreement where Indian law is specifically mentioned to negate this conclusion. While a change in*

[16] dated 31.08.2010 in the Petition No. 1000 of 2010
[17] Dated 07.09.2011 in the Petition No. 184 of 2010
[18] http://www.thehindubusinessline.com/companies/article3712147.ece
[19] Dated 5.07.2012 in the Petition No.155 of 2012

Indonesian law would not qualify as a change in law under the guidelines read with the PPA, change in Indian law certainly would". (ii) For Force Majeure: *"The doctrine of frustration cannot apply to these cases as the fundamental basis of the PPAs remains unaltered. The PPAs do not contain any clause that coal is to be procured only from Indonesia at a particular price. In fact, it is clear on a reading of the PPA as a whole that the price payable for the supply of coal is entirely for the person who sets up the power plant, to bear. The fact that the fuel supply agreement has to be appended to the PPA is only to indicate that the raw material for the working of the plant is there and is in order. It is clear that an unexpected rise in the price of coal will not absolve the generating companies from performing their part of the contract for the very good reason that when they submitted their bids, this was a risk they knowingly took."*

What is significant to note is that the Supreme Court directed relief to be granted to APL; it just needed the regulators to look within the framework of the PPA and the competitive bidding guidelines while determining what relief should be granted for change in law.

Diminishing ambiguity and information asymmetry

While submitting bids, especially in the power sector, bidders are often expected assess the risks, understand what costs cannot and will not be passed through to the consumers and knowingly take on such risks. The authority is also expected to set out clear stipulations in relation to the risks in the tender conditions. If the authority wishes to re-write or re-negotiate these commercial terms once the tender or the contract has been crystallised, then the economics would change and the project may no longer be viable at the price contemplated by the bidder. Which is why, when the Ministry of Power (MOP) sought to revise the cap the fixed/ capacity charges component of rate of electricity of the power generating companies that had been declared as successful bidders (of coal mines with power being the specified end-use), the Delhi High Court on March 9, 2017 in the cases of *Monnet Power Company Limited v. Union of India and Others, Mandakini Exploration Mining Ltd. and Others v. Union of India and Others and Jaiprakash Power Ventures Limited v. Union of India and Others,* upheld *the sanctity of the tender process* and allowed the successful bidders to withdraw from the bids and get refund of the bid security without any penalty.

Policy paralysis and performance by trial and error often imposes colossal costs on the economy and the taxpayers. While it is generally agreed that the best principle for risk allocation is that a particular risk should be borne by the party that can mitigate or manage the risk at the lowest cost, this principle can be flawed as the economics can often be based on contingent events that may or may not happen. In such circumstances, a project can become unviable, as seen in the recent case of APL. However, in order to support and protect infrastructure projects, should we encourage ambiguity in interpretation of the terms? In both the cases discussed earlier, while the court's decisions would lead to distress in the short run, it will go a long way in maintaining the sanctity of contracts, competitive bidding processes and consumer's interests.

VIII. Flemingo Duty Free Case

The Airports Authority of India (AAI) was established in 1994 and is the statutory organization responsible for the management of airports in India. In the wake of privatization, the Airports Authority of India Act, 1994 (AAI Act) was amended to foster private sector investments in airport projects. Pursuant to such amendment, the AAI was empowered to make a lease of the premises of an airport, in public interest or in the interest of better management of airports, to carry out some of its functions. Consequently, entities such as Mumbai International Airport Private Limited (MIAL) were incorporated and entrusted with the operation and the management of airports.

Facts

In 2006, MIAL, the lessee of the Chhatrapati Shivaji International Airport, Mumbai (Mumbai Airport) made a public announcement calling for expressions of interest for setting up duty free shops. Flemingo Duty-Free Shop Private Limited (Flemingo) along with its partner Aer Rianta International submitted its expression of interest. However, Flemingo was not informed about the short-listing of the applications or the issuance of the tender documents. Aggrieved by this, Flemingo filed a writ petition before the High Court of Bombay (High Court) challenging MIAL's decision of non-issuance of the tender documents to Flemingo.

The primary issue considered by the High Court in this case was whether the MIAL is a 'State' for the purposes of Article 12[20] of the Constitution of India (Constitution) or even if was not a 'State' was it amenable to writ jurisdiction under Article 226[21] of the Constitution. In the event either of these answers were to be held in the affirmative, the High Court would have the power to issue directions to MIAL to enable the enforcement of any of the fundamental rights conferred by the Constitution, which *inter alia* include the right to equality.

Contentions

The counsels for Flemingo contended that since MIAL is a joint venture company (with the AAI holding 26% (twenty six per cent) of the shareholding of MIAL) entrusted with the performance of the statutory functions of the AAI, such an entity would be an instrumentality or an agency of the State. It was contended that the process of awarding the tender was arbitrary and lacked transparency and as MIAL was an instrumentality of the State, the contract awarded to DFS Venture Singapore (Pte) Ltd. was liable to be set aside as it was in violation of the right to equality under the Constitution.

It was argued that the procedure adopted by MIAL was against the prescribed and well-established principles of awarding of tenders/contracts in public law. The core argument on behalf of Flemingo was that allotment of duty free shops at airports was a public function which was being performed by MIAL and consequently MIAL was to act fairly, reasonably, justly and in accordance with objective and clear norms in performance of such public function.

[20] Article 12 of the Constitution defines "the State" to, unless the context otherwise requires, include the Government and Parliament of India and the Government and the Legislature of each of the States and all local or other authorities within the territory of India or under the control of the Government of India.

[21] This Article empowers High Courts to issue to any person or authority, including in appropriate cases, any Government, directions, orders or writs, including writs in the nature of habeas corpus, mandamus, prohibition, quo warrantor and certiorari, or any of them, for the enforcement of any of the fundamental rights conferred by the Constitution and for any other purpose.

MIAL on the other hand rebutted Flemingo's contentions on the grounds that it is a purely private company which is financially, functionally and administratively independent of the AAI. MIAL was managed and controlled by its board of directors, majority of which were nominees of MIAL's private promoters. Accordingly, it was argued that MIAL was not a 'State' or an instrumentality of the State as it failed the tests that have been judicially prescribed for an entity to be classified as 'State'. It was argued that MIAL was discharging private and commercial functions which were in furtherance of the intent of distancing the state from commercial activities. As providing for duty free shops was a purely commercial activity, it was contended that no public law element should be involved in awarding such a contract.

Decision

The High Court observed that even if MIAL were justified in short listing the expressions of interest adopting the criteria for short-listing at its sole discretion, such short-listing should have been on some rational and objective basis. In this regard, the High Court relied on settled judicial principles that if a classification is founded on an intelligible differential and such differential has a rational relation to the object sought to be achieved, it would not be violative of the right of equality. Accordingly, the High Court held that the total absence of any reason in the document of evaluation and the admitted non-communication of any reason to Flemingo *inter alia* indicate that MIAL acted in an arbitrary manner in short listing the applicants.

As regards whether the High Court has the power to exercise writ jurisdiction in respect of the arbitrary action of MIAL, the High Court held that since MIAL was performing a public duty in allotting duty free shops, it was under a duty to act reasonably and fairly. The High Court observed that when MIAL chooses to give a contract for any activity which is for the public benefit, it must choose a person by an open competition according to objects and clear norms and its action should be transparent. Consequently, it was held that such actions could be examined by the High Court in exercise of its writ jurisdiction on the touch-stone of fairness and reasonableness.

Based on the following observations about MIAL (i) being a joint venture company supported by the Government of India in operating, managing and developing the Mumbai Airport on property that is owned by the AAI and is public property; (ii) performing statutory functions and exercising statutory powers; (iii) not being a simple lessee of public property; (iv) having the power to use a summary procedure to evict unauthorized occupants on the area leased to it, the High Court observed that MIAL is 'State' for the purposes of the Constitution.

Implications

In the events entities such as MIAL are considered as 'State' and their actions are amendable to judicial review, the same may defeat the intent of the amendment to the AAI Act made in 2003. The intent of such amendment was to provide for an effective legal framework which would encourage private investments and ensure that investors have operational and managerial independence. If any action by private entities can be challenged on the grounds of violation of the fundamental rights, the same may hamper operations and be counterproductive to the primary intent of preserving public interest.

Whilst currently there is a stay on the decision of the High Court, it would be interesting to see how this issue is judicially settled by the Supreme Court as this may have far reaching implications on contracts across all infrastructure sectors. If, private entities involved in implementing one aspect of an infrastructure project in partnership with a public entity are regarded as an instrumentality of the State, this may possibly jeopardize

public-private partnerships as private entities may consequently need to conduct their business in a manner that an instrumentality of the State is required to do.

Private entities which are declared as 'State' may *inter alia* be required to adhere to principles of fairness, natural justice and equal treatment in conduct of their business. Such entities would be required to adhere to judicially propounded principles for awarding of contracts. Further, employees of such entities may be able to challenge dismissals and seek to be re-instated, if the dismissal can be proven to be in violation of the principles of natural justice. In *Sirsi Municipality by its President, Sirsi v. Cecelia Kom Francis Tellis*, AIR 1973 SC 855, the Supreme Court held that where a State or a public authority dismisses an employee in violation of the mandatory procedural requirements or on grounds which are not sanctioned or supported by statute or contrary to rules of natural justice, the courts may exercise jurisdiction to declare the act of dismissal to be a nullity.

Importantly, accounts of such entities could potentially be subject to audit by the Comptroller and Auditor General of India. In *United RWAS Joint Action and Others vs Union of India*[22], the High Court of Delhi observed that the words "body or authority" in Article 149 of Constitution are of wide amplitude and not confined to "body or authority" which satisfy the test of 'State' within the meaning of Article 12, but extend to "private body or authority also". Accordingly, it held that the Comptroller and Auditor General of India would *inter alia* have a right to audit the books of such authority.

Further, on the basis of the findings of the High Court in the *Flemingo* case, it may also be contended that private entities such as MIAL are 'public authorities' for the purposes of the Right to Information Act, 2005 and are therefore subject to the disclosures prescribed under such statute. A case[23] is presently pending before the High Court of Delhi in respect of whether the MIAL is a 'public authority' for the purposes of the Right to Information Act, 2005.

All of the above may impact the ability of private entities such as MIAL to take decisions on a purely commercial basis and may result in them making choices that may not be the most effective, efficient or economic.

[22] Writ Petition 895 of 2011 decided on October 30, 2015.

[23] In 2011, the Central Information Commission had vide an order dated May 30, 2011, declared that the MIAL is a 'public authority'.

IX. The Road Ahead for Indian Infrastructure

Infrastructure development projects differ from other industrial projects in that they are high investment, high risk, and long gestation period projects. In these projects, not only are there greater risks due to the large size of the project but also the generation of revenues from the use of the facility or services by the consumers is highly uncertain. It is this characteristic that makes Infrastructure development projects more risky than normal industrial ventures.

Consequently, the implementation and investment in infrastructure development projects call for a different approach and perspective than that adopted in the case of industrial projects. Development of infrastructure projects with private participation requires a distinct approach that has to be project specific. This is because each project has its distinct investment requirements, risk profile, user profile and gestation period.

There can be no general approach towards infrastructure development in various sectors, and even within the same sector each project will require tailor-made approaches specific to the project.

India's rapid economic growth over the last decade has placed tremendous stress on its limited infrastructure, bringing the shortage of infrastructure to the fore. The approach paper to the Twelfth Five Year Plan envisages a growth of 9%-9.5% for the country in the years 2012-2017 amidst a slowing global demand and an uncertain business environment especially in the Eurozone and the United States, two of India's key trading partners.

In such a scenario, the fulfillment of India's aggressive growth aspirations depends on its ability to invigorate its domestic demand through investment, particularly in infrastructure projects and its ability to provide a congenial business environment for all concerned players. The country needs to urgently accelerate the conceptualization and implementation of all its infrastructure development to enable planned growth.

The significance of India's infrastructure deficit has not been lost on its policy makers, a realization that has seen the investment in infrastructure going up from 5.7% of the GDP in the base year of the eleventh plan to around 8% of the GDP in the last year of the plan. The pace of investment has been particularly buoyant in some sectors, notably telecommunications and oil & gas pipelines, while falling short of targets in electricity, railways, roads and ports. Efforts to attract private investment into infrastructure through the public-private partnerships (PPP) route have met with reasonable success, both at the Central and State government levels. A lot however still needs to be done to ensure that the need-gap is met.

Abbreviations

Term	Meaning
AAI	Airports Authority of India
AAI Act	Airports Authority of India Act, 1994
Act	Electricity Act, 2013
AIIB	Asian Infrastructure Investment Bank
ALM	Asset Liability Management
APL	Adani Power Limited
APTEL	Appellate Tribunal for Electricity
ARCs	Asset Reconstruction Companies
BLT	Build Lease and Transfer
BOO	Build Own and Operate
BOOT	Build, Own, Operate, and Transfer
BOT	Build Operate and Transfer
BROT	Build Rehabilitate Operate and Transfer
BTO	Build Transfer and Operate
CAO	Contract Add and Operate
CERC	Central Electricity Regulatory Commission
CDR	Corporate Debt Restructuring
CICs	Core Investment Companies
Code	Insolvency and Bankruptcy Code, 2016
CPPIB	Canada Pension Plan Investment Board
Companies Act	Companies Act, 2013
Constitution	Constitution of India
DBFO	Design Build Finance and Operate
DBFOT	Design Build Finance Operate and Transfer
DEA	Department of Economic Affairs
DDT	Dividend Distribution Tax
DOT	Develop Operate and Transfer
DIPP	Department of Industrial Policy and Promotion
ECB	External Commercial Borrowings
EPC	Engineering Procuring and Construction
FATF	Financial Action Task Force
FFC	Fare Fixation Committee
FDI	Foreign Direct Investment
FIIs	Foreign Institutional Investors
FPIs	Foreign Portfolio Investors
Flemingo	Flemingo Duty-Free Shop Private Limited
GERC	Gujarat Electricity Regulatory Commission
GDP	Gross Domestic Product
GOM	Government of Maharashtra

GST	Goods and Services Tax
GUVNL	Gujarat Urja Vikas Nigam Ltd
HAM	Hybrid Annuity Model
High Court of Bombay	High Court of Bombay
IDFs	Infrastructure Debt Funds
IIPDF	India Infrastructure Project Development Fund
IT Act	Income-tax Act, 1961
InvITs	Infrastructure Investment Trusts
InvITs Regulations	Securities and Exchange Board of India (Infrastructure Investment Trusts) Regulations, 2014
IRP	Insolvency Resolution Professional
JLF	Joint Lenders Forum
LLP	Limited Liability Partnership
LROT	Lease Renovate Operate and Transfer
Metro Construction Act	Metro Railways (Construction of Works) Act, 1978
Metro O&M Act	Metro Railways (Operation and Maintenance) Act, 2002
MIAL	Mumbai International Airport Private Limited
MMOPL	Mumbai Metro One Private Limited
MMRDA	Mumbai Metropolitan Region Development Authority
MOP	Ministry of Power
MRA	Metro Railway Administration
Mumbai Airport	Chhatrapati Shivaji International Airport, Mumbai
NBFC-AFCs	NBFCs-Asset Finance Companies
NBFC-IFCs	Non-Banking Financial Companies-Infrastructure Finance Companies
NHAI	National Highways Authority of India
NHDP	National Highways Development Project
NIIF	National Investment and Infrastructure Fund
OMT	Operate Maintain Transfer
Order	GoM's order dated September 3, 2013
PFI	Private Finance Initiative
PIS	Portfolio Investment Scheme
PPA	Power Purchase Agreements
PPP	Public Private Partnerships
PPPAC	Public Private Partnership Appraisal Committee
PRS	Permanent Residency Status
QIA	Qatar Investment Authority
RBI	Reserve Bank of India
RDBs	Rupee Denominated Bonds
Regulation	Regulation 17, 2010 (of Indonesia)
REITs	Real Estate Investment Trusts
REITs Regulations	Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014

ROO	Rehabilitate Own and Operate
ROT	Rehabilitate Operate and Transfer
S4A Scheme	Scheme for Sustainable Structuring of Stressed Assets
SEBI	Securities and Exchange Board of India
SEBI Takeover Regulations	Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeover) Regulations, 2011
SEZs	Special Economic Zones
SDR	Strategic Debt Restructuring
SMA	Special Mention Accounts
SPV	Special Purpose Vehicle
TDRs	Transferable Development Rights
UDAY Scheme	Ujwal DISCOM Assurance Yojana
UK	United Kingdom
VGF Scheme	Scheme for Financial Support to PPPs in Infrastructure

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