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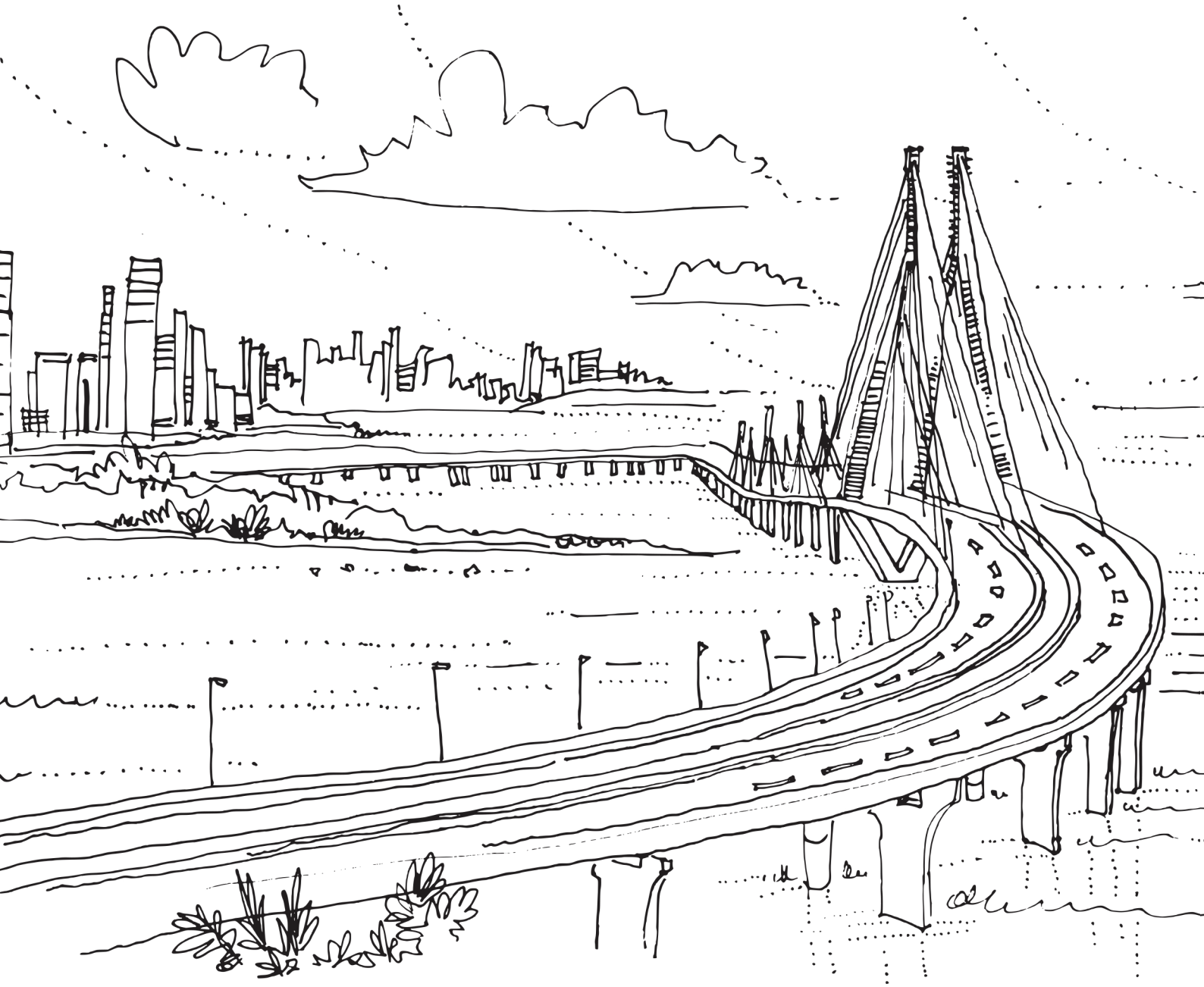

# INFRASTRUCTURE PROJECTS IN INDIA

## FROM CRADLE TO GRAVE TO RESURRECTION

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ELP

# Foreword

The Indian infrastructure sector has gone through two cycles of investment. The current inflection point is borne out of the changing economic and legal landscapes as well as experiences in privatization. It is tempting to refer to the current scenario in the sector as 'Infrastructure 3.0' - heralding different models of private participation in infrastructure with more sophisticated sharing of risks, set against the difficult backdrop of availability of funding.

Private – public sector partnerships (PPPs) are all veering towards toll-operate-transfer concessions (where construction risk is absent) and hybrid annuity model projects (where construction risk is shared). The scope of PPPs has also extended to different sectors and permit greater exploitation of surrounding real estate, where revenues from the projects may not yield enough returns. Indeed, there seems to be an acknowledgement of a need to rebalance risks between public and private sectors. This in no small part is necessitated by the huge investment needs and shrinking financial resources.

Attendant with sector specific changes, the general legal and regulatory framework has also undergone transformation. The advent of the Insolvency and Bankruptcy Code, 2016 along with its impact on other laws and pending disputes, the relaxation of FDI norms and the conception of Infrastructure Investment Trusts clearly indicate a move towards easing the flow of capital into infrastructure. There seems to be a recognition of differing risk profiles for diverse kinds of investors. Projects and vehicles now cater to different appetites, from adventurous project developers to the more staid pension funds and insurance companies.

More changes are needed - issues such as protracted dispute resolution, snarls in land acquisition and approvals and issues around contract enforcement still plague projects and disincentivize investments. There is a recognition of the need for addressing these systemic risks to strengthen the sector and changes to laws and processes are being brought about accordingly. Careful replication of successful regulatory and contractual innovations adopted in some other sectors could also resolve common issues in infrastructure.

From hereon we expect (and hope) that the new capital (both local and foreign) that will find its way slowly back into infrastructure, will come with strict discipline and force the recipients of such capital to be accountable every step of the way.

It is against this dynamic context, that ELP has curated its book 'Infrastructure Projects in India: From Cradle to Grave to Resurrection'. This book is our endeavor to give our readers an in-depth view of ELP's collective cross - practice experience on infrastructure projects in India. We attempt to highlight practical difficulties that arise from the complex tangles created in the intersections of law, project development and financing.

We have also been lucky to get a 'hands on' view from clients and experts in their field, for which we are very grateful.

The next edition will cover more sectors and areas after taking into account your views.

We do hope this makes for some interesting reading. We enjoy every reader's opinion and welcome your feedback on insights@elp-in.com

Regards

**Team ELP**

# Public – Private Partnerships (PPPs) in Infrastructure Projects

“

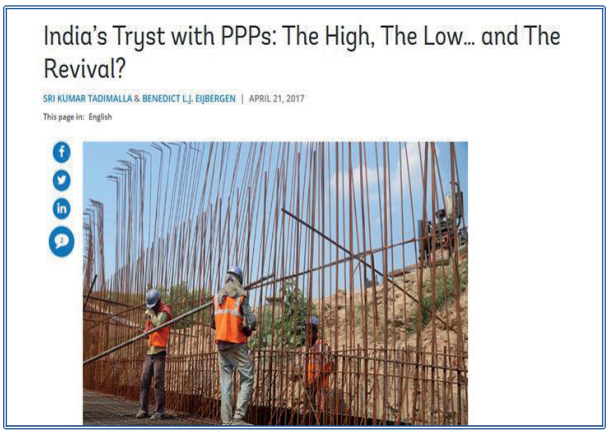
**The Bandra-Worli Sea link has steel wires equal to Earth’s circumference…**

# Public - Private Partnerships (PPPs) in Infrastructure Projects

## Public private participation in infrastructure

For many years the development of infrastructure has served as one of the cornerstones of Indian economic policy. Vast outlays are provided year on year in the union budget of India for the infrastructure sector. In the union budget for the financial year 2019-2020, the Government of India (**GOI**) has announced its intention to invest INR 100 lakh crores in infrastructure over the next 5 years. As always, there is also a massive expectation that the private sector will support infrastructure development. To be fair, over the past few years, the Government of India (GOI) has attempted to resolve the bottlenecks of PPP projects and to address the policy paralysis that have long plagued the pace of growth of infrastructure in India.

*This image is part of a World Bank blog on India's PPPs*[1]




Private participation in infrastructure has a long history in India. Early examples include private investments in the railroads in the late 1800s and private enterprises producing electricity in Kolkata and Mumbai in the early 1900s. Internationally as well, governments relied on support from the private sector for infrastructure development. The role and scope of the private sector differed through the years - where earlier private sector entities worked merely as suppliers of materials and equipment, their role gradually expanded to that of service providers and contractors to the GOI.

In India, since the past 30 years or so, PPPs have emerged as the preferred mode for infrastructure development with the private sector assuming greater implementation and operational risks under long term contracts. In India, the 90s saw PPPs taking root and the first concession agreements being executed between the government and private entities for implementation of road and port projects.

Serious efforts have been made by the GOI to mainstream PPP in infrastructure after some early successes. In 2006, the GOI established a 'Public Private Partnership' Cell (**PPP Cell**) for facilitating PPPs and related capacity building. Set up by the Department of Economic Affairs (Infrastructure Policy & Finance Division), the PPP Cell is responsible for matters concerning Public PPPs, including policy, schemes, programs and capacity building and all other matters relating to mainstreaming PPPs. Various grants are also made available for significant and capital-intensive PPP projects in the form of loans, equity and development funds. A central PPP appraisal committee has been formed to streamline approval and appraisal of projects. It acts as the Secretariat for policy level matters concerning PPPs, including policies, schemes, programs, and capacity building. Additionally, a PPP toolkit has been created with the assistance of the World Bank as a guide to government officials to implement PPP schemes.

## PPPs: Legal framework and definition

### Power to legislate

Under the Constitution of India (**Constitution**), the union (centre) and the states (provinces) are empowered to legislate on various subjects. The Seventh Schedule of the Constitution has three lists namely, the 'Union List', the 'State List' and the 'Concurrent List' which enumerate the matters on which the union and the state can legislate.

Only the Indian parliament can make laws on the subjects mentioned in the Union List, while the respective state legislatures can make laws on subjects mentioned in the State List. Both the Indian parliament and the state legislatures

[1] https://blogs.worldbank.org/endpovertyinsouthasia/india-s-tryst-ppps-high-low-and-revival

can legislate on subjects mentioned in the Concurrent List. If any provision of law made by the state legislatures on subjects mentioned in the Concurrent List conflicts with any provision of law made by the Indian parliament, then the provision of law made by the state legislature will be void to the extent of such a conflict. However, if a provision of law made by the state legislature has been reserved for the President of India's consideration and has received the president of India's assent, then such a provision of law made by the state legislature prevails in that state. In any event, the Indian parliament has the power to repeal, modify or amend any state law by a subsequent central enactment even if the president of India's assent has been accorded to the state law.

The distribution of jurisdiction under the Constitution of India over subjects relating to infrastructure sectors between the Union and the states can be divided into 2 broad categories:

- Distribution of the infrastructure sectors themselves
- Distribution of subjects that are relevant for the development and financing of infrastructure projects

The following is the distribution of jurisdiction over infrastructure sectors under the Seventh Schedule:

| **List I**<br><br>**Jurisdiction of the Union** | **List II**<br><br>**Jurisdiction of the State** | **List III**<br><br>**Concurrent jurisdiction of the Union and State** |
|---|---|---|
| Ports declared by or under law made by Parliament or existing law to be a major port, including their delimitation and the constitution and powers of the port authorities therein | Communications, that is to say, roads, bridges, ferries and other means of communication not specified in List 1; inland waterways and traffic thereon subject to the provisions of List I and List III with regard to such waterways; vehicles other than mechanically propelled vehicles | Ports other than those declared by or under law made by Parliament or existing law to be major ports |
| Shipping and navigation on inland waterways; Regulation and development of interstate rivers and river valleys | Water, that is to say, water supplies, irrigation and canals, drainage and embankments, water storage and water power | Shipping and navigation on inland waterways as regards mechanically propelled vehicles, and the rule of the road on such waterways, and carriage of passengers and goods on inland waterways subject to the provision of List I with respect to the national waterways |
| Highways declared by or under law made by Parliament to be national highways | Land, that is to say, rights in or over land, land tenures including the landlord and tenant, and the collection of rents, transfer and alienation of agricultural land, land improvement and agricultural loans | Mechanically propelled vehicles including principles on which the taxes on such vehicles would be levied |
| Maritime shipping and navigation | Regulation of mines and mineral development subject to the provision of List I with respect to the regulation and development under the Control of the Union | |
| Railways | | |
| Airways, aircrafts and air navigation; provision of aerodromes; regulation and organization of air traffic and aerodromes; provision for aeronautical education | | |
| Carriage of passengers and goods by railways, sea or air or by national waterways | | |

While the union and states have power to legislate on matters in the Concurrent List, only the Indian parliament is empowered to make laws on matters that are not included in any list[2].

Accordingly, private participation in infrastructure sectors mentioned in the Union List will be governed by the central/ union laws and administered by the centre and its agencies. Likewise, participation in infrastructure sectors mentioned in the State List will be primarily governed and administered by state governments and its agencies. There are usually overlaps in terms of governance and administration of sectors in the Concurrent List but, it is not essential to comment on the same for the purpose of this book.

The underlying theme emerging from the above is that, on account of the federal structure of our constitution, for infrastructure projects to be successful in India, it is imperative to obtain structural support from the states in certain areas. As an example, national highways are under the jurisdiction of the Union List however, certain critical services such as police support & healthcare (ambulances etc.) will be enforced by the state. For providing such support to set up and implement a project, State Governments often execute 'State Support Agreements' with the concessionaire, assuring all necessary support such as assistance in procuring approvals for the project, coordination with law and order agencies etc. Such agreements are valid throughout the concession period. Interestingly, such state support obligations are not specifically incorporated in concession agreements. At the same time, State Support Agreements do not prescribe any specific consequences of failure of the State Government to provide the promised support.

## PPPs defined

### Central level

Currently there is no comprehensive central legislation that exclusively defines and governs PPPs in infrastructure sector.

- In 2012, The Public Procurement Bill, 2012 was tabled in the lower house of Parliament under the previous government of the United Progressive Alliance. However, the bill had lapsed with the dissolution of the house holding general elections[3]. The bill sought to regulate and ensure transparency in procurement by the central government and its entities. It provided for aspects such as processes and method of procurement (which includes award of PPP projects), institutional mechanisms, grievance redressal mechanisms, offences and penalties in relation to the public procurements. **Section 2 (w) of the bill defined PPP as**:

  *"PPP" means, an arrangement between the Central Government, statutory entity or any other Government owned entity on one side and a private sector entity on the other, for the provision of public assets or public services or both, through investments being made or management being undertaken by the private sector entity, for a specified period of time, where there is defined allocation of risk between the private sector and the public entity and the private entity receives performance linked payments that conform (or are benchmarked) to specified and predetermined performance standards, measurable by the public entity or its representative; "*

- **As per the Scheme for Financial Support to PPPS in Infrastructure, of the GOI**[4] :

  "*The **PPP** Project means a project based on contract or concession agreement between a Government or statutory entity on the one side and a private sector company on the other side, for delivering an infrastructure service on payment of user charges.*"

- **The Department of Economic Affairs, Ministry of Finance, GOI (DEA)** has defined PPP as:

  *"A PPP means an arrangement between 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 period of time, 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, pre-determined and measurable performance standards"*[5].

[2] The Constitution (74th Amendment) Act decentralised the responsibilities of the state governments in respect of urban infrastructure to a substantial extent to urban local bodies. These included solid waste management, urban roads and bridge, water supply etc.

[3] The new National Democratic Alliance government sought to revamp the bill through a new Public Procurement Bill, 2015. However, the draft of the same is unavailable online.

[4] https://www.pppinindia.gov.in/documents/20181/21751/VGF_GuideLines_2013.pdf

[5] PPP Guide for Practitioners issued by the DEA in April 2016 (PPP Guide 2016)

## State level

Certain states have created their own framework in the form of policies and even specific legislations for PPP in the infrastructure sector. While the states of Andhra Pradesh, Gujarat, Bihar and Punjab have passed specific legislations defining PPPs and setting out implementation aspects, states of Assam, Goa, Karnataka, Odisha, Rajasthan and West Bengal are guided by the policies for development and implementation of the infrastructure sector through PPP. Some of these policies define PPP:

- **The Tamil Nadu Infrastructure Development Act, 2012** defines PPP as**:**

  *"PPP" means an arrangement between a public agency and a private sector participant for the provision of infrastructure through investment made or through design, development, construction, maintenance or operation undertaken by the private sector participant, where risks are allocated between them such that the private sector participant takes on the risk beyond the stage of design and construction and the payment for the services are performance linked, in the form of user charges, annuities or unitary payment;"*

- **The Andhra Pradesh Infrastructure Development Enabling Act, 2001 and the Bihar State Infrastructure Enabling Act, 2006** define PPP as under

  *"PPP" means investment by private Sector Participant in an Infrastructure Project of the Government Agency or the Local Authority in the State."*

**Given the above definitions it can be concluded that**:

- PPPs envision the provision of public goods or services (such as operation of projects) for public benefit by the private sector where substantial risk associated to such goods and services is that of the private sector. In consideration payments are received by the private party from the user or public sector based on the performance standard set out in the contract for PPP. Thus, under PPP, the private partner assumes the role which is traditionally of the public entity (i.e. delivery of goods and services to the public).
- During the implementation and operation of the project under PPP, the role of the public sector becomes that of monitoring the performance of the private partner and enforcing the terms of the contract executed with the private partner in relation to the project. Under the applicable law or the terms of the contractual arrangement with the private party, the public entity may or may not have a recourse to the private party for any deficiency or defects in services of the private party. However, the ultimate accountability towards users for the services, rests with the public entity.

Although the definitions of PPP above, are not limited to infrastructure projects, in the Indian context, PPP is largely used for the delivery of infrastructure and ancillary services to the public.

## PPPs: Models/arrangements

PPPs involve multiple stakeholders, key of which include: (i) the public entity (i.e. the government including its agencies and institutions) who awards the project and to a certain extent, provide viability funding for the same (ii) the private partner or the concessionaire (which can be a consortium of partners) to whom the project is awarded by the public entity (iii) the Special Purpose Vehicle (**SPV**) created as a legal manifestation of the private partner/consortium for the implementation of the project (iv) the lenders financing the project (v) independent engineers (**IE**) and consultants of the project (vi) the users, who are the ultimate beneficiaries of the project. These key stakeholders play a significant role in the success of the project as their interests coincide with the same.

Thus, it is imperative that the structure and framework of a PPP project is such that the interests of the stakeholders are duly considered, and the risks associated with the project are carefully identified and appropriately distributed among the stakeholders most capable of assuming such risks. Appropriate allocation of risks to the stakeholders in a project increases efficiency in developing and managing the project and will also be considerably cost effective. If the risks of

the projects are not appropriately identified and allocated, the project is likely to suffer delays in implementation and heavy costs and costs overruns which would ultimately adversely affect all the stakeholders of the project.

The risks addressed in a typical PPP contract can be broadly categorized into pre-construction phase risks, construction phase risks and operation phase risks. The instances of risks in each of the above categories may vary from project to project and may depend on various circumstances.

Pre-construction risks would include risks such as:

- Delay in acquisition of the land required for the project within the envisaged timelines
- Inability and delay in obtaining commitment from the lenders for financing the project
- Delay in obtaining necessary approvals such as environmental clearances, approvals of access to project site etc. required for commencing a project
- Inadequate project viability studies carried out by the government/implementing authority (in connection with the project) based on which a private player is expected to bid for the project

The risks in the construction phase would pertain primarily to:

- Project design
- Delay in construction due to change in construction parameters such as project specification, requirement of additional material
- Failure or delay in obtaining the regulatory approvals

The operational risks would include maintenance related risks as the asset so constructed would firstly be required to be maintained for longer duration of time and yet perform to desired levels. Other risks pertaining to the project during the operational phase are payment related risks (for instance, in case of low recovery of tolls etc.) and financial risks (*The given list of risks during various phases of the project is merely indicative*).

Further, there could also be events beyond the reasonable control of the government/private party which may adversely affect their abilities to perform their respective obligations with respect to the project. Such instances are commonly known as force majeure events. PPP contracts would generally exempt the affected party from performing its obligations during the period of force majeure. The contract may further provide that the affected party would not be liable to the other party for any non-performance by the affected party due to any force majeure event.

The kind of PPP structure is usually chosen by the government depending upon factors such as the nature of project (whether greenfield or brownfield), the kind and extent of private participation determined by the public entity such as construction, management or both, duration of the PPP contract, revenue sources of the project, demand stability, forecast in respect of the project and most importantly desired allocation of risks among the stakeholders.

Project contracts for implementation of PPPs could broadly be classified as:

- Service contracts
- Operations & maintenance (**O&M)** (management) contracts
- Capital projects (i.e. high capital-intensive long-term projects involving building and/or improving a capital asset) with O&M contracts

The general models/schemes of contractual arrangements for PPPs in projects include Build Operate and Transfer (**BOT**), Build Own Operate and Transfer (**BOOT**), Build and Transfer, Build Transfer and Operate, Develop Operate and Transfer, Lease Renovate Operate and Transfer, Build Lease and Transfer (**BLT**), Build Transfer and Lease (**BTL**), Build Own Lease Transfer etc. Although the nomenclature of the models mentioned above gives a sense of the scope of responsibilities of the private entity, the most commonly used/major models and their variants are briefly discussed :

## Build Operate and Transfer

BOT is a contractual arrangement under which the private entity (**project developer**) undertakes construction, financing and O&M of the project. The assets of the project facility created by the developer are transferred by the developer back to the concerned government agency upon termination or expiry of the contract. BOT contracts are usually long-term contracts (i.e. period of 20-30 years) where the ownership of the assets of the projects lie with the public entity. These could be toll based (**BOT Toll**) or annuity based (**BOT Annuity**).

Under BOT Toll and the BOT Annuity models, the developer is required to meet upfront/construction costs and maintenance expenditures. While under BOT Toll model, the developer recovers its costs and return on investments through collection of tolls from the users, under BOT Annuity, the developer gets returns on its investments through pre-determined cost of returns out of the annuities paid by the concession authority each year[6].

The revenue risk of the private developing entity in toll-based BOT projects is usually high risk. However, in annuity-based BOT contracts the revenue risk is low as the government retains the risk with respect to traffic and fixed charges are to be paid by the public authority to the developer at regular intervals.

Depending upon the allocation of roles and risks, some of the variants of BOT model are Design Build Operate (**DBO**), Design Build Finance Operate Transfer (**DBFOT**). DBO contracts are usually short to mid-term contracts (i.e. 3 to 5 years), however they are not very common in India.

BOT is the most common model used in Indian PPPs. Sectors where BOT models are currently used include roads - largely used by the National Highways Authority of India (**NHAI**) - and in the port industry[7].


*The Durg Bypass Project*


*Jaipur Kishangarh*

Both of the above projects were awarded for development on a Build-Operate-Transfer (BOT) basis.

## Build Own Operate and Transfer

In this model, the private entity/developer undertakes the financing, construction and O&M of the project. Recovery of the developer's investment is through tolls, rentals, fees etc. from the users/consumers. The asset is owned by the private partner during the term of the contract and the developer may assign the O&M to a facility operator. BOOT contract is typically a long-term contract[8] .

Build Own Operate model is much like the BOOT model. However, the ownership of the asset remains with the private entity and the service/facility provision responsibility is also with the private entity. BOOT model is not common in India. These are typically perpetual contracts.

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[6] In BOT Toll models for highways, the viability of the project greatly depends on the traffic (i.e., toll). However, with a view to bridge the gap between the investment required and the gains arising out of it, i.e., to increase the viability of the projects, capital grant is also provided by the government (up to a maximum of 40% of the project cost).

[7] The Delhi Gurgaon Expressway, the 2nd terminal Nahvasheva International Container Terminal, JNPT are good examples of BOT projects. The Tuni Anakapalli Road Project is a BOT annuity project. The 4-laning of Muzaffarnagar - Saharanpur Road (SH-59) is implemented on DBFOT basis.

[8] Greenfield minor port concessions in Gujarat are on a BOOT basis. The Bangalore International Airport Limited (**BIAL**) operates the Kempegowda International Airport in Bangalore on a BOOT basis

## Management Contracts

Under this model, the private party undertakes operation and maintenance of public facilities or services. Although the ultimate obligation of providing service remains with the public authority, the day-to-day management control of the facility vests with the private sector. The ownership of the assets/facilities and the investments therein remain with the public entity. The private entity is entitled to a pre-determined fixed fee for the management services along with performance-based incentives. The public entity engages a private partner for a short term (3 – 5 years). This model is prevalent in urban projects such as water supply, drainage management etc.[9]. These also include highway management contracts.

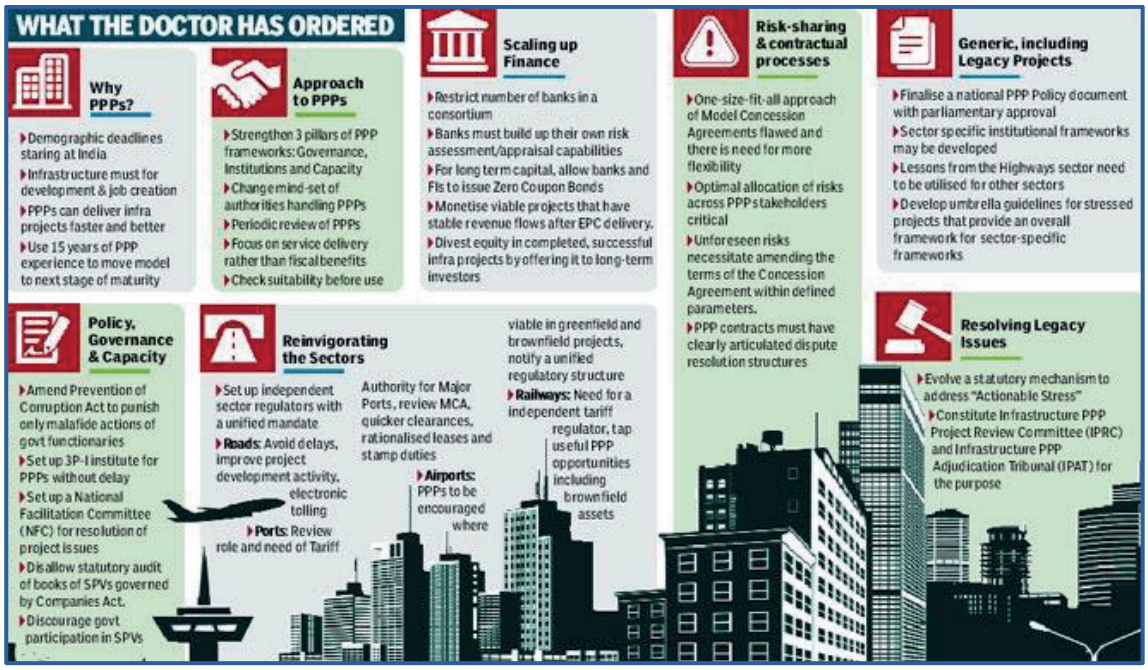
Management contract with rehabilitation and expansion is another variant in this model. The private contractor takes a management and financial risk for a volume incentive under this model. These are mid to short term contracts and usually are applied to brownfield projects. Projects under this model generally entail limited investments. This mode has been adopted in the power distribution and water supply sectors[10].

## Lease Contracts

These are usually mid-term to long term contracts which may involve capital investment by the private partner. Under this model, the public entity leases the asset to a private partner. The private partner would usually require certain assurances in terms of tariff levels, term of the lease and mechanism for review of tariff to meet the envisaged estimates. The model is seen in retail outlets at railway stations by Indian Railways and in water supply contracts.

Other variants of lease contracts are BLT or build operate lease transfer (**BOLT**) and BTL. The BLT or BOLT involves building of assets by the private party and leasing it to the government. After recovery of the investment made by the private party, the asset is transferred to the government. This model has been seen in railway contracts and water desalination plants. The contracts under BLT or BOLT model are mid-term contracts.

Under the BTL model, the private party builds the asset and transfers it to the government. Thereafter the same asset is leased by the private party from the government. The private party earns revenue by collection of user charges.




*Snapshot of a news article in the Financial Express on PPPs[11]*

[9] Karnataka Urban Water Supply Improvement Project is based on simple management model.

[10] Bhiwandi Distribution Franchise, Latur Water Supply Project are examples of management contracts with expansion and rehabilitation model.

[11] https://www.financialexpress.com/industry/bridging-the-public-private-divide/188781/

## Finance structures for PPPs

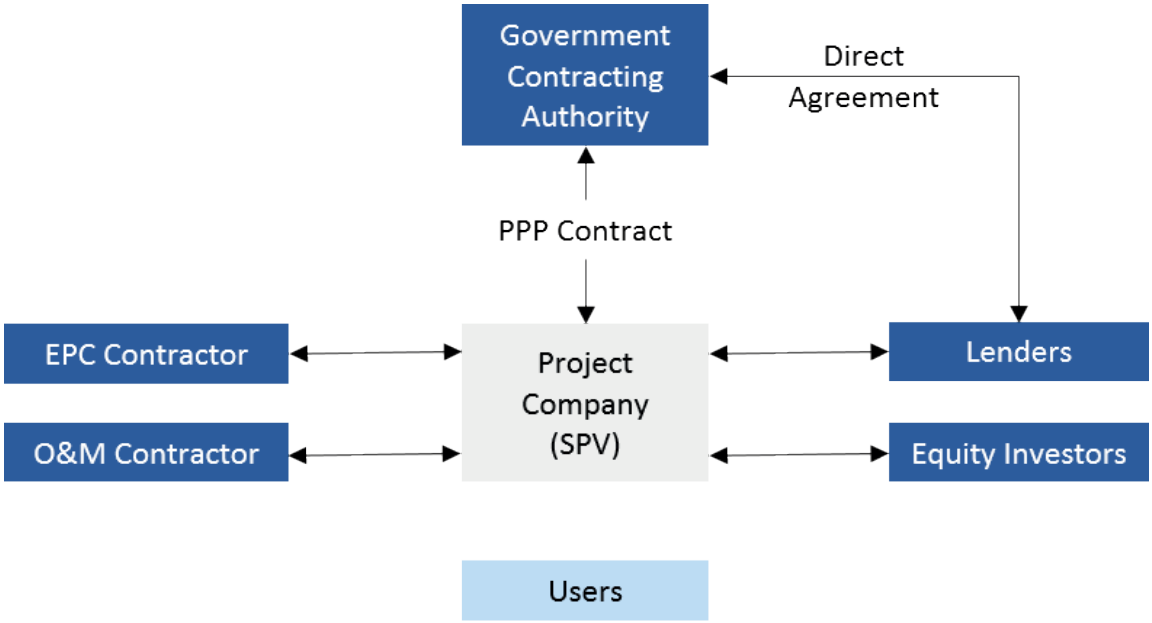
The private party to most PPP contracts is a specific project company formed for that purpose—the SPV. This project company raises finance through a combination of equity—provided by the project company's shareholders—and debt provided by banks, or through bonds or other financial instruments. The finance structure is the combination of equity and debt, and contractual relationships between the equity holders and lenders.

The government's primary contractual relationship is with the project company. This may be complemented by a direct agreement between contracting authority and lenders; although often this relationship is limited to the provisions in favor of the lenders included in the PPP agreement, such as step-in rights or senior debt repayment guarantees.

The initial equity investors, who develop the PPP proposal, are typically called project shareholders. Typical equity investors may be project developers, engineering or construction companies, infrastructure management companies, and private equity funds. Lenders to PPP projects may include commercial banks, multilateral and bilateral development banks and finance institutions, and institutional investors such as pension funds and insurance companies.

The project company contracts with firms to manage design and construction (usually known as an Engineering, Procurement and Construction (**EPC**) contract), and O&M. These contractors may be affiliated with the equity investors.

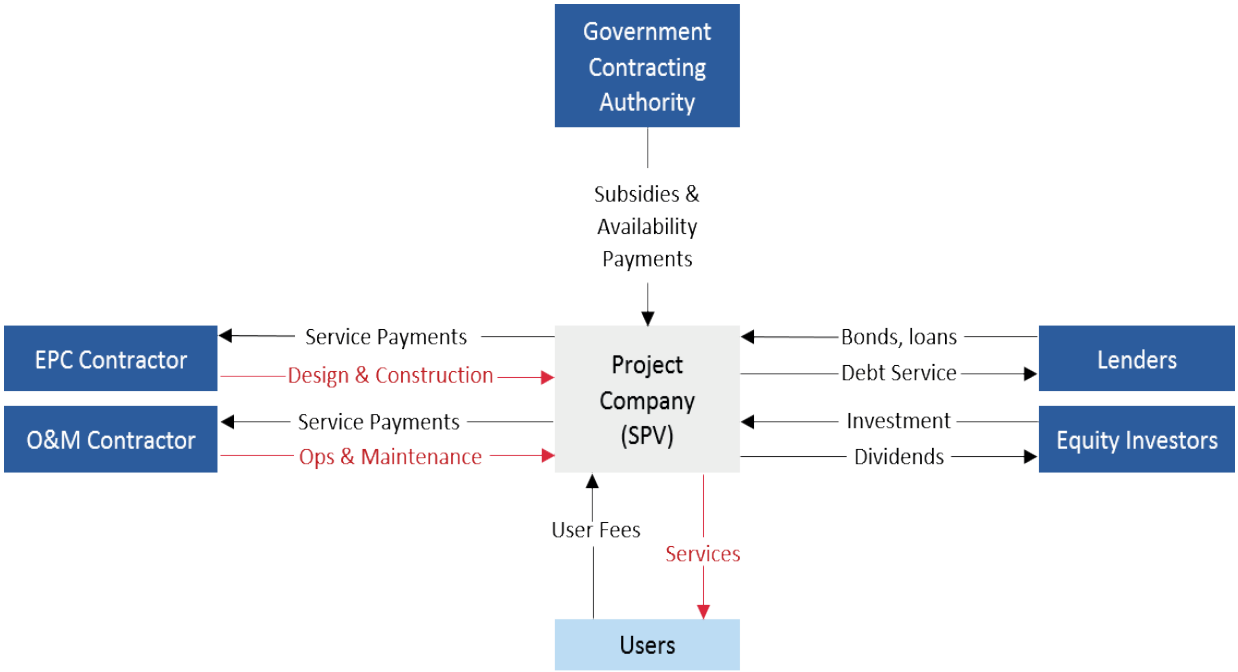
### Typical PPP project structure




### Non-recourse project finance for PPPs

Under non-recourse project finance, lenders can be paid only from the project company's revenues without demanding compensation from the equity investors. That is, the project company's obligations are ring fenced from those of the equity investors, and debt is secured on the cash flows of the project. PPP project finance structures typically involve a large proportion of debt. In many cases, it ranges from 70 to 95 % of total finance. From the equity investors' perspective, this helps manage risk by limiting exposure to a project and makes it possible to undertake much larger projects than would otherwise be the case. For lenders, it means undertaking rigorous due diligence, focusing on the project cash flow and contractual structure.

## Flow of funds




## Alternatives to non-recourse project finance

While helpful for raising finance for large, highly leveraged investments, project finance comes at a cost. Interest rates for project-finance debt are more expensive than government borrowing, and often more expensive than borrowing by established companies. The transaction cost—setting up the contractual structure and carrying out adequate due diligence—can make it unattractive for smaller deals. For this reason, many smaller PPP projects do not adopt the non-recourse project finance structure – this is to achieve greater contractual flexibility or lower the financing cost.

One option is for project shareholders to back up the project company by providing a corporate guarantee to the lender for repayment for all or part of the project debt.

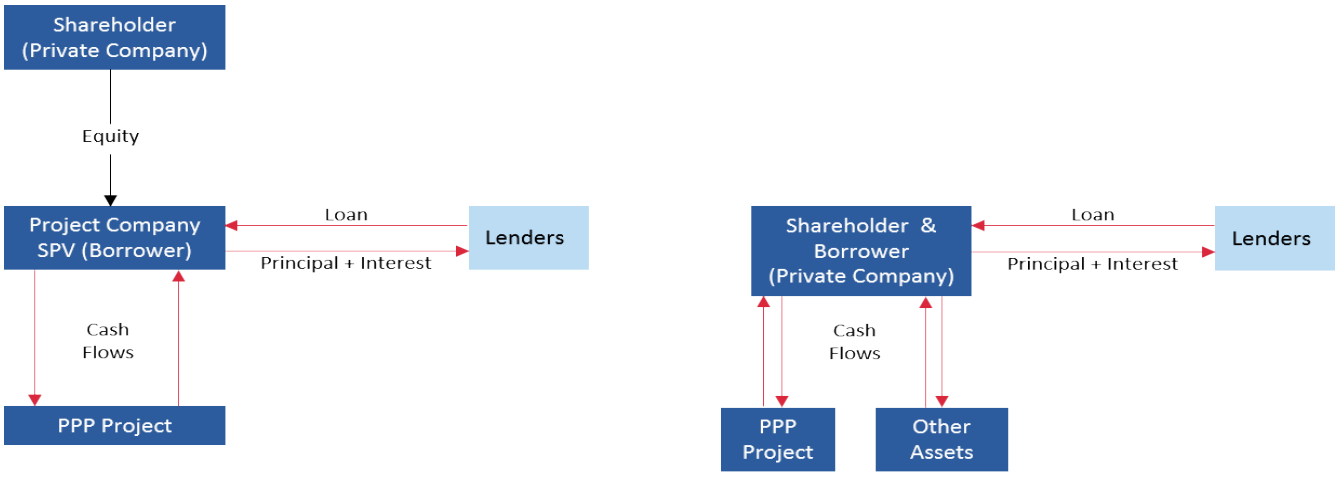
Large infrastructure companies can structure the financing of their projects either through traditional full recourse corporate finance or through limited recourse project finance. If the corporate finance route is followed, the lenders provide loans directly to the parent company, on the strength of its credit rating and balance sheet. In case of default the lenders have full recourse to the balance sheet of the company, but their loan is generally unsecured, which means that it is not backed by a specific asset. In project finance, an SPV is created to hold the assets of the project exclusively. The SPV is owned by the infrastructure company and other equity investors. Lenders provide loans to the SPV. Their recourse in case of default is limited to the cash flows generated by the assets of the SPV but not to the balance sheet of the equity investors. On the other hand, lenders will typically have security over the assets of the SPV. In general, investors prefer limited recourse, because the risk of the project is limited to the equity they put in the SPV company. The cost of debt is generally higher, but the risk is circumscribed. From the public sector standpoint, if the limited recourse project finance route is followed, it is important to ensure that the SPV is not too thinly capitalized, that is, the debt/equity ratio should not be too high. Otherwise, the investors' interests might not be aligned with those of the public sector, and financial close might be difficult to achieve. In addition, project finance induces lenders to focus on the PPP project assets and their ability to generate cash flows—implying that lenders will implement better due diligence, and that they may later create an additional layer of protection to the public interest by exercising step-in rights in order to guarantee service delivery according to standards.

From the lender's perspective, limited recourse project financing will often not be sufficient. They will typically require additional credit support from the PPP company shareholders and/or third parties. Sometimes, lenders will ask for step-

in rights in case of default. In full recourse schemes, the only drawback is a potentially long and complex process for redress, especially if the investors' parent company is based overseas.

These two cases are not the only financing structures available. PPP financing is actually quite diversified. In some countries with less developed financial institutions, where project finance is not common, but where contracting authorities wish to design good PPP arrangements, investors are required to create a PPP company (the SPV), which then obtains loans with guarantees from the PPP company shareholders.

### Non-recourse and full-recourse corporate project finance structures




### Government finance

Another alternative to lower the cost of finance for a PPP is for the government to participate in the finance structure. The government — or a government owned financial institution — could provide finance as a lender to the project company, or could provide a guarantee to some, or all, of the project debt.

At the most basic level, governments need to ensure that the project design is bankable — that is, the project company can raise debt. Although the ability to raise debt is a necessary feature, too much debt can undermine risk-transfer, so governments may want to limit the amount of debt finance (leverage) allowed. More arcane but still important details include:

- How to manage risks in going from contract award to financial close
- How to deal with the possibility of refinancing project debt
- How to define step-in rights for lenders and the government

Governments may also participate in the finance structure. Governments can provide debt, equity, or guarantees — either directly, or through government-owned financial institutions such as development banks and pension funds.

The exclusive use of private finance is not a defining characteristic of a PPP — governments can also partially finance PPP projects. Reducing the amount of capital investment needed from private entities reduces the extent of risk transfer — weakening private sector incentives to create value for money and making it easier for private entities to abandon the project if things do not go according to plan. Nonetheless, there are several reasons why governments may choose to provide finance for PPP projects. These include:

- **Avoiding excessive risk premiums** — the government may consider the risk premium charged by the private sector for the project to be excessive in relation to the actual project risks. This can be a difficult call to make, since financial markets are usually better at assessing risk than governments, but can apply particularly for new projects or markets, or during financial market disruptions.

- **Mitigating government risk** — where project revenues depend on regular payments from government, the risk of default by the government will be assessed by the private party and will be reflected in the project cost. Where reliability of government payments may be in doubt, providing subsidies or payments upfront in the form of loan or grant finance, rather than on-going payments, could improve the bankability and lower the cost of the project.
- **Improving availability or reducing cost of finance** — particularly when capital markets are under- or disrupted, the availability of long-term finance may be limited. Governments may choose to provide finance at terms that would otherwise be unavailable. Governments have access to finance on concessional terms, which they may pass on to lower the cost of infrastructure projects. This is part of a broader policy of involving state financing institutions to provide long-term lending for developmental purposes.

There are different ways in which governments can contribute to the financing structure of a PPP. Governments may provide loan or grant finance directly to the project company or provide a government guarantee on a commercial loan.

## Viability Gap Fund

*Snapshot of an article in the Livemint on the importance of funding from multilateral agencies*

India's Viability Gap Fund uses funds appropriated from the national budget to provide upfront capital subsidies for PPP projects. Viability Gap Funding up to INR 100 crore for each project may be sanctioned by the empowered Institution, subject to the budgetary ceilings indicated by the Finance Ministry. The Empowered Institution will also consider other proposals and place them before the Empowered Committee.

**Eligibility:**

- The PPP projects may be posed by the Central Ministries, State Government or Statutory Authorities (like Municipal Authorities and Councils), which own the underlying assets
- To be eligible for financing under the scheme, the PPP projects should be implemented, i.e. developed, financed, constructed, maintained and operated for the Projects term by a Private Sector Company to be selected by the Government or a statutory entity through a transparent and open competitive bidding process
- The criterion for bidding should be the amount of Viability Gap Funding required by the Private Sector Company for implementing the project where all other parameters are comparable
- The project should provide a service against payment of pre-determined tariff or user charge
- This Scheme will apply only if the contract/concession is awarded in favor of a private sector company which is not a 'Government Company' as defined under section 2(45) of the Companies Act, 2013
- The approval to projects is given prior to invitation of bids and actual disbursement takes place once the private entity has expended his portion of the equity
- The final Viability Gap Funding (**VGF**) is determined through the bidding

## India Infrastructure Project Development Fund (IIPDF)[12]

The IIPDF provides financial support for quality project development activities. This fund has been created by the DEA with an initial corpus of INR 100 crore for supporting the development of credible and bankable PPP projects that can be offered to the private sector.

[12] https://www.pppinindia.gov.in/schemes-for-financial-support

# Concession Agreements in India – An Introduction

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Each cable of the Bandra-Worli Sea link is capable of holding 900 tons of weight and the entire weight of the establishment is equivalent to that of 50,000 African elephants…

# Concession Agreements in India – An Introduction

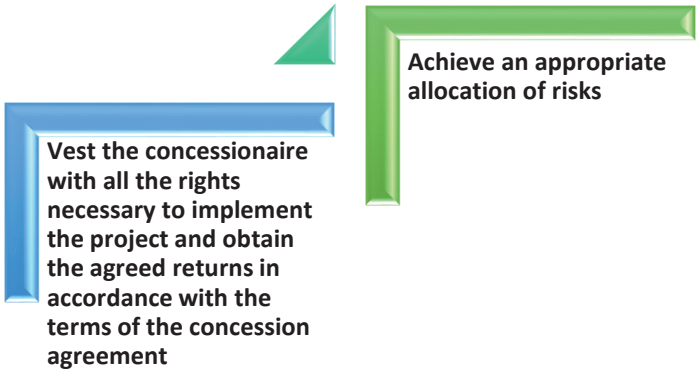
## Concession Agreements

The grant of rights for development, construction and O&M of a PPP project to a private partner is done by the government either through grant of a license under a governing statute or by executing a contract with the private party[13]. The right of the government to execute such contracts is enshrined in Article 298 of the Constitution which prescribes that the executive power of the Union or States, extend to carrying on any trade or business, the acquisition, holding and disposal of property and the making of contracts for any purpose (subject to certain provisos).

The complex arrangements that comprise a PPP project are usually enshrined in agreements commonly known as concession agreements - the concession being a grant to a private sector entity permitting it to undertake actions for the provision of public good or service, which would otherwise be provided by a public-sector entity.

A concession is a license granted by the relevant public authority to a private party to undertake the delivery of a public service and in some cases, appropriate the user charges, the legal authority for which lies exclusively with the public authority. Along with the grant of such right, a public authority seeks to pass on certain risks to the private party[14].

The concession agreement is therefore the agreement wherein the public-sector entity grants the private sector entity the right to develop and implement an infrastructure project. Its purpose is to:




The grant of rights to the private entity is usually carried out through a competitive bidding process. The government agency inviting proposals details the terms under which the bid is to be made by the private entities, and the entity offering the most favorable terms is awarded the right to implement the project.

The commercial viability of the project determines whether the payment is to be made by the private party to the public authority (in the form of a revenue share/concession payment) or vice versa (in the form of grant or annuity payment).

[13] Sectors such as airports, national highways, major ports, power and cable TV have legislations that not only provide the legal framework for the infrastructure of the projects in such sectors but also for private participation therein.

[14] Concession agreement is defined under various state legislations as under:

The Andhra Pradesh Infrastructure Development Enabling Act 2001: *""Concession Agreement" means a contract of the nature specified in Schedule I between the Developer and the State Government or Government Agency or the Local Authority relating to any Infrastructure Project or such other contract as may be Prescribed from time to time by the Government."*

The Punjab Infrastructure (Development & Regulation) Act, 2002: *""Concession Agreement" means any of the contracts executed for the purposes of private participation in an infrastructure project between a concessionaire and a public infrastructure agency in terms of this Act, or the rules or regulations made there under as per the model specified in Schedule II;"*

The Himachal Pradesh Infrastructure Development Act, 2001: *""concession agreement or arrangement" means a contract of the nature specified in Schedule-II between a developer and the Government or a Government agency relating to a project."*

## Development of MCAs

The foundation of a PPP project is the allocation of risk to parties that are most capable of bearing such risks. Excessive and inappropriate risks taken by either the public or private entity would result in difficulties and in some cases failure of the projects. This is well known. Additionally, even where risks are appropriately allocated, the manner of addressing such risks also is a decisive factor in whether a PPP project will be successful. This can be clearly seen in the evolution of concession agreements as the PPP market and players in India matured.

In the early stages of PPP projects, various state governments and authorities developed their own versions of concession agreements for individual projects. Difficulties in implementation led to the need for creation of a standard framework for PPP projects in India. The Planning Commission, through Mr. Gajendra Haldea, published in 2000 an MCA for the highways sector. Almost simultaneously, the NHAI developed its own draft concession agreements that had significant commonalities with the Planning Commission's MCA. The NHAI completely adopted the MCA developed by the Planning Commission in totality from 2008 onwards.

MCAs were then developed for sectors other than roads. Currently, there are MCAs for highways, metros, airports, railway stations, ports and food storage. Even for sectors not covered under MCAs or concession agreements issued by various States, language and concepts from MCAs are heavily borrowed. However, some authorities continue to use their own standard concession agreements that predate the publication of the MCA (e.g. the port concession agreement for non-major ports as used by the Gujarat Maritime Board).

MCAs brought a standardization to the entire bidding process, the advantages of which are consistency in approach and efficiency in the bidding and transaction process. However, there are several criticisms to the indiscriminate use of MCAs in the PPP process. The topic of MCAs is covered in greater detail in the subsequent chapter.


*Currently, there are MCAs for highways, metros, airports, railway stations, ports and food storage*

# Model Concession Agreement

“India’s road network is long enough to loop around Earth over 117 times…

# Model Concession Agreement (MCA)

## Rationale for MCAs

Proponents for MCAs put forth the view that MCAs are preferable than a more individualistic approach as they believe that use of such standardized documents results in reduced transaction time and cost, simplifies the bidding process and develops the confidence of the bidders and financiers in the contracts. Given that the MCAs have been formulated by relevant governmental agencies after considering technical, financial and legal advice, by using standardized documentation, the administrative timelines of the relevant agencies using the MCAs is greatly reduced. Further, the MCAs are used as templates by smaller local government agencies that may not have access to the same level of expertise as the agencies responsible for drafting the MCAs.

*The DEA itself has recommended that for sectors where the relevant Ministries have not issued an MCA, usually the MCA for the development of National Highways may be used as a template and guidance material for the preparation of the concession agreement*[15].

## Implementation and criticism

The actual implementation has left much to be desired as MCAs have been and are being used indiscriminately without enough regard being paid to characteristics of each project. There is also a sense that the allocation of risks in the MCAs is not entirely appropriate or otherwise the risk mitigation mechanisms are not workable or equitable. Being long term and often complex contracts, it is probably impossible to account for all the risks or other developments that may arise during the construction and operation of an infrastructure project. Any abrupt changes in the economic and policy environment could adversely affect the financial ability and inclination of a contractor in implementing the project unless the terms and conditions of the concession could be re-negotiated in full transparency. The MCAs are not responsive to such changes and their lack of flexibility can be a deterrent to private developers or financiers.

Concession agreements differ from other agreements for provision of commercial creditors and services in several ways, such as:


[15] PPP Guide for Practitioners issued by the DEA in April 2016 (PPP Guide 2016)

Accordingly, it is natural for there to be a lot of complexity in such agreements that need to be suitably addressed and for which a straight-jacketed approach may not be appropriate. This has led to limited reliefs available through the MCA, in case of events outside the control of the concessionaire (i.e. the private party). It has been noted that this creates a perception of risk transfer but the likely (and actual) outcome is disputes which are settled in an unstructured way, thereby undercutting the certainty and consistency of approach mooted as the rationale for the concession agreements.

Further, the MCAs do not permit the amendment of the same/concession agreement. The need for setting out an appropriate framework for renegotiation has been proposed time and again by various stakeholders. Certain flexibility in relation to tariff related issues is sometimes built into the MCA. However, similar flexibility in relation to other issues such as major changes in scope, operating conditions or market conditions is missing. The scope of negotiating MCAs is also quite limited, and this has resulted in a one-size-fits-all approach. Hence, project-specific risks remain unaddressed. It has been noted that such an approach has resulted in multiple obligations not being met and the project purpose being compromised.

Given that concession agreements are long term contracts, the inflexibility in the MCAs do not consider difficulties in forecasting and providing for technological, commercial, financial, economic and legal developments. This has led to litigation as well as underperformance of the MCA[16].

The terms and conditions of the concession agreements across many sectors/industries are common and, in many cases, identical as the MCA prescribed by the government for highway projects seem to have been applied to the same. Thus, the project specific risks do not get addressed and lead to implementation as well as contractual issues and disputes with the concessionaires. Due to this, prospective bidders are seen to request numerous modifications of the terms of the concession agreement which is often seen by the bidding authority as a request for substantial change in the terms of the concession.

The draft concession agreements which are usually floated with the bid documents should be appropriately modified keeping in mind the industry as well as the factual issues pertaining to the project in question. Consequently, negotiations on the terms of the concession agreements during the bid stage would be minimal and could lead to lesser litigations/disputes amongst stakeholders. Please see our detailed observations in the chapter on 'Balancing of Risks' in PPP projects to get a deeper understanding of the issue.

## International approach and way forward

It is interesting to note that Australia has moved away from the usage of standardized documents. Instead, Infrastructure Australia provides a set of commercial principles that are applied to each project using suitably qualified and experienced commercial advisors and internal staff in public agencies. This is backed up by advisory teams from the state treasuries. At the other end of the spectrum, South Africa has moved towards a completely standardized approach, not permitting any deviation from the prescribed contract forms. However, these drafts were developed after an extensive review of global best practices and consultations with numerous public and private sector actors by some of the best international advisors available.

There is definitely great value in using model agreements as they do result in lower transaction costs and consistent approaches. However, there are valid criticisms of the use of standardized documentation. A periodic overhaul of MCAs together with inbuilt mechanisms for recalibration of the terms could be an approach to make them less rigid. Further, institutional mechanisms for renegotiation of contracts should also be put into place.

[16] Kelkar Committee report

# Infrastructure Projects: Highway Sector

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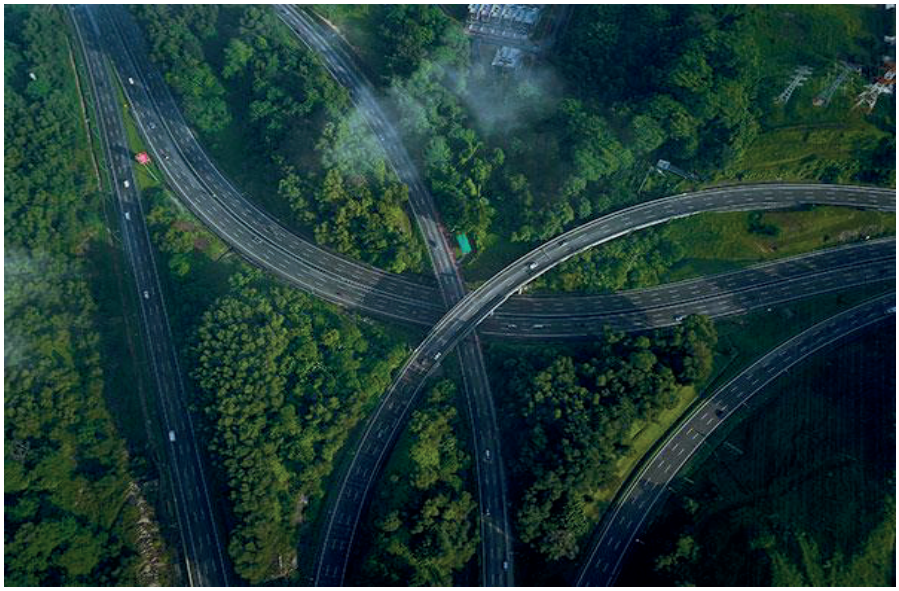
India’s road network is the second largest in the world…

# Infrastructure Projects: Highway Sector

## Broad overview of the legal and institutional framework of the road sector

India had the second largest road network in the world with over 4.24 million kilometers of roads in 2013-2014, consisting of national highways, expressways, state highways, major district roads, other district roads and village roads[17]. The road network in India consists of National Highways, State Highways, District Roads, Rural Roads, Urban Roads and Project Roads. National Highways (the primary system of road transportation in India) run through the length and the breadth of the country connecting capitals of states and union territories, major ports, rail junctions, industrial and tourist centers and link up with border roads and highways of neighboring countries. On the other end, State Highways link National Highways, district headquarters of the state, important towns, tourist centers and minor ports. Likewise, district roads and rural roads connect areas within the district and talukas which ultimately connect with the National Highways and/or the State Highways.



Under the Constitution, the Central Government has the power to regulate highways which have been declared either: (i) by law, or (ii) under law made by the Parliament, to be National Highways[18]. As regards, road and bridges[19], the state legislatures have been empowered to frame laws. Accordingly, the development and maintenance of roads in India are undertaken by various agencies of both Central Governments and State Governments. The Ministry of Road Transport and Highways **(MORTH)** is the nodal ministry responsible for development and maintenance of National Highways. It does so through NHAI, National Highway Infrastructure Development Corporation of India Limited, State Public Works Departments (**PWD**s) and Border Roads Organisations, etc. State roads and district roads are constructed and maintained through State PWDs. Rural roads are executed by Panchayati Raj Departments, State PWDs and Rural PWDs, and the National Rural Road Development Agency of the Ministry of Rural Development.

By virtue of the power vested in it under the Constitution[20], the Central Government enacted the National Highways Act, 1956 (**NH Act**) to declare certain highways as national highways to help the Central Government to exercise its powers with respect to the development and maintenance of such highways more effectively[21]. Recognizing the need to tap private resources for the development of highways, the NH Act was amended in 1995. Pursuant to the amendment in 1995, Section 8A was inserted in the NH Act which empowers the Central Government to enter into an agreement with any person in relation to the development and maintenance of the whole or any part of a national highway. Such person would be entitled to collect and retain fees at such rates, for services or benefits rendered by him

[17] The draft 'Three Year Action Agenda 2017-18 to 2019-20', circulated to the Governing Council of the NITI Aayog on April 23, 2017.

[18] Constitution of India, Seventh Schedule, List I (Union List), Entry 23.

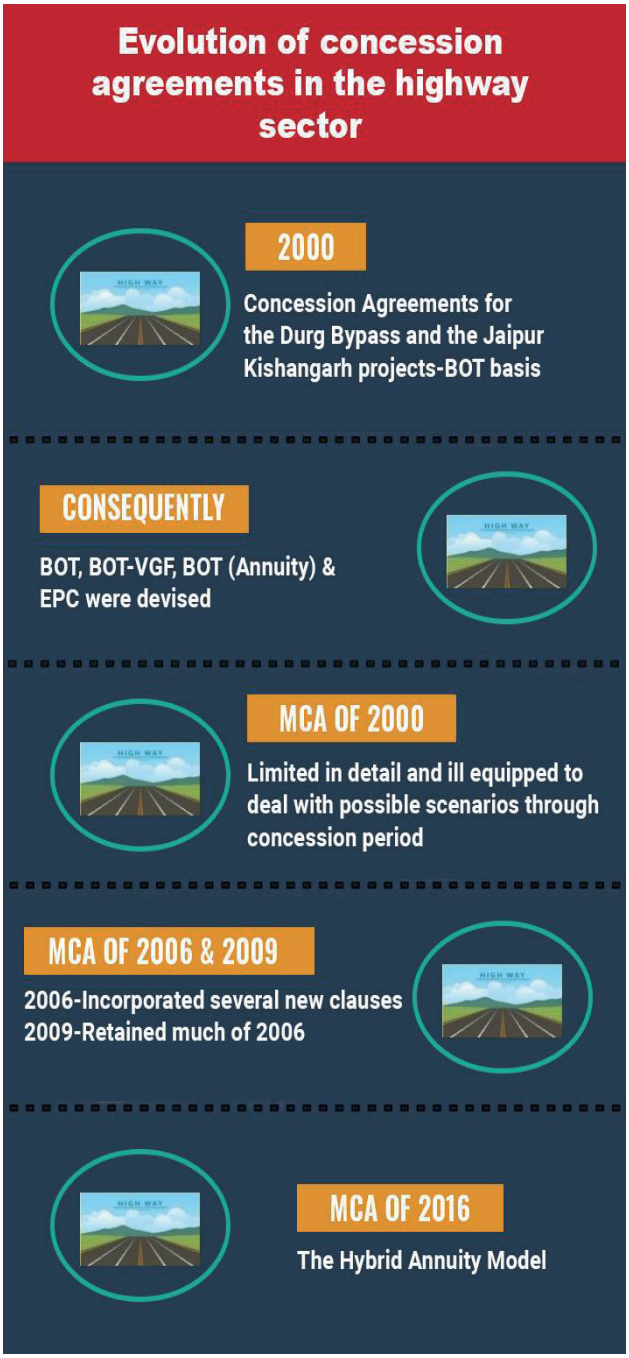
[19] Constitution of India, Seventh Schedule, List II (State List), Entry 13.

[20] *supra* note 2.

[21] Statement of Objects and Reasons to the NH Act.

as the Central Government may, by notification specify. Thus, the amendment in 1995 paved the way for PPP in highways.

This chapter focuses on national highway concessions.




## Evolution of Concession Agreements for national highways[22]

Following the economic liberalization in 1991, the highway sector was one of the first sectors which opened up to private participation.

The first highway concession agreements in India were for the Durg Bypass project and the Jaipur Kishangarh project around the year 2000. Both projects were awarded for development on a BOT basis.

Following this, several projects were opened up for private participation with different types of development models on offer decided by the Government on the basis of anticipated interest and the search for the most efficient model in pursuit of maximum efficiency and minimum stress on the Government exchequer.

Consequently, several models viz. BOT, Build-Operate-Transfer-Viability-Gap-Funding (**BOT-VGF**), BOT on an annuity basis, and EPC were devised. These were introduced and used for bidding in projects at different points. As an illustration, the earliest use of the BOT (**Annuity**) model was as early as 2001 in the Panagarh-Palsit project. The model is still being used.

Subsequently, policy makers sought for a model to be standardized. Initially, standardized models were extended only to BOT-VGF projects. The Planning Commission came out with MCAs in the years 2000, 2006 and 2009.

As indicated earlier, the first set of concession agreements were developed for projects on a BOT basis as the policy framework for toll-based BOT projects was approved by the Cabinet in 1997[23]. Subsequently, in-principle approval of National Highway Development Programme (**NHDP**) Phase I and II was given by the Cabinet on April 5, 2000 followed by the Cabinet Committee on Economic Affairs' (**CCEA**) approval of the NHDP-I on December 12, 2000[24]. Under the said approval of NHDP, contracts were to be awarded to the extent possible on BOT (Toll)/BOT (Annuity) model[25].

[22] The national highways are primarily governed by the Union Government and NHAI is the nodal agency which governs and implements such projects. State highways are usually governed by the public works department or other development corporations of the respective states. This chapter focuses on the NHAI concessions.

[23] The 'Report of the Core Group Financing of the National Highway Development Programme' published by the Secretariat for the Committee on Infrastructure, Planning Commission, Government of India.

[24] *Id.*

[25] *Id.*

However, whilst an MCA for BOT (Toll) was already in place at that point in time, the MCA for BOT (Annuity) was yet to be finalized[26]. Consequent to discussions between the Planning Commission and the NHAI from 2006 to 2009, the Planning Commission published improved versions of the MCAs in 2009[27].

*Picture sourced from an article in the Tribune which discusses NHAI halting land acquisition for a four-lane road project*

Although an MCA continued to exist through the 2000s, there continued to be extensive deviation from the MCAs, on the basis of project requirements, anticipated interest, and post-bid NHAI-concessionaire negotiations. During this period, competitive bidding was carried out on the basis of lowest quoted VGF or payment of a premium to the NHAI, in applicable projects. In many cases, over-competitive bidding, unanticipated cost-overruns, inability to procure permits, inability to achieve financial closure and lower-than-expected toll revenues pushed an increasing number of projects into failure and unresolvable limbo. Meanwhile, this increased the number of non-performing assets in the accounts of banks and affected their ability to fund more such inherently risky and uncertain long-term projects.

Some of the major issues concerning NHAI concession and awards during this period were:

- Over aggressive bidding causing drops in Internal Rate of Return (**IRR**), exposing them to increased possibility of failure due to factors such as cost overruns and drop in revenues
- Already overleveraged balance sheets causing inability to pump in promoter capital or obtain refinancing to fund cost overruns
- Delays and uncertainty in the procedure for obtaining permits from various points of governmental departments, causing delays in financial closure, penalties and interest
- Delays and inability in acquisition of land required for the project

[26] *Id.*

[27] Evolution of Model Concession Agreement for National Highways in India by Ramakrishnan. T. S and Raghuram. G, published by the Indian Institute of Management, Ahmedabad.

- Unavailability of sufficient assets with the concessionaire leading to higher provisioning and capital adequacy norms, as ownership of land and project assets existed with the NHAI
- Inability to divest from the ownership and control of projects due to restrictions incorporated in the concession agreements
- Lower than expected traffic flowing through the highways causing drops in revenue
- Force majeure events or changes in law causing cost overruns, disruption in revenues, and unmanageable repayment obligations
- Refusal of the NHAI to engage in re-negotiation of terms of concession agreement

## BK Chaturvedi Committee Report

In August 2009, the then Prime Minister constituted a committee headed by Shri B.K. Chaturvedi (**BKC Committee**) for implementation of the National Highways Development Project. The BKC Committee, in its report proposed several changes to the MCA. The major recommendations were as follows:

- In the existing MCA, the NHAI could terminate the agreement, if the average daily traffic of passenger cars exceeded the designated capacity for specified accounting years. The BKC Committee was of the view that such a provision left very little incentive for the concessionaire to augment the facility. Accordingly, the BKC Committee recommended that in such circumstances a detailed project report be commissioned by the NHAI based on which NHAI could determine the required extension in the concession period.
- The Toll based MCA released in 2016 (**Toll MCA of 2016**) gave NHAI the right to terminate the concession in the event of variation in estimated traffic while the Toll Operate Transfer MCA released in 2017 (**TOT MCA of 2017**) has implemented this suggestion.
- The BKC Committee recommended revising the definition of change in ownership to mean the bidder consortium's equity shareholding dropping below 51% any time until 2 years after Commercial Operations Date (**COD**). The BKC Committee further recommended that each consortium member whose technical and financial capacity was evaluated for the purposes of pre-qualification and short-listing in response to the request for qualification should hold at least 26% of equity until 2 years after COD. Prior to the recommendations, the NHAI (i) required the bidder consortium to hold 51% of the shareholding of the concessionaire during the construction period, (ii) allowed the bidder consortium to reduce their shareholding to 33% on COD and for the period up to 3 years into the operations period, and (iii) required the bidder consortium to maintain 26% (or such lower proportion as may be permitted by the NHAI) till the end of the concession period.
- The aforementioned recommendation was first implemented in the MCA released in 2009 (**MCA of 2009**) and has been subsequently implemented in the Toll MCA of 2016, Hybrid Annuity Model (**HAM**) MCA released in 2016 (**HAM MCA of 2016**).
- The BKC Committee recommended that the three modes of delivery viz. BOT (Toll), BOT (Annuity) and EPC contract (item rate contract) should be carried out concurrently rather than sequentially. The then extant policy required that all projects are to be first bid out as BOT (Toll) and on failure of the same, are to be then offered under BOT (Annuity) and if this also fails, then they are to be taken under EPC after taking specific approval from CCEA.
- Another recommendation made by the BKC Committee was to make an explicit provision in the MCA for permitting lenders to create a charge on the Escrow Account to the extent permissible as per their priority in the 'waterfall'. This suggestion was implemented in the Toll MCA of 2016. The HAM MCA of 2016 provides for a lien on the escrow account.

## Process for framing MCAs

The MCAs are released periodically by the Government taking into account the economic scenario and needs of the sector. Prior to 2014, the Planning Commission was responsible for formulating the MCAs, while currently the MORTH has taken over this responsibility.

The process of formulating MCAs involves inviting comments from stakeholders, investors, developers and industry experts on the existing MCAs. The drafts are also circulated to inter-ministerial groups for review and revision. In addition to such comments, reports of expert committees also play an important role while drafting such MCAs. For example, the MCA of 2009 was drafted considering the recommendations made by the BKC Committee. The amendments are made to address the changing economic climate and to make the MCAs more investor friendly. They are aimed at inducing lenders to invest in such road projects. To illustrate, the Toll MCA of 2016 was amended pursuant to the BKC Committee report, to make a provision for charge on escrow mechanism in favor of senior lenders.

## Risk allocation in PPP Models in the road sector

The most common concession models for PPPs in road sector in India are BOT Toll, BOT Annuity and HAM. The comparison of the terms of each of the above models is set forth in the latter part of this chapter. Set forth immediately below, is a risk matrix available on the website of PPP India summaries typical allocation of risks in some of the road sector PPP models[28].

| | Risk Type | BOT Toll | BOT Annuity | BOT Shadow Toll | Performance Based Maintenance Contracts |
|---|---|---|---|---|---|
| **A** | **Pre-Operative Task Risks** | | | | |
| A1 | Delays in Land Acquisition | Public Sector | Public Sector | Public Sector | Not Relevant |
| A2 | External Linkages | Public Sector | Public Sector | Public Sector | Not Relevant |
| A3 | Financing Risks | Private Sector | Private Sector | Private Sector | Not Relevant |
| A4 | Planning[29] | Private Sector | Private Sector | Private Sector | Not Relevant |
| A5 | Approvals | Private Sector | Private Sector | Private Sector | Not Relevant |
| **B** | **Construction Phase Risks** | | | | |
| B1 | Design Risk | Private Sector | Private Sector | Private Sector | Not Relevant |
| B2 | Construction Risk | Private Sector | Private Sector | Private Sector | Not Relevant |

[28] https://www.pppinindia.gov.in/toolkit/highways/module1-oopmv-raudpm.php?links=oopmv1c

[29] Although the aforementioned table mentions that the planning and approvals related risks (A4 and A5) in BOT projects are that of the private sector, in our experience with BOT based concessions, the obligation to obtain the pre-construction approvals such as environmental clearance, mining related approvals are that of the concession authority / public sector. However, the concession agreements typically do not prescribe any compensation to the private entity/ concessionaire in the event of any delay in performance of pre-construction obligations by the public entity. Accordingly, in the event of delay by the authority in performing its pre-construction obligations such as obtaining required approvals, if any costs such as interest on capital borrowed and/or employed, liquidated damages to third party contractors etc. are incurred by the concessionaire, the same are at the risk of the concessionaire / private party.

| | Risk Type | BOT Toll | BOT Annuity | BOT Shadow Toll | Performance Based Maintenance Contracts |
|---|---|---|---|---|---|
| B3 | Approvals | Private Sector | Private Sector | Private Sector | Not Relevant |
| **C** | **Operations Phase Risks** | | | | |
| C1 | Technology Risk | Private Sector | Private Sector | Private Sector | Private Sector |
| C2 | Operations & Maintenance Risk | Private Sector | Private Sector | Private Sector | Private Sector |
| C3 | Volume Risk | Private Sector | Public Sector | Private Sector | Public Sector |
| C4 | Payment Risk | Private Sector | Public Sector | Public Sector | Public Sector |
| C5 | Financial Risk | Private Sector | Private Sector | Private Sector | Private Sector |
| **D** | **Handover Risk Events** | | | | |
| D1 | Handover Risk | Private Sector | Private Sector | Private Sector | Private Sector |
| D2 | Terminal Value Risk | Private Sector | Private Sector | Private Sector | Private Sector |
| **E** | **Other Risks** | | | | |
| E1 | Change in Law | Public Sector* | Public Sector* | Public Sector | Public Sector |
| E2 | Force Majeure | Shared | Shared | Shared | Shared |
| E3 | Concessionaire Risk | Public Sector | Public Sector | Public Sector | Public Sector |
| E4 | Sponsor Risk | Private Sector | Private Sector | Private Sector | Private Sector |
| E5 | Concessionaire Event of Default | Private Sector | Private Sector | Private Sector | Private Sector |
| E6 | Government's Event of Default | Public Sector | Public Sector | Public Sector | Public Sector |

** In case of financial implications lower than Rs. 1 crore, risk is retained by private sector (Source: NHAI model concession agreement)*

## Comparative look at MCAs

To illustrate the changes to the NHAI MCAs in light of the evolving PPP landscape as well as the requirements to address the risks realized after implementation, we have set below a table comparing certain key terms in the 2009 MCA, the 2016 MCA, 2017 MCA, the 2001 BOT Annuity model and the 2016 HAM.

| SR NO. | PARTICULARS | TOLL | | | ANNUITY | |
|---|---|---|---|---|---|---|
| | | 2009 MCA | 2016 MCA | 2017 MCA | 2001 BOT Annuity MCA | HAM MCA of 2016 |
| 1. | **Mode of returns/ payments to concessionaire** | Toll | Toll | Toll | Annuity | Annuity |
| 2. | **Concession model (as provided under the concession agreement)** | DBFOT | DBFOT | TOT | BOT | Design, Build, Operate, and Transfer (**DBOT**) |
| 3. | **Concession period** | For a period of 20 years commencing from the Appointed Date.<br>*[Appointed Date shall be the date on which the project enters into commercial service/ commercial operations on completion/waiver of all of the conditions precedent as under the concession agreement.]* | For a period of 20 years from the Appointed Date.<br>*[Appointed Date shall be the date on which financial close as under the concession agreement is achieved, or an earlier date that the parties may decide by mutual consent.]* | For a period of 30 years from the Appointed Date.<br>*[Appointed Date shall be the date on which all Conditions Precedent have been satisfied in accordance with Article 4 of the concession agreement.]* | For a period of 17 years and 6 months from the Commencement Date.<br>*[Commencement Date shall be the date 7 months from the date of the concession agreement]* | For a period of 15 years commencing from COD.<br>*[COD shall be the date on which the completion certificate or the provisional certificate as under the concession agreement is issued.]* |
| 4. | **Land procurement obligation** | ▪ NHAI to provide vacant access and ROW to the Concessionaire with 80% being handed over on Appointed Date.<br>▪ NHAI may require Concessionaire to procure | ▪ NHAI to provide vacant access and ROW to the Concessionaire with 80% being handed over on Appointed Date.<br>▪ NHAI to procure land for Change of Scope. | Not applicable | To be acquired by NHAI. | ▪ NHAI to provide vacant access and ROW to the Concessionaire with 80% being handed over on Appointed Date. |

| SR NO. | PARTICULARS | TOLL | | | ANNUITY | |
|---|---|---|---|---|---|---|
| | | 2009 MCA | 2016 MCA | 2017 MCA | 2001 BOT Annuity MCA | HAM MCA of 2016 |
| | | additional land for Change of Scope or for toll plazas etc. | | | | ▪ NHAI to procure land for Change of Scope |
| 5. | **Permits procurement obligation** | NHAI to procure:<br>▪ ROW<br>▪ Approval of the railway authorities in the form of a general arrangement drawing that would enable the concessionaire to construct road overbridges/ underbridges at level crossings on the project highway in accordance with the specifications and standards and subject to the terms and conditions specified in such approval.<br>▪ All applicable permits relating to environmental protection and conservation of the site.<br>If environmental protection and conservation of site permits pertain to only small portion of site, it will be included in the remaining 20% land to be obtained by the concessionaire.<br>Further, NHAI may postpone the period within which it needs to acquire the above permits, up to an aggregate | NHAI to procure:<br>▪ ROW<br>▪ Approval of the railway authorities in the form of a general arrangement drawing that would enable the concessionaire to construct road overbridges/underbridges at level crossings on the project highway in accordance with the specifications and standards and subject to the terms and conditions specified in such approval.<br>▪ All applicable permits relating to environmental protection and conservation of the site.<br>If environmental protection and conservation of site permits pertain to only small portion of site, it will be included in the remaining 20% length of road to be obtained by the concessionaire.<br>Further, NHAI may postpone the period within which it needs to acquire the above | NHAI to procure the ROW:<br>The Concessionaire is required to:<br>▪ Make applications for obtaining the Applicable Permits.<br>▪ Obtain requisite regulatory permits and approvals for employment of foreign nationals.<br>▪ Obtain the Applicable Permits for felling of trees to be identified by the Authority, if such trees cause a material adverse effect on the operation or maintenance of the Project Highway. | To be procured by the concessionaire | NHAI to procure:<br>▪ ROW<br>▪ All applicable permits relating to environmental protection, and conservation in respect land forming part of the ROW.<br>▪ Forest clearance for and in respect land forming part of the ROW.<br>▪ Approval of the general arrangement drawings for the road over bridges/under bridges at level crossings on the project.<br>The above permits will be procured by NHAI, provided they are not for the area falling within the 20% length of road to be acquired by the concessionaire.<br>Further, NHAI will be entitled to a penalty free |

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| | | 2009 MCA | 2016 MCA | 2017 MCA | 2001 BOT Annuity MCA | HAM MCA of 2016 |
| | | period of 6 months, beyond which it will be considered to fall within the 20% area of land to be acquired by the concessionaire, and an additional period of 12 months will be provided to construct the overhead bridges.<br><br>The concessionaire shall obtain all remaining permits. | permits, up to an aggregate period of 6 months, beyond which it will be considered to fall within the 20% area of land to be acquired by the concessionaire, and an additional period of 12 months will be provided to construct the overhead bridges.<br><br>The concessionaire shall obtain all remaining permits. | | | period of 90 days additional to the period provided for this purpose.<br><br>The concessionaire shall obtain all remaining permits. |
| 6. | **Maintenance obligations prior to appointed date** | During the development period, NHAI shall:<br><br>▪ Maintain the project highway at its own cost and expense.<br><br>▪ Undertake routine maintenance during the development period.<br><br>▪ In the event of any material deterioration or damage other than normal wear and tear, undertake repair thereof, or pay the concessionaire the cost and expense as determined by the IE for undertaking such repair after the appointed date. | During the development period, NHAI shall:<br><br>▪ Maintain the project highway at its own cost and expense.<br><br>▪ Undertake routine maintenance during the development period.<br><br>▪ In the event of any material deterioration or damage other than normal wear and tear, undertake repair thereof, or pay the Concessionaire the cost and expense as determined by the IE for undertaking such repair after the appointed date. | Prior to Appointed Date or the O&M Handover Date (in case of Annuity Concession/New EPC), NHAI shall, at its own cost and expense:<br><br>▪ Maintain the Project Highway.<br><br>▪ Undertake repair of Project Highway in the event of any material deterioration or damage other than normal wear and tear.<br><br>▪ Undertake routine maintenance.<br><br>▪ Undertake special repairs only for ensuring safe operation of the | Prior to commencement of any construction activity, the concessionaire shall finalise, in consultation with the IE, an operations and maintenance plan for the project during the implementation period. | During the development period, the concessionaire shall:<br><br>▪ Maintain the existing project road.<br><br>▪ In the event of any material deterioration or damage other than normal wear and tear, undertake repair thereof.<br><br>▪ In the event of excessive deterioration or damage caused due to unforeseen events such as floods or torrential rain, NHAI shall undertake special repairs at its |

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| | | 2009 MCA | 2016 MCA | 2017 MCA | 2001 BOT Annuity MCA | HAM MCA of 2016 |
| | | | | Project Highway or in the event of excessive deterioration or damage caused due to unforeseen events. | | own cost and expense. |
| 7. | **Financial closure** | ▪ The concessionaire is to achieve financial close within 180 days from the date of the concession agreement.<br>▪ Period may be extended to 320 days on payment of damages, provided that no damages shall be payable if such delay is attributable to default or delay by NHAI or due to force majeure. | ▪ The concessionaire is to achieve financial close within 180 days from the date of the concession agreement.<br>▪ Period may be extended to 120 days on payment of damages, provided that no damages shall be payable if such delay is attributable to default or delay by NHAI or due to force majeure. | Financial closure is defined to mean fulfilment by Concessionaire of all condition precedents set out under the Financing Agreement, so that the financial assistance sought to be disbursed thereunder, are ready and available to be disbursed on demand. | To be achieved on or before the Commencement Date. | ▪ The concessionaire is to achieve financial close within 150 days from the date of the concession agreement.<br>▪ Period may be extended to 215 days on payment of damages, provided that no damages shall be payable if such delay is due to force majeure. |
| 8. | **Deemed termination** | If financial close is not achieved within the prescribed periods, the concession agreement would be deemed to have been terminated by mutual consent of the parties. | If financial close is not achieved within the prescribed periods, the concession agreement would be deemed to have been terminated by mutual consent of the parties. | Not provided for. | Not provided for. | If financial close is not achieved within the prescribed periods, the concession agreement would be deemed to have been terminated by mutual consent of the parties. |
| 9. | **Variation of costs arising from change in law** | **Increase in costs:**<br>If as a result of change in law, the concessionaire suffers an increase in costs or reduction in net after-tax return or other financial burden, the aggregate | **Increase in costs:**<br>If as a result of change in law, the concessionaire suffers an increase in costs or reduction in net after-tax return or other financial burden, the | **Increase in costs:**<br>If as a result of Change in Law, the concessionaire suffers an increase in costs or reduction in net after-tax return or other | **Increase in costs:**<br>If as a direct consequence of a change in law, the concessionaire is obliged to incur additional cost in any accounting year, such additional | **Increase in costs:**<br>If as a result of change in law, the concessionaire suffers an increase in costs or reduction in net after-tax return or other |

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| | | 2009 MCA | 2016 MCA | 2017 MCA | 2001 BOT Annuity MCA | HAM MCA of 2016 |
| | | of which exceeds the higher of INR 1 crore and 0.5% of the realizable fee in any accounting year, the concessionaire may so notify NHAI and propose amendments to the concession agreement so as to place the concessionaire in the same financial position as it would have been in, had there been no such change in law causing the cost increase.<br><br>**Decrease in costs:**<br><br>If as a result of change in law, the concessionaire benefits from a reduction in costs or increase in net after-tax return or other financial gains, the aggregate of which exceeds the higher of INR 1 crore and 0.5% of the realizable fee in any accounting year, NHAI may so notify the concessionaire and propose amendments to the concession agreement so as to place the concessionaire in the same financial position as it would have been in, had there been no such change in law causing the cost decrease. | aggregate of which exceeds the higher of INR 1 crore and 0.5% of the realizable fee in any accounting year, the concessionaire may so notify NHAI and propose amendments to the concession agreement so as to place the concessionaire in the same financial position as it would have been in, had there been no such change in law causing the cost increase.<br><br>**Decrease in costs:**<br><br>If as a result of change in law, the concessionaire benefits from a reduction in costs or increase in net after-tax return or other financial gains, the aggregate of which exceeds the higher of INR 1 crore and 0.5% of the realizable fee in any accounting year, NHAI may so notify the concessionaire and propose amendments to the concession agreement so as to place the concessionaire in the same financial position as it would have been , had there been no such change in law causing the cost decrease. | financial burden, the aggregate of which exceeds the higher of INR 1 crore and 0.5% of the realizable fee in any Accounting Year, the concessionaire may so notify NHAI within 45 days of knowledge of applicability of such Change in Law and propose amendments to this Agreement so as to place the concessionaire in the same financial position as it would have been had there been no such change in law resulting in the cost increase, reduction in return or other financial burden as aforesaid.<br><br>Decrease in costs:<br><br>If as a result of change in law, the concessionaire benefits from a reduction in costs or increase in net after-tax return or other financial gains, the aggregate financial effect of which exceeds the higher of INR 1 crore and 0.5% of the realizable fee in any Accounting Year, | cost shall be allocated and shared between the concessionaire and NHAI as follows:<br><br>**Increase in capital expendit-ure** — **NHAI's share**<br>From INR 0 to 6 crores — 0%<br>Above INR 6 crores — 100% of the capital expenditu-re in excess of INR 6 crores<br><br>**Increase in Costs/ Taxes** — **NHAI share**<br>From INR 0 to 1 crore — 0% | financial burden, the aggregate of which exceeds the higher of INR 1 crore and 2% of the total annuity payments in any accounting year, the concessionaire may so notify NHAI and propose amendments to the concession agreement so as to place the concessionaire in the same financial position as it would have been in, had there been no such change in law causing the cost increase.<br><br>**Decrease in costs:**<br><br>If as a result of change in law, the concessionaire benefits from a reduction in costs or increase in net after-tax return or other financial gains, the aggregate of which exceeds the higher of INR 1 crore and 2% of the total annuity payments in any accounting year, NHAI may so notify the concessionaire and propose amendments to |

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| | | 2009 MCA | 2016 MCA | 2017 MCA | 2001 BOT Annuity MCA | HAM MCA of 2016 |
| | | | | NHAI may so notify the concessionaire within 45 days of knowledge of applicability of such Change in Law and propose amendments to this Agreement so as to place the concessionaire in the same financial position as it would have been, had there been no such change in law resulting in the decreased costs, increase in return or other financial gains . | Above INR 1 crore: 100% of the amount in excess of INR 1 crore<br><br>**Decrease in costs:**<br>Not provided for. | the concession agreement so as to place the concessionaire in the same financial position as it would have been in, had there been no such change in law causing the cost decrease. |
| 10. | **Change of scope** | Expenses arising out of a change in scope order aggregating over 0.25% of the total project cost shall be reimbursed by NHAI. | Expenses arising out of a change in scope order aggregating over 0.25% of the total project cost shall be reimbursed by NHAI. | Expenses borne by the concessionaire from carrying out works required by NHAI through a change of scope order shall be reimbursed to it by NHAI. | NHAI may require a change in the scope of the project, provided that such change does not involve additional capital expenditure exceeding INR 17 crores and 50 lakhs. | Expenses borne by the concessionaire from carrying out works required by NHAI through a change of scope order shall be reimbursed to it by NHAI. |
| 11. | **Commercial operations date (COD)** | COD shall be the date on which all conditions precedent as under the concession agreement have been satisfied or waived.<br><br>Provided that, the period for achievement of COD shall be within 180 days of the date of the concession agreement. An additional period of 120 days shall be provided to the | COD shall be the date of Financial Close or Appointed Date, whichever is later.<br><br>Provided that, the period for achievement of COD shall be within 180 days of the date of the concession agreement. An additional period of 120 days shall be provided to the concessionaire subject to | Not applicable. | COD shall be the date on which the IE has issued the provisional certificate or the completion certificate.<br><br>Provided that, COD shall be on or before the scheduled project completion date as defined under the concession agreement, such date being 2.5 | COD shall be the date on which the completion certificate or the provisional certificate as under the concession agreement is issued.<br><br>Provided that, COD shall occur prior to the 90th day after the SCOD as defined under the concession agreement, |

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| | | concessionaire subject to payment of damages for the achievement of COD.<br>Exclusions to payment of damages for the period of delay in achievement of COD:<br>▪ Due to delay in achievement of COD solely attributable to default or delay by the NHAI in satisfying its conditions precedent under the concession agreement<br>▪ Due to force majeure | payment of damages for the achievement of COD.<br>Exclusions to payment of damages for the period of delay in achievement of COD:<br>▪ Due to delay in achievement of COD solely attributable to default or delay by the NHAI in satisfying its conditions precedent under the concession agreement<br>▪ Due to force majeure | | years from the commencement date. | failing which, the concessionaire shall pay damages to NHAI in a sum calculated at the rate of 0.2% of the amount of performance security for delay of each day until COD is achieved.<br>*[The 550th day from the Appointed Date shall be the SCOD of the Project.]* |
| 12. | **Change in ownership** | ▪ The concessionaire shall not undertake or permit any change in ownership as defined under the concession agreement, except with the prior approval of NHAI.<br>▪ Promoters/consortium to hold at least 51% of the shareholding in the concessionaire until 2 years from the COD.<br>▪ Each member of the consortium whose financial or technical capacity was evaluated for the purposes of pre-qualification and short-listing in response to the request for qualification | ▪ The concessionaire shall not undertake or permit any change in ownership as defined under the concession agreement, except with the prior approval of NHAI.<br>▪ Promoters/consortium to hold at least 51% of the shareholding in the concessionaire until 2 years from the COD.<br>▪ Each member of the consortium whose financial or technical capacity was evaluated for the purposes of pre-qualification and short-listing in response to the request for | ▪ The concessionaire shall not undertake or permit any change in ownership as defined under the concession agreement, except with the prior approval of NHAI.<br>▪ The aggregate holding of the selected bidder together with (its/their) associates, in the issued and paid-up equity share capital of the concessionaire shall not decline below 51% thereof during the first two years of the Concession Period | ▪ In the event that any of the representations or warranties made/given by a party ceases to be true or stands changed, the party who had made such representation or given such warranty shall promptly notify the other party of the same.<br>▪ Promoters/consortium to hold at least 51% of the shareholding in the concessionaire until 3 years from the COD.<br>▪ After a period of 3 years from the COD, promoters/ consortium to hold at least 26% of the shareholding in | ▪ The concessionaire shall not undertake or permit any change in ownership as defined under the concession agreement, except with the prior written approval of NHAI.<br>▪ Promoters/ consortium to hold at least 51% of the shareholding in the concessionaire until 2 years from the COD.<br>▪ Each member of the consortium whose financial or technical capacity was evaluated for the |

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| | | shall hold at least 26% of the shareholding in the concessionaire until 2 years from the COD. | qualification shall hold at least 26% of the shareholding in the concessionaire until 2 years from the COD. | ▪ Each member of the consortium whose technical and financial capacity was evaluated for the purposes of pre-qualification and short-listing in response to the RFP shall hold at least 26% of such equity during the first two years of the concession period along with its associates. | the concessionaire for the term of the concession. | purposes of pre-qualification and short-listing in response to the request for qualification shall hold at least 26% of the shareholding in the concessionaire until 2 years from the COD. |
| 13. | **Levy and collection of fees** | On and from the COD till the date of transfer of the project to NHAI, the concessionaire shall have the sole and exclusive right to demand, collect and appropriate fee from the users subject to and in accordance with the concession agreement and the applicable laws. | On and from the COD till the date of transfer of the project to NHAI, the concessionaire shall have the sole and exclusive right to demand, collect and appropriate fee from the users subject to and in accordance with the concession agreement and the applicable laws. | On and from the appointed date till the date of transfer of the project to NHAI, the concessionaire shall have the sole and exclusive right to demand, collect and appropriate fee from the users subject to and in accordance with the concession agreement and the applicable laws. | ▪ The concessionaire shall not levy, demand or collect from or in respect of any vehicle or person, any sum whatsoever in the nature of a toll or fee.<br>▪ NHAI shall have the authority to levy toll or fee on the vehicles using the project facilities and demand, collect, retain and appropriate the fee in accordance with the applicable laws. NHAI may do so by itself or authorise any person for this purpose. | Not provided for. |
| 14. | **Charge on escrow account in favour of senior lenders** | Not permitted. | A charge on the escrow account arising or created in the ordinary course of business and a charge on receivables of the concessionaire as security only for indebtedness to the | Not permitted<br><br>*[A security over the project receivables through by way of hypothecation/charge thereon, for the purposes* | Not permitted. | A lien on the escrow account, subject to and without prejudice to the rights of NHAI under the concession agreement is permitted. |

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| | | | senior lenders under the finance agreements and/or for working capital arrangements for the project is permitted. | *of securing repayment of the financial assistance availed from lenders is permitted]* | | |
| 15. | **Annuity payments** | Not applicable. | Not applicable. | Not applicable. | Biannual instalments as provided for the specific project under Schedule J of the relevant concession agreement. | Biannual instalments over a period of 15 years commencing from COD. |
| 16. | **Capacity augmentation** | NHAI may issue a notice to the concessionaire to undertake augmentation as determined by NHAI. On refusal, non-acceptance, or failure by the concessionaire to undertake such augmentation, an indirect political event shall be deemed to have occurred and NHAI may in its discretion terminate the concession agreement by issuing a termination notice and making the termination payment as under the concession agreement. | NHAI may issue a notice to the concessionaire to undertake augmentation as determined by NHAI. On refusal, non-acceptance, or failure by the concessionaire to undertake such augmentation, an indirect political event shall be deemed to have occurred and NHAI may in its discretion terminate the concession agreement by issuing a termination notice and making the termination payment as under the concession agreement. | ▪ NHAI may, require the capacity augmentation of the project highway in the event the average daily traffic of PCUs in any accounting year exceeds the designed capacity of target traffic of project highway and continues to exceed the designed capacity for 3 consecutive accounting years following thereafter.<br>▪ NHAI would bear the costs towards required land acquisition, shifting of utilities/facilities as would be necessary for undertaking the capacity augmentation. | NHAI may invite bids from eligible persons for capacity augmentation. On failure of the concessionaire, after participating in the bidding process to give the lowest bid, the concessionaire shall be given the right of first refusal to match the preferred bid. On refusal or failure of the concessionaire to take up such option to undertake works for capacity augmentation, NHAI shall be entitled to accept the preferred bid and terminate the concession agreement with the concessionaire and pay to the concessionaire an amount equal to the termination payment as provided under the respective concession agreement. | Not provided for. |
| 17. | **Refinancing** | No specific provision. However, the definition of 'Financing | ▪ Refinancing permitted in accordance for the purpose | NHAI can, in conformity with any regulations or | No specific provision. However, the definition of 'Lenders' | Refinancing permitted in accordance for the |

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| | | Agreements' includes refinancing. | of the project and with the consent of NHAI.<br>▪ Refinanced debt to be repaid within 1 year prior to expiry of concession period. | guidelines that may be notified by the Government or the Reserve Bank of India, permit and enable the concessionaire to secure refinancing on such terms as may be agreed upon between the concessionaire and the entity providing such refinancing; NHAI would not unreasonably withhold such consent. | includes financial institutions, banks, funds or trusts who refinance debt. | purpose of the project and with the consent of NHAI. |

## Additional concerns/risks in existing road concessions based on MCAs

In addition to the general risks around any concessions, some key concerns that may be seen in road concessions are mentioned below:

### Termination payments

In BOT concession model, in the event of termination of a concession agreement due to an event of default of the concessionaire or of the concession authority, the project asset reverts to the authority and the concessionaire is entitled to certain payments by the concession authority known as 'termination payments'. Under the BOT concession models, termination payments are only payable if the contract has been terminated after the project has achieved the COD. If the concession agreement has been terminated for any reason whatsoever prior to the COD, the concessionaire is not entitled to any termination payments. However, the HAM MCA of 2016 and the TOT MCA of 2017 provide for termination payments in event of termination before COD.

In certain contracts, termination payments are also to be made if the concession agreement had to be terminated on account of a force majeure event (i.e. where the non-performance in the contract was for reasons which were beyond the reasonable control of either parties to the concession agreement).

It has been reported that the MORTH is seeking to amend the termination clauses in BOT concession agreements in order to revive the BOT concession model by making it more investor friendly[30]. However, the revised guidelines have not yet been issued.

### Debt due

The amounts to be paid to the concessionaire towards termination payments usually vary depending upon the event leading to the termination (i.e. whether the termination was due to default or force majeure). Usually, termination payments are an amount equal to certain percentage of the 'Debt Due'[31] less insurance proceeds and certain adjusted equity. Debt due is defined to include, *inter alia*, the principal amount provided by lenders to finance the 'Total Project Cost'. The Total Project Cost is usually defined as a percentage of Bid Project Cost. Additionally, certain models of road concessions provide a cap on the Total Project Cost[32].

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[30] https://economictimes.indiatimes.com/news/economy/infrastructure/nhai-identifies-950-km-highway-projects-to-be-built-at-rs-30000-cr-under-ppp/articleshow/71202337.cms?from=mdr

[31] HAM MCA of 2016 defines Debt Due as:

**"Debt Due"** means the aggregate of the following sums expressed in Indian Rupees outstanding on the Transfer Date:

(a) the principal amount of the debt provided by the Senior Lenders under the Financing Agreements for financing the Total Project Cost (the "principal") but excluding any part of the principal that had fallen due for repayment two years prior to the Transfer Date;

(b) all accrued interest, financing fees and charges payable under the Financing Agreements on, or in respect of, the debt referred to in Sub-clause (a) above until the Transfer Date but excluding (i) any interest, fees or charges that had fallen due one year prior to the Transfer Date, (ii) any penal interest or charges payable under the Financing Agreements to any Senior Lender, and (iii) any pre- payment charges in relation to accelerated repayment of debt except where such charges have arisen due to Authority Default; and

(c) any Subordinated Debt which is included in the Financial Package and disbursed by lenders for financing the Total Project Cost;

provided that if all or any part of the Debt Due is convertible into Equity at the option of Senior Lenders and/or the Concessionaire, it shall for the purposes of this Agreement be deemed to be Debt Due even after such conversion and the principal thereof shall be dealt with as if such conversion had not been undertaken

[31] HAM MCA of 2016 defines Total Project cost as

**"Total Project Cost"** means 60 % (sixty percent) of the Bid Project Cost specified in Clause 23.1.

[32] HAM MCA of 2016

The Bid Project Cost is already pre-determined and is fixed by the NHAI. It does not take into consideration the actual expenditure incurred by the concessionaire in developing and operating the project. Thus, essentially the actual debt incurred by the concessionaire may be more than the Debt Due under the concession agreement. This is an important issue, especially in the event of termination, where payments must be made to lenders in accordance with the escrow mechanism provided in the concession agreement. Since a portion of the actual debt would not fall under the definition of Debt Due, such unallocated debt would not be prioritized over other payments which are required to be made under the concession agreement. Further, such unallocated debt would not form part of the termination payments which will be paid by the NHAI/concession authority.

The 236th report of Parliamentary Standing Committee on Transport, Tourism and Culture revolved around infrastructure lending in road sector (**Standing Committee Report**). The committee after interacting with stakeholders had noted that NHAI typically underestimates the project costs and the concessionaires who bid out a project, have to approach banks and financial institutions with an inflated project cost for taking loans. The committee suggested that the total project cost should be realistic irrespective of the model of the project[33].

NHAI *vide* its circular dated November 18, 2013[34] has allowed refinancing/restructuring of loans in cases where there is no change in loan amount. If the revised repayment schedule extends beyond the original repayment schedule, refinancing would be permitted provided that 'Debt Due' would be treated as zero beyond the original payment schedule.

## Computation of traffic volume (PCUs)

Concession agreements provide for estimated traffic volumes in terms of passenger car units (**PCUs**) which are required to be met by the concessionaires. A failure to meet the expected traffic volumes usually result in an extension of the concession period. Such an extension may not always further the best interests of the concessionaire as it may impose additional liabilities and obligations for the extended term. Further, the PCU factor is computed as per the 'Indian Roads Congress' publication of 1990. Given the evolving state of the sector, the three-decade old mechanism should perhaps be re-analyzed.

Additionally, the traffic forecast used by the NHAI may be outdated. As a result, the actual traffic volume will outnumber the projections from the beginning. This may result in queuing at toll booths and delays in traversing the stretch. Thus, further changes would have to be made to the project resulting in extra costs. This was seen in the Delhi Gurgaon expressway project awarded on BOT (Toll) model in 2002[35].

Further, the Bharatmala program of the GOI is expected to result in diversion of traffic from the existing road network to new roads, thereby affecting the PCU/traffic volume, toll collection and, consequently, the debt servicing ability of some of the BOT and Operations, Maintenance and Tolling (**OMT**) projects.

[33] http://164.100.47.5/newcommittee/reports/EnglishCommittees/Committee%20on%20Transport,%20Tourism%20and%20Culture/236.pdf

[34] https://nhai.gov.in/writereaddata/portal/images/pdf/10-Re-Financing.pdf

[35] https://www.pppinindia.gov.in/toolkit/pdf/case_studies.pdf

## Lengthy and ineffective dispute resolution process

The MCAs provide for a lengthy dispute resolution process which normally involves mediation, conciliation and arbitration. The disputes are required to be first resolved amicably by the Parties, failing which conciliation with the help of the IE (appointed under the terms of the concession agreement) is required to be undertaken. Usually a time period is provided for resolving disputes through the conciliation process but even that can be extended by mutual consent. In the event of failure of such conciliation, the disputes are referred to arbitration. Despite having a detailed dispute resolution procedure, a substantial number of the arbitral awards are appealed against in courts, thereby increasing the duration of such disputes even further and rendering the whole process of mediation, conciliation and arbitration ineffective.

### Case Study

The Supreme Court has in few instances acknowledged that with public sector undertakings (**PSU**s), the option of not filing the appeal is generally not open for fear of corruption allegations and vigilance enquiries. Recently, the Supreme Court in the case of *Ssangyong Engineering & Construction Co. Ltd vs. NHAI*[36], emphasized on the fact that the grounds for appeal under Section 34 of the Arbitration and Conciliation Act, 1996 (**Arbitration Act**) are available only in exceptional circumstances.

Additionally, even the 'Committee for Revisiting and Revitalizing the PPP Model of Infrastructure' (also known as the **Kelkar Committee**) in its report had welcomed the review and amendment of the Arbitration Act and had endorsed the need for time limit on hearings. It further suggested that disputes related to change of scope, delayed land handover, delayed COD, termination, cost overrun, delayed payments, penalties, and claims may be disposed of in a time-bound manner through an independent body with representatives of NHAI, developers, lenders and an independent chairman.

## Delay in payments by NHAI

In the event of any award passed against the government/concession authority, the concession authority invariably ends up challenging the same. Such a situation would result in deferring payments to the concessionaire (leading to a cash crunch/liquidity issue with the concessionaire) and the concessionaire incurring extra costs for the arbitration proceedings. The TOT MCA of 2017 does not mention that the arbitral award is final and binding on the parties. On the contrary it makes provisions in case the award is challenged. The HAM MCA of 2016 mentions that the arbitral award is final and binding, however NHAI may still challenge the award and further defer such claims.

To address this issue NITI Aayog released an office memorandum in September 2016[37], providing measures for revival of the construction sector. The measures were referred to and approved by the CCEA in its meeting held on August 31, 2016. NITI Aayog, *inter alia*, instructed the government departments, ministries, PSUs that in the event claims where the PSU/department has challenged the already announced arbitral award, 75% of the award would be payable by the PSU/department to the contractor/concessionaire against a bank guarantee without prejudice to the final order of the Court. To this effect MORTH issued a standard operating procedure (**SOP**)[38] which provides that prior to making an application for payment of 75% of the arbitral award, a designated escrow account is required to be established by the concessionaire with the 'Lead Bank'. A tripartite agreement between the PSU/department, concessionaire and the bank would be required to be executed. The SOP further provides details on bank guarantee, rate of interest, 'Arbitral Award Escrow Default' and closure/termination of the escrow account and agreement.

[36] 2019 (3) Arb LR 152 (SC)

[37] OM No. 14070/14/2016-PPPAU dated September 5, 2016

[38] http://morth.nic.in/showfile.asp?lid=2510

The withdrawal mechanism from the escrow account provides that the funds will be appropriated in the following order: (i) payment of lender dues (ii) payments for completion of project (iii) payments for completion of other projects of same department/PSU as mutually agreed (iv) balance may be used by the contractor/concessionaire with prior approval of the department/PSU. This was aimed to ensure that payment to the concessionaires are not deferred for long periods.

This measure, however, has not been as successful as it was expected to be. Statistics of the past year show that the less than 10% of the eligible concessionaires have opened an escrow account and furnished bank guarantees[39]. One of the reasons for failure to furnish bank guarantees is due to the hesitation of banks and lenders to advance money to such concessionaires who are already involved in such cost intensive litigations.

Stricter policy/criteria for internal assessment in a time bound manner should be put in place which shall be satisfied before challenging of such awards by the government/concession authority. In respect of amounts that are stuck with the government, a policy for immediate relief through take out funding etc. could also be envisaged and firmed up to ease the stress on availability of working capital with the concessionaires. A well-defined policy of the government in respect of release of award money and in respect of challenging of awards would be helpful in supporting availability of working capital for re-investment in the project and servicing of financing facilities availed for the purposes of the project. The same may be appropriately built in the terms and conditions of the concession agreements.

## Additional funding scheme by NHAI

With an aim to revise and physically complete the languishing BOT projects, NHAI *vide* its circular dated June 9, 2015[40] prescribed a scheme for a one-time fund infusion in the project companies. As per the scheme, NHAI would provide the financial assistance/bridge funds on loan basis to projects in BOT (Toll) that have achieved at least 50% (fifty percent) physical completion and where moderate funding would bring about completion of the project. This scheme was further extended to BOT (Annuity) projects by the Cabinet Committee on Economic Affairs in October 2015[41]. The scheme provides that after completion of the project, first charge on the toll receivables of the project would be ensured for NHAI by executing a tripartite agreement between senior lenders, concessionaire and the NHAI. This is a risk for the lenders since NHAI has first charge on the toll receivables.

Even the Standing Committee Report found the insistence of NHAI for the first charge on toll/annuity in the project which is 50% completed as impractical. The committee recommended that NHAI should offer its help to complete the incomplete project rather than claiming rights of collecting revenue. Further NHAI should pay full attention to its duty towards extending all facilities/help to concessionaire in completing the projects [42].

As an alternate to such funding, the concessionaire can securitize the annuity payments receivable from NHAI and thereby raise debts at very low interest rates. This ensures lower cost funding.

[39] http://morth.nic.in/index3.asp?sslid=2614&subsublinkid=1391&lang=1

[40] https://nhai.gov.in/writereaddata/portal/images/pdf/12-One-time-fund.pdf

[41] http://pib.nic.in/newsite/mbErel.aspx?relid=128702

[42] http://164.100.47.5/newcommittee/reports/EnglishCommittees/Committee%20on%20Transport,%20Tourism%20and%20Culture/236.pdf

**This alternate mode of funding was tried during the operations period in the Tuni-Anakapalli project (above image) in Andhra Pradesh and contributed to the success of the project[43]. The project was based on the (BOT Annuity) model.**

## Absence of major Maintenance Reserve

Major maintenance reserve (**MMR**) is the largest expense item during the operations phase of a BOT road project. In a study of 35 road projects, conducted by ICRA, in 60% of the projects MMR was not created whereas in other 25%, though created, it was inadequate to fund the associated costs. The absence or inadequacy of MMR would mean that the concessionaires will have to either depend on the sponsors for fund infusion or will have to utilize its tail period to raise additional debt by further leveraging the project. Other implications would include exponential increase in maintenance cost and penalties from NHAI in case of delayed maintenance activity.

## Substitution of concessionaire

Clause 3.4.4 of the Substitution Agreement included in the HAM MCA of 2016 gives NHAI the power to object to any substitution of the concessionaire by the senior lenders provided it gives a reasoned order after hearing the lenders' representative. In the event of any such objection, the lenders' representative may nominate another company for substitution and then the same process would apply. There is no limit on the number of times that NHAI can object to the nominations made by the lender's representative. Thus, in practice, substitution by lender's representatives may not be easy considering that NHAI can keep objecting to the nominated candidates. Any dispute related to the NHAI's reasoned order would result in arbitration (unless settled amicably) further delaying and complicating such substitution.

### Case Study

In one of the highway concessions, NHAI had issued a termination notice to Delhi Gurgaon Super Connectivity Limited (the concessionaire). The lenders led by Infrastructure Development Finance Company (**IDFC**) raised a dispute with NHAI, claiming that they did not get the termination notice from NHAI as envisaged under the agreement. NHAI justified it by claiming that they never recognized these lenders which were replaced by the concessionaire, additionally they did not execute the substitution agreement and escrow agreement with them. IDFC claimed that despite submitting the financing documents and following up, NHAI did not execute the substitution and escrow agreements as a result of which their rights under the agreement were in a fix[44].

## Right of Way and effect of change in scope on the O&M costs

Clause 10.3.4 of the HAM MCA of 2016 provides that if NHAI is unable to provide any part of the site within 180 days from the 'Appointed Date', the remaining site of the 'Project Highway' will be removed from the scope of work under the provision of 'Change of Scope'. If the 'Change in Scope' leads to a reduction or increase in the length of the 'Project Highway', the 'O&M Payments' will be reduced or increased in proportion to the reduction or increase in the length of the 'Project Highway'.

On a conjoint reading of Clause 10.3.4 and Clause 16.7 of the HAM MCA of 2016, it is clear that in the event NHAI is not able to hand over 'Right of Way' (**ROW**) for a particular stretch of the 'Project Highway', it would be dealt as a 'Change in Scope' of the project leading to reduction of the length in the 'Project Highway' thereby amounting to a proportionate reduction in the 'O&M Payments'. This may affect the repayment of the debt provided by the senior lenders, as the 'Financial Close' is achieved prior to the reduction in the change in length envisaged under 10.3.4. This will also mean that for the project the concessionaire has provided a higher

[43] https://www.pppinindia.gov.in/documents/20181/27199/Compendium_July8.pdf/74f766db-c9ba-4ff9-8492-a0ff4493103f

[44] https://timesofindia.indiatimes.com/business/india-business/Lenders-NHAI-fight-over-Delhi-Gurgaon-expressway/articleshow/12013412.cms

'Performance Security', which should have been reduced after the change in scope is reduced as the 'Total Project Cost' gets reduced.

## COD on Completion Certificate

As per the HAM MCA of 2016, upon completion of the 'Construction Works' and the IE determining that the tests to demonstrate the completion of the project, are successful, the IE is required to issue a 'Completion Certificate' or a 'Provisional Certificate' (if minor punch list items are outstanding) to the concessionaire.

Clause 15.1.1 provides that the commercial operation date of the project shall be on the date on which the 'Completion Certificate' or the 'Provisional Certificate' is issued. Clause 15.2 further provides that if the COD does not occur prior to the 91st day after the 'Scheduled Completion Date'(**SCOD**) due to reasons other than 'Force Majeure' or NHAI's default, damages will be payable by the concessionaire for such delay @ 0.2% of the 'Performance Security' for each day of such delay.

Historically, NHAI has viewed the date of the issue of the final completion certificate as the COD Date for all purposes under the concession agreement.

Further, it is pertinent to note that the concession agreement does not specify the time period (from the completion of construction work and successful completion of tests) within which the IE must issue the 'Completion/Provisional Certificate'. As mentioned above, the date of the 'Completion Certificate' or the 'Provisional Certificate' will be the COD and if the COD is delayed beyond 90 days from the SCOD, the concessionaire is liable to pay damages. In the absence of any definite timelines for issuance of the 'Completion/Provisional Certificate' or any deemed issuance provision, a delay in issue of the 'Completion/Provisional Certificate' could potentially expose the concessionaire to damages.

## Compensation for default by NHAI

As per Clause 29.2 of the HAM MCA of 2016, in the event of a material breach by NHAI, compensation payable by NHAI will not include any:

- Loss of annuity payments
- Debt repayment obligations
- Consequential losses
- Loss of profits
- EPC contractor claims

The Clause also does not clarify whether the compensation of direct costs suffered by the concessionaire would be in addition to the termination payments prescribed under the concession agreement. The concessionaire would not be compensated for loss of any annuity payments on account of any delay or defaults by NHAI. This is critical as the concessionaire has no toll collection rights to improve its cash flows and would be relying solely on annuity payments and O&M payments during the concession period.

The exclusion of EPC contract claims (which may arise directly or indirectly) due to any NHAI default is also critical as the concessionaire would have no control or mitigation over any delays or defaults caused due to events such as delay/failure in land acquisition, delay/failure in procuring ROW, shifting of utilities, procurement of environmental approvals etc. In order to mitigate its risks, the concessionaire should ensure that under the EPC Contract, the concessionaire should exclude its liability towards any claims that the EPC contractor may raise which arises out of or is attributable to any breach or delay by NHAI.

## Vignettes of issues in the highways sector

*Delays in acquisition of land*

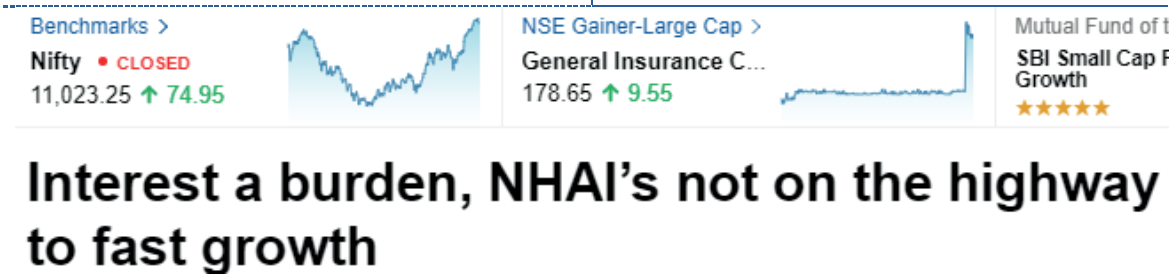
*Everyday Disruptions*

*Floods*

*A Unique method in India: Candies for Change*


*Lower than expected traffic*

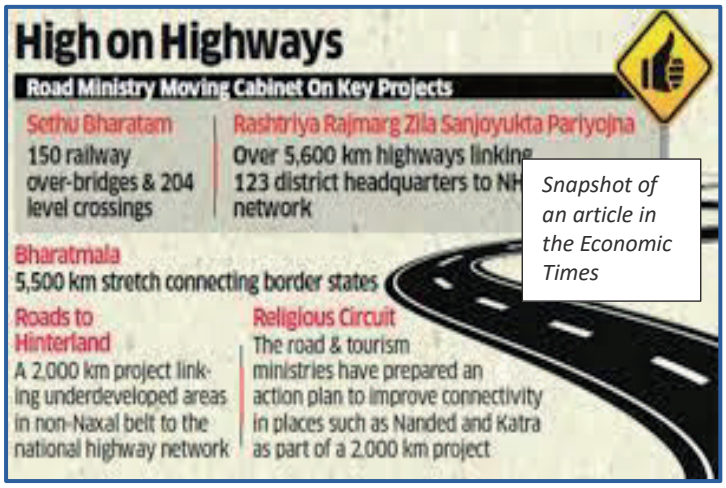

*Construction delays*




*The picture immediately above is from the ET online website (August 29, 2019). The issue being the widening gap between toll collection and interest outgo which is limiting the ability of National Highways Authority of India (NHAI) to expand the national highway network in India.*

## Current trends in NHAI concessions

The introduction of the HAM model in 2016 brought a major boost to the roads sector. This was primarily since the projects were financially viable to the lenders as 40% of the project costs was released by the NHAI in the construction phase itself. By combining the features of the EPC model and BOT-toll model, the HAM model ensures that the project is partly financed by the government unlike the EPC model. Additionally, the risks associated with toll collection and revenue generation in the BOT-toll model are also taken care of as the concessionaire receives 40% of the project costs in the construction period itself and its revenue is in the form of annuity paid by NHAI.




*Snapshot of an article in the Economic Times*

Statistics from NHAI show that in the year 2018-2019, 54 projects out of 77 projects were EPC, 19 were based on the HAM model and 4 were item rate[45]. In a written reply provided in the Lok Sabha in November 2019, the Union Minister for Road Transport and Highways indicated that national highways projects worth approximately INR 10,000 crore have already been approved in the financial year 2018-2019 till October 31, 2019 under the HAM mode. However, despite the recent trends, the HAM model is also facing certain critical issues**. One of the primary issues is failure to achieve financial closure due to lack of appetite and lending freeze on many public sector banks[46].** A report by CRISIL states that a number of HAM projects are awaiting appointed dates despite having achieved financial closure because of delays in land acquisition and environment clearances[47]. One of the recent developments in the highway concessions is roll out of the Toll Operate Transfer (**TOT**) model under the Bharatmala scheme. The model was approved in March 2018[48] and has been discussed below.

### TOT Model

The GOI, in 2016, had authorized NHAI to monetize public funded National Highway projects which are operational and are generating toll revenues for at least two years after the COD through the TOT model[49].

- Under the TOT model, the right of collection and appropriation of fee of existing operational highways is assigned to the concessionaire for a period of 30 years.
- The fee collected by the concessionaire during the term of the concession agreement is assigned to the pocket of the concessionaire.
- In exchange of such right to collect the fee, the concessionaire, is required to pay an upfront, one-time, lump sum bid concession fee to NHAI, which is to be quoted by the concessionaire in its bid.

[45] https://nhai.gov.in/bid-awarded-in-year.htm

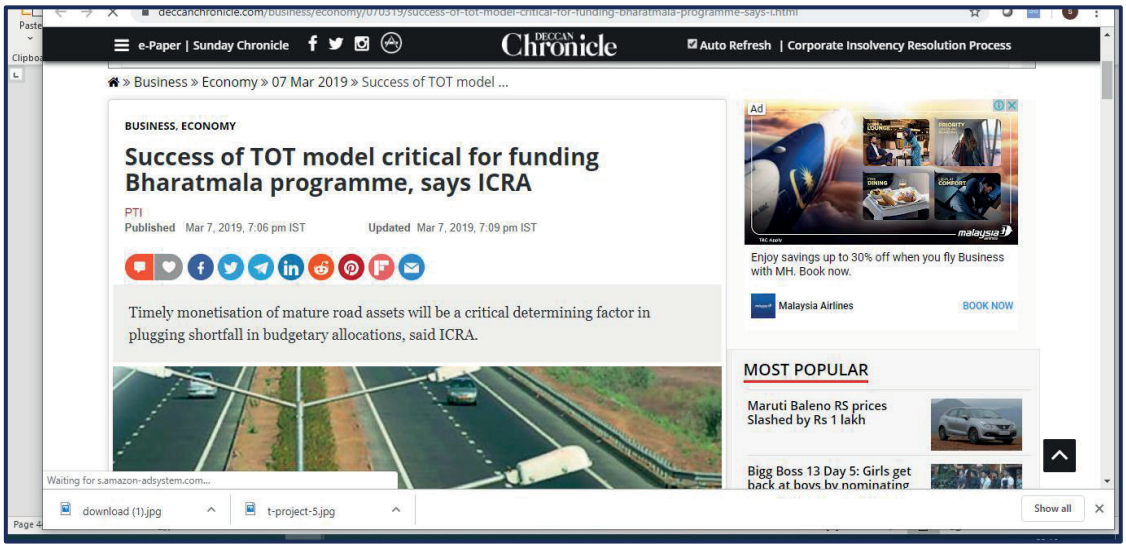
[46] https://www.indiaratings.co.in/PressRelease?pressReleaseID=33980&title=FY19-Mid-Year-Infrastructure-Outlook%3A-Reasonable-Stability-with-No-Big-Surprises

[47] https://www.crisil.com/content/dam/crisil/our-analysis/reports/Research/documents/2018/november/crisil-opinion-ham-in-a-jam.pdf

[48] http://pib.nic.in/newsite/PrintRelease.aspx?relid=177882

[49] http://pib.gov.in/newsite/PrintRelease.aspx?relid=148306

- As per the request for proposal[50] the bid concession fee for a project would be summation of 'Net Present Value' (**NPV**) of 'Net free Cash Flow' as estimated by the concessionaire during the entire concession period at the concessionaire's own discount rate.
- Sum of bid concession fee for all the projects in the bundle would be considered for selection of concessionaire. The bid concession fee would be the sole criteria for evaluation of bids.




*Screenshot of an article in the Deccan Chronicle on the importance of the TOT model*

The scope of work of the concessionaire includes O&M of the project during the concession period. The projects are more suited to private investment since major issues related to land acquisition, environmental clearances and other construction risks are eliminated since the highways are already functional and operational.

However, considering that the concession period is for 30 years, a large amount of financing would be required for payment of upfront sum. Thus, the repayment obligations of the concessionaire would kick in sooner than other finances where the repayment obligations usually kick in post the COD of the project.

Currently, a total of 3 bundles of highways have been auctioned since the inception of the TOT model. While the first model which was launched in February 2018 was a huge success, the second bundle launched in August 2018 received a lack luster response due to estimation of poor expected toll revenue and geographical location of the highways, following which NHAI cancelled the second round of auction. The bid for the third bundle was floated by the NHAI in June 2019. After a significant period of time since the first bundle, in November 2019, Cube Highways and Infrastructure Pte Limited emerged as the highest bidder in the third round of auctions. As a result of a poor response, the NHAI is contemplating a new mechanism wherein an SPV would be formed and NHAI would seek equity participation from investors for highway projects[51]. In relation to the bid for the third bundle, Chairman of the NHAI, Shri Narendra Nath Sinha indicated that several more bundles would be offered in the months to come[52]. Mr. Sinha invited investors to come up with more innovative investment models for the infrastructure sector.

[50] http://morth.nic.in/showfile.asp?lid=2960

[51] https://economictimes.indiatimes.com/industry/indl-goods/svs/construction/after-muted-tot-response-nhai-toys-with-equity-offer-to-raise-funds/articleshow/69193126.cms?from=mdr

[52] https://pib.gov.in/PressReleseDetail.aspx?PRID=1581157

## Recent Trends

The most recent development in the sector was the announcement by the MORTH that the NHAI has identified certain stretches covering about 950 km on a pan India basis[53]. Such stretches have been identified in an attempt to revive PPP for national highways and would be constructed through on the BOT (Toll) mode. The estimated cost of such stretches is stated to be INR 30,000 crores. The MORTH also noted that certain modifications have also been made in the existing request for annual pre-qualification to make it more industry friendly.

Whilst the Government has been actively inviting bids for national highways, issues such as delays associated with land acquisition continue to plague the sector. Adding to the woes, the Supreme Court has in its order dated September 19, 2019 in *Union of India and Another vs. Tarsem Singh and Others*, held that Section 3J of the NH Act which stated that Land Acquisition Act, 1894 would not be applicable for acquisitions of land under the NH Act was unconstitutional. It was further held that provisions of the Land Acquisition Act, 1894 regarding payment of solatium and interest would also apply to acquisitions made under the NH Act. On the other hand, vide an order dated August 27, 2019, the Supreme Court held that the power to appoint an arbitrator under Section 3G(5) of the NH Act in relation to disputes as regards compensation in lieu of acquisition of land under the NH Act was exclusively vested with the Central Government and any application filed under Section 11(6) of the Arbitration and Conciliation Act, 1996 for appointment of an arbitrator was not maintainable as regards such disputes.

Separately, a report dated September 17, 2019 by CARE Ratings[54] predicted that the overall pace of construction would slow down from the current rate of 30 km per day to about 26-27 km per day during April 2019 to March 2020 owing to slow down in pace of awards, limited budgetary support, high risk aversion of public sector banks to infrastructure projects, worsened liquidity position of non-banking financial companies and disruption in construction activity during monsoon and high cost of land acquisition. Furthermore, any short fall in external borrowings or any short fall in fund raising under toll operate transfer model has also been estimated to have a negative impact on construction rate. In this regard, CARE Ratings was of the view that the Government needs to mitigate or eliminate traffic risks and construction risks to attract private investment in BOT road projects viz. by way of extending concession period in case of shortfall in traffic estimates.

It has also been reported[55] that the Government is considering doing away with the requirement of furnishing bank guarantees for highway projects as procuring the same has continued to be a challenge for concessionaires. While the Government may bring in an alternative to the bank guarantee requirement, such proposal is an indication that the Government is mindful of the issues faced by concessionaires and is taking steps to remedy them.

Accordingly, the MORTH *vide* its circular dated October 7, 2019 has amended the bid security provisions of the standard Request for Proposal (**RFP**) for National Highways and centrally sponsored road works implemented on EPC mode. The requirement of submitting a bid security has been replaced by a bid securing declaration. Under the amended RFP, the bidders are required to sign and submit a declaration in the prescribed format, stating that if the bidder withdraws or modifies its bid during the period of validity or fails to sign the contract or submit a performance security before the deadline, the bidder would be suspended for participation in the tendering process for works of MORTH/NHAI/National Highways and Infrastructure Development Corporation Limited (**NHIDCL**) and works under other centrally sponsored schemes, for a period of 1 year from the bid due date of the work for which the bid was originally submitted.

[53] https://pib.gov.in/PressReleseDetail.aspx?PRID=1585561

[54] http://www.careratings.com/upload/NewsFiles/SplAnalysis/Highways%20construction%20to%20slow%20down%20to%2026-27%20km%20per%20day%20in%20FY2020.pdf

On November 26, 2019 the Cabinet Committee on Economic Affairs (CEA) approved the proposed amendments in the TOT Model developed by the National Highways Authority of India (NHAI). These amendments are aimed at monetizing existing operational projects that have a 1-year history of revenue generation through tolls. The Ministry of Road Transport and Highways or the NHAI will approve projects for monetization on a case to case basis.

The following changes have been proposed:

- The current TOT model considered existing projects that have been generating revenue for a minimum period of two years.
- The proposed amendments have reduced this period to 1 year of revenue generation so as to expand the ambit of the TOT model in order to make the proposition more attractive to investors.
- As such, 75 projects have been identified for monetization under the TOT model, which will be bundled under 10 separate bids.
- This is aimed at attracting the economies of scale of the private sector.
- Another significant change that has been reportedly proposed in the existing model is that the NHAI now would have the power to vary the concession period of the projects to 15-30 years as opposed to the present concession period of 30 years.

On December 11, 2019, the Union Cabinet approved another proposal by the NHAI aimed at monetizing completed and operational national highway projects. The NHAI has proposed setting up an Infrastructure Investment Trust (**InvIT**) under the Indian Trusts Act, 1882 and SEBI (Infrastructure Investment Trusts) Regulations, 2014 so as to enable private players to invest directly in the construction of national highways. Like the TOT Model, it is proposed that national highways with a toll collection track record of at least one year would be considered for monetization. The InvIT may hold the asset directly, or through a SPV. The setting of an InvIT, along with the TOT model described above, are attempts made by the NHAI optimize the value of existing projects and incentivize private participation in funding the development of national highways under the GOI's Bharatmala program[56].

Recently, the NHAI and Indian Highways Management Company Limited engaged the National Payments Corporation of India (**NCPI**) with the aim of arriving at a viable solution to meet electronic tolling requirements of the national highways in India. The national electronic toll collection program (**NETC**) was launched in December 2016 pursuant to this engagement[57]. The embodiment of the NETC is the 'FASTag', a radio frequency identification (RFID) enabled tag that can be affixed to the windshield of the vehicle and allows the automatic deduction of the toll from the person's linked bank account as they pass through the toll gate. The FASTag method has seen steady growth since its introduction and electronic toll collections made through the FASTag have for the first time in December 2019, surpassed cash collections.

[56] https://pib.gov.in/Pressreleaseshare.aspx?PRID=1595947

[57] https://www.npci.org.in/sites/default/files/Press%20release-%20Extending%20FASTag%20program%20across%20State%20and%20City%20toll%20plaza....pdf

# Infrastructure Projects: Ports Sector

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**The longest national highway in India measures a distance of 3,745 km from Srinagar to Kanyakumari and the shortest national highway is only about 5 km from Asanbani to Jamshedpur…**

# Infrastructure Projects: Ports Sector

## Broad overview of the legal and institutional framework of the ports sector

India has approximately 7,500 kilometers of coastline spanning 13 maritime states and union territories. India's ports are broadly classified into 2 categories namely, major ports and non-major ports (also referred to as minor or intermediate). There are 12 major ports[58] and about 187 minor ports in India.

The distinction between major ports and minor ports is based on the distribution of maritime jurisdiction between Central Government and the State Governments.

- Major Ports are listed in entry 27 of the Union List and are administered primarily under the Major Ports Trusts Act, 1963 (**MPTA**).
- All ports other than major ports are listed in entry 31 of the Concurrent List and are administered jointly by Central Government and State governments under the Indian Ports Act, 1908.

While major ports are declared as such under the MPTA and have specific port trusts constituted for their administration, minor ports are under the operational jurisdiction of the states/maritime boards set up by the states. Pursuant to the Indian Ports Act, 1908, states are empowered to set up bodies to govern minor ports. Certain states have established dedicated maritime boards for this purpose while in other states, there are designated state departments which supervise the functioning of minor ports. Some of the states which have established a maritime board are the states of Gujarat, Maharashtra and Tamil Nadu.

The main activities of the ports include maintenance of port infrastructure, pilotage, towage, berthing and un-berthing of ships, handing and warehousing, storage and transportation of goods etc. The main sources of revenue from cargo traffic include wharfage/landing fees, cargo related charges, rentals from warehouses, demurrage charges, charges for providing port infrastructure for movement and transportation of goods, revenue from ships such as in respect of ship docking, pilotage, port dues etc. Tariffs, in the case of major ports, are regulated by [59]Tariff Authority for Major Ports (**TAMP**) [60] and in case of minor ports are decided by the State

[58] The major ports are located at Kolkata/Haldia, Chennai, Cochin, Ennore, Jawaharlal Nehru Port at Nhava Sheva, Kandla, Mormugao, Mumbai, New Mangalore, Paradip, Tuticorin and Vishakhapatnam.

[59] TAMP was constituted in April 1997. It regulates all tariffs, both vessel related and cargo related, and rates for lease of properties in respect of major port trusts and the private operators located therein. The MPTA was amended by Port Laws (Amendment) Act 1997 to constitute the TAMP.

Governments or the appropriate body appointed by State Governments. The Major Ports are free to fix tariffs on various services at any level, which is less than the notified tariff ceilings prescribed by TAMP. TAMP's mandate is limited to only notification of the tariff bands.

The characteristics of major ports and minor ports do not necessarily suggest differences in terms of importance of port infrastructure since some of the minor ports (such as **Mundra port in Gujarat**) have large amounts of traffic volumes and a higher level of investment made in comparison to some of the major ports.

The GOI intends to replace the MPTA with a new law. For this purpose, the government has approved the draft Major Port Authorities Bill, 2016 which is still pending approval (**MPA Bill**). The bill aims to provide greater efficiency to major ports by providing them full autonomy in decision making. Some of the key salient features of the proposed bill are:

- To allow the concessionaire to fix the tariff based on market conditions, for PPP projects
- To frame the scales of rates for assets and services available at major ports
- To constitute an adjudicatory board for adjudication of disputes among major ports, PPP concessionaries and captive users
- To entitle the board of each major port to create a specific master plan in respect of any development or infrastructure established or proposed to be established within the port limits and the land appurtenant thereto. This master plan shall be independent of any local or State Government regulations of any authority whatsoever.

Ports have enormous potential for wide ranging investment and modernization. The pace of development gathered momentum since the GOI invited private sector participation in development of major ports infrastructure in 1996[61].

For the purpose of this Chapter, we are primarily focusing on concessions pertaining to major ports.

## PPP in major ports

In order to encourage private participation, the GOI, had through MORTH, issued the guidelines dated October 2, 1996 to be followed by Major Port Trusts for private participation in the major ports. As per the PPP Guidelines, participation/investment by the private sector is permitted through leasing of existing assets or concession agreements for construction/creation of new assets and operation and maintenance of the same. The major areas which have been thrown open for private investment, mainly on BOT basis, include construction of cargo handling berths, container terminals and warehousing facilities, installation of cargo handling equipment, construction of dry-docks and ship-repair facilities, etc. Private sector participation is permitted through an open competitive bidding process.

Further the MORTH has with the guidelines for private sector participation in ports through joint ventures (**JV**s) and foreign collaboration dated June 1, 1998 approved the formation of JVs between: (i) major ports and foreign ports (ii) major ports and minor ports (iii) between major ports and companies or a consortium of companies for facilitating major ports to:

[61] In India, Foreign Direct Investment (**FDI**) of up to 100 %[61] is permitted under the automatic route for port and harbour construction and maintenance projects. However, the GOI has also issued certain guidelines to be followed by major port trusts for private sector participation wherein specific areas have been identified for participation/investment by the private sector and also subject to certain approval requirements It has also facilitated a 10-year tax holiday to enterprises that develop, maintain and operate ports, inland waterways and inland ports. In 2016, 19% of PPP projects have attracted foreign investors.

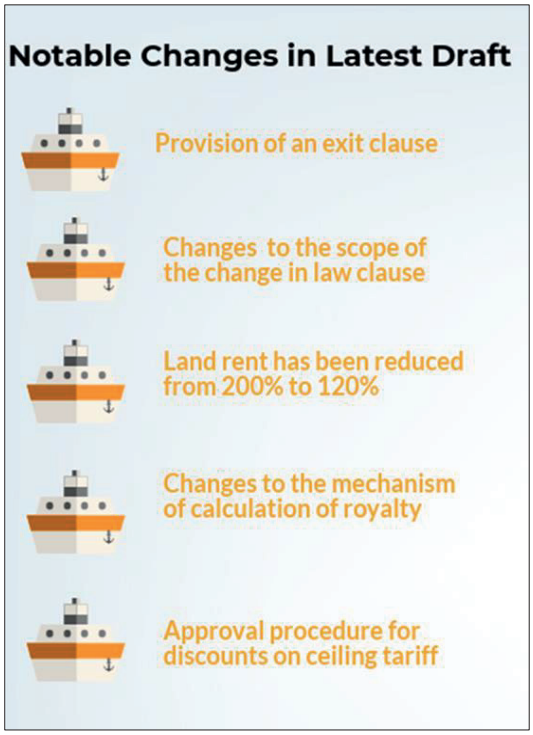
- Attract new technology
- Introduce better managerial practices
- Expedite implementation of schemes
- Enhance confidence of private sector in funding ports

## Evolution of concession agreements in ports

The port sector has seen significant investments through the PPP model. The preferred model for private participation in the port sector has been DBFOT and both major and non-major ports and terminals therein are bid out and awarded to private players.

An MCA for ports was introduced in the year 2001 by IDFC Limited. Prior to 2014, the Planning Commission released MCA for major ports. Presently, the Ministry of Shipping releases MCAs for major ports from time to time.

By periodically revising the ***MCA**s*, the Central and State Governments essentially aim at addressing the views of stakeholders and the changing requirements of the evolving industry. *An MCA for ports was introduced in the year 2001 by IDFC. An MCA was also developed by the Ministry of Shipping, and projects under both these regimes continue till this day. Separate concession agreements for State ports i.e. non-major ports was also issued.*




Separately, several states have adopted their own concession agreements for non-major ports that are different from the MCAs drafted by the central authorities. For instance, the MCAs developed by the Gujarat Maritime Board, which predate the MCAs issued by the Planning Commission's draft, expressly recognize grant of sub-concessions while the MCA do not directly recognize this.

### Salient features of latest MCA

Set out below are some of the salient features of the latest MCA issued by the Ministry of Shipping for major ports in January 2018. The release of the latest version of the MCA (**2018 Port MCA**) was notified by the Ministry of Shipping vide press release dated January 3, 2018.

The notable changes brought into the 2018 Port MCA are as follows:

- **The Society for Affordable Redressal of Disputes Ports** (**SAROD-PORTS**). It provides for constitution of SAROD-PORTS as a dispute resolution mechanism similar to a provision available in the highway sector.
- **Provision of an exit clause.** It provides exit route to developers by way of divesting their equity upto 100% after completion of 2 years from the COD.
- **Reduction of rent for additional land.** Under the clause relating to provision of additional land to the concessionaire, land rent has been reduced from 200% to 120% of the applicable scale of rates for the proposed additional land.

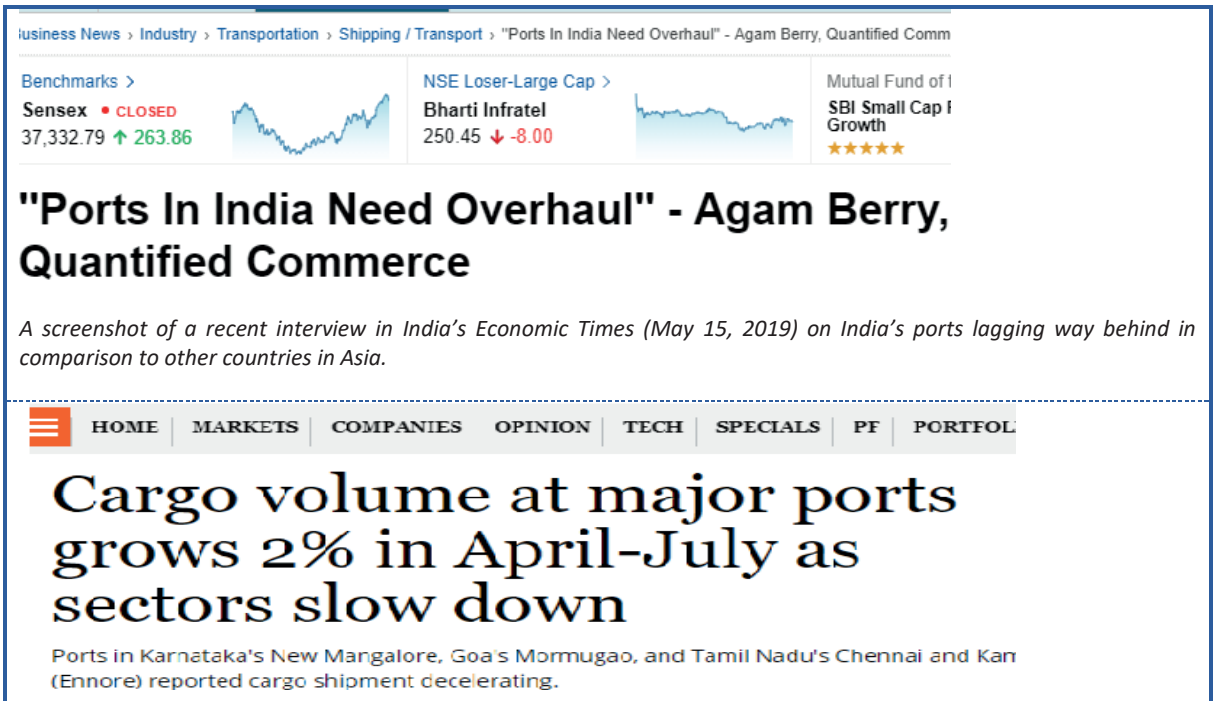
- **Calculation of royalties payable.** Concessionaire would pay royalty on "(MT) of cargo/TEU (Twenty-foot Equivalent Unit) handled" basis which would be indexed to the variations in the Wholesale Price Index (**WPI**) annually. This will replace the present procedure of charging royalty which is equal to the percentage of Gross revenue, quoted during bidding, calculated on the basis of upfront normative tariff ceiling prescribed by TAMP. This will help to resolve the long pending grievances of the PPP operators that revenue share is payable on ceiling tariff and price discounts are ignored. The problems associated with fixing storage charges by TAMP and collection of revenue share on storage charges (which has plagued many projects) will also get eliminated.

- **Changes to the scope of the change in law clause.** The new definition of change in law includes:
  - **Imposition of standards and conditions** arising out of the guidelines/orders issued by the TAMP, environmental laws, and labor laws.
  - **Increase and imposition of new taxes, duties, etc.** for compensating the concessionaire. Since the viability of the project was affected, the concessionaire will now be compensated for the increase and imposition of new taxes, duties etc. except in respect of imposition/increase of a direct tax, both by the Central and State Governments.

- **Commencement of operations before COD**. Provision for commencement of operations before COD has been prescribed. This will lead to better utilization of assets provided by the Port in many projects before the formal completion certificate.

Many issues in port concessions and implementation continue to remain unaddressed. Some of these are common to most concessions i.e. delays in land acquisitions and approvals. Other port specific issues such as the lack of connectivity to ports (which often is an obligation of the port authorities), requirements for minimum throughput which may not track realistic levels and providing for a revenue share instead of a profit share (which results in a skewed sharing of returns) still remain.

### Vignettes of issues in the ports sector




*A screenshot of a recent interview in India's Economic Times (May 15, 2019) on India's ports lagging way behind in comparison to other countries in Asia.*

*A screenshot of an article in Business Standard (August 27, 2019) on cargo growth at India's major ports falling to 2% in April-July this fiscal year.*

## Comparative look at MCAs

A comparison of the key terms in the 1999 MCA issued by the Gujarat Maritime Board (**GMB**) for minor ports, the 2008 MCA issued by the Ministry of Shipping for major ports, the 2016 MCA issued by the Ministry of Shipping for major ports, and the 2018 MCA issued by the Ministry of Shipping (**MoS**) for major ports is provided below to trace the evolution of concession agreements in the port sector.

| Sr No. | Particulars | 1999 MCA – GMB – Minor Ports[62] | 2008 MCA – MoS – Major Ports[63] | 2016 MCA – MoS – Major Ports[64] | 2018 MCA – MoS – Major Ports[65] |
|---|---|---|---|---|---|
| 1. | **Concession model (as provided under the concession agreement)** | BOOT | BOT | BOT | BOT |
| 2. | **Concession period** | Unless otherwise provided under the concession agreement, the concession period shall be for a period of 30 years from the date of signing of the concession agreement.<br><br>Provided that, the concession period may be extended by a maximum of 2 years or the period taken for the institution of transport linkages required for the operation of the port as provided in the approved detailed project reports. | As determined on a project-to-project basis. However, the MCA states that the maximum concession period shall be 30 years.<br><br>Notwithstanding which, the same can be extended by the Authority, or terminated by either party in accordance with the terms of the concession agreement. | As determined on a project-to-project basis. However, the MCA states that the maximum concession period shall be 30 years.<br><br>Notwithstanding which, on the basis of the actual target traffic achieved in terms of the concession agreement, the concession period can be extended by a maximum period of 10 years or reduced by a maximum period of 3 years in accordance with the terms of the concession agreement. | As determined on a project-to-project basis. However, the MCA states that the maximum concession period shall be 30 years.<br><br>Notwithstanding which, the same can be extended by the Authority, or terminated by either party in accordance with the terms of the concession agreement. |

[62] https://gmbports.org/policy-structure

[63] https://www.pppinindia.gov.in/documents/20181/36970/MCA_for_Major_Ports_22072019.pdf/191b5961-3ba3-4a7d-bfe6-21bdee0f7cb0?version=1.0

[64] http://sagarmala.gov.in/sites/default/files/666788205MCA18052016.pdf

[65] http://shipmin.gov.in/writereaddata/l892s/FinalMCA17012018-18610118.pdf

| Sr. No. | Particulars | 1999 MCA – GMB – Minor Ports | 2008 MCA – MoS –Major Ports | 2016 MCA – MoS –Major Ports | 2018 MCA – MoS –Major Ports |
|---|---|---|---|---|---|
| 3. | **Land procurement obligation** | The Authority shall acquire the land for subsequent phases of the project, as identified in the approved detailed project report within 18 months of the date of the agreement.<br><br>Ownership of leased land, reclaimed land and waterfront land shall remain with the Authority. | The ownership of the land shall remain with the Authority and the concessionaire may use such assets for the purposes of the project.<br><br>The concession agreement does expressly not lay down obligations relating to land acquisition. | The ownership of the land shall remain with the Authority and the concessionaire may use such assets for the purposes of the project.<br><br>The concession agreement does expressly not lay down obligations relating to land acquisition. | The ownership of the land shall remain with the Authority and the concessionaire may use such assets for the purposes of the project.<br><br>The concession agreement does expressly not lay down obligations relating to land acquisition. |
| 4. | **Additional land** | The Authority shall acquire and keep in reserve additional land from the boundary of the leased premises as identified in the Approved detailed project report for future expansions of the port. | Not provided for. | On deemed insufficiency of land by the concessionaire for the purpose of providing services under the concession agreement, the concessionaire may approach the Authority in this regard. The Authority, on consideration of the issue, and subject to availability, provide such additional land. | On deemed insufficiency of land by the concessionaire for the purpose of providing services under the concession agreement, the concessionaire may approach the Authority in this regard. The Authority, on consideration of the issue, and subject to availability, provide such additional land.<br><br>The concession agreement additionally states that, in case of non-facilitation of such additional land by the authority, the concessionaire would not be entitled, on these grounds, to any relaxation on the performance of its obligations under the concession agreement. |

| Sr. No. | Particulars | 1999 MCA – GMB – Minor Ports | 2008 MCA – MoS –Major Ports | 2016 MCA – MoS –Major Ports | 2018 MCA – MoS –Major Ports |
|---|---|---|---|---|---|
| 5. | **Permits procurement obligation** | The Authority agrees to make reasonable efforts to assist the concessionaire in obtaining clearances. | Specific permits to be procured by either the concessionaire, or the Authority as determined during the execution of the project specific concession agreement.<br>Provided that the permits to be obtained by the Authority shall be clearances relating to the project site, including clearances from the Ministry of Environment and Forests, and any in-principle clearances, as the case may be. Such permits to be obtained by the Authority may also include consents to establish. | Specific permits to be procured by either the concessionaire, or the Authority as determined during the execution of the project specific concession agreement.<br>Provided that the permits to be obtained by the Authority shall be clearances relating to the project site, including clearances from the Ministry of Environment and Forests, and any in-principle clearances, as the case may be. Such permits to be obtained by the Authority may also include consents to establish. | Specific permits to be procured by either the concessionaire, or the Authority as determined during the execution of the project specific concession agreement.<br>Provided that the permits to be obtained by the Authority shall be clearances relating to the project site, including clearances from the Ministry of Environment and Forests, and any in-principle clearances, as the case may be. Such permits to be obtained by the Authority may also include consents to establish. |
| 6. | **Financial closure** | Financial close shall occur upon the fulfilment of all conditions precedent to the initial availability of funds under the financing documents, and on receipt of commitments for the equity required for the first phase of the project. | Financial close shall occur upon:<br>▪ The conditions precedent under the concession agreement being fulfilled by both the concessionaire and the Authority.<br>▪ Completion of all actions relating to financial assistance as provided under the respective concession agreement, including the concessionaire obtaining access to financial assistance. | Financial close shall occur upon:<br>▪ The conditions precedent under the concession agreement being fulfilled by both the concessionaire and the Authority.<br>▪ Completion of all actions relating to financial assistance as provided under the respective concession agreement, including the concessionaire obtaining access to financial assistance. | Financial close shall occur upon:<br>▪ The conditions precedent under the concession agreement being fulfilled by both the concessionaire and the Authority.<br>▪ Completion of all actions relating to financial assistance as provided under the respective concession agreement, including the concessionaire obtaining access to financial assistance. |

| Sr. No. | Particulars | 1999 MCA – GMB – Minor Ports | 2008 MCA – MoS –Major Ports | 2016 MCA – MoS –Major Ports | 2018 MCA – MoS –Major Ports |
|---|---|---|---|---|---|
| 7. | **Termination due to failure to achieve financial close** | On failure of achievement of 'zero day' within a period of 18 months from the date of signing of the concession agreement, the concession agreement would stand terminated. | Conditions precedent provided under the concession agreement shall be fulfilled within a period of 90 days from the date of execution of the concession agreement. | Conditions precedent provided under the concession agreement shall be fulfilled within a period of 180 days from the date of execution of the concession agreement. | Conditions precedent provided under the concession agreement shall be fulfilled within a period of 180 days from the date of execution of the concession agreement. |
| 8. | **Variation of costs arising from change in law** | In the event that a change in law renders exercise by the concessionaire of any of its material rights or performance of its obligations impossible, the concessionaire may serve a termination notice to the Authority. However, the parties to the concession agreement shall engage in consultations, failing which, the matter may be referred for dispute resolution. | The Authority and the concessionaire may discuss and make modifications to the terms of the concession agreement so as to mitigate the effect of the change in law. | The Authority and the concessionaire may discuss and make modifications to the terms of the concession agreement so as to mitigate the effect of the change in law. | The Authority and the concessionaire may discuss and make modifications to the terms of the concession agreement so as to mitigate the effect of the change in law. |
| 9. | **Change of scope** | Any expansions outside the scope of the approved development plan shall be subject to the prior approval of the Licensor. Any expansion, including any expansion envisaged in the and/or approved detailed project report, entailing capital investment in excess of 25% of the 'Capital Cost for Contracted Assets for Phase 1' shall be considered a Major Expansion. | The Authority may require the concessionaire to carry out works other than what has been agreed to, through a change in scope order, provided that, the cost of implementing a single change of scope order shall not exceed 5% of the estimated project cost and the cumulative cost of such change in scope orders issued during the concession period shall not exceed 20% of the estimated project cost.<br><br>The Authority shall make payments for the increased costs arising from the change of scope order.<br><br>The Authority may also seek competitive bids for carrying out | The Authority may require the concessionaire to carry out works other than what has been agreed to, through a change in scope order, provided that, the cost of implementing a single change of scope order shall not exceed 5% of the estimated project cost and the cumulative cost of such change in scope orders issued during the concession period shall not exceed 20% of the estimated project cost.<br><br>The Authority shall make payments for the increased costs arising from the change of scope order. | The Authority may require the concessionaire to carry out works other than what has been agreed to, through a change in scope order, provided that, the cost of implementing a single change of scope order shall not exceed 5% of the estimated project cost and the cumulative cost of such change in scope orders issued during the concession period shall not exceed 20% of the estimated project cost.<br><br>The Authority shall make payments for the increased |

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| | | | of works in relation to a change of scope. The concessionaire shall have an option to match the preferred bid in order to carry out works under a change of scope order, in the terms of the agreement. | The Authority may also seek competitive bids for carrying out of works in relation to a change of scope. The concessionaire shall have an option to match the preferred bid in order to carry out works under a change of scope order, in the terms of the agreement. | costs arising from the change of scope order.<br><br>The Authority may also seek competitive bids for carrying out of works in relation to a change of scope. The concessionaire shall have an option to match the preferred bid in order to carry out works under a change of scope order, in the terms of the agreement. |
| 10. | **Change in ownership** | The Lead Promoter shall maintain a minimum interest of 26% in the shareholding of the concessionaire till the completion of a period of 7 years from the date of the concession agreement. The combined shareholding of key promoters in the concessionaire shall not be less than 51% for a period of 7 years from the date of the concession agreement. A reduction in shareholding below 51% can be undertaken with the prior permission of the Authority.<br><br>During the term of the concession agreement, an acquisition of more than 10% direct or indirect interest in the shareholding of the concessionaire by any person (either alone or together with its associates) shall require and shall be subject to the prior approval of the Licensor.<br>Any change in shareholding, other than those which require the approval of the Authority, shall be | Management control shall be retained in the concessionaire at least until the expiry of the exclusivity period.<br><br>*[Management control shall mean the power to elect or appoint more than 50% of the directors, managers, partners or other individuals exercising similar authority with respect to the concessionaire.]*<br><br>*[Exclusivity period shall be (i) the period of 5 years from the scheduled project completion date of the project, as provided under the* respective *concession agreement, or (ii) until when the average annual turnover of cargo handled reaches a level of at least 75% of the project capacity for two consecutive years. In cases where an exclusivity period is not provided for, such period shall be till the expiry of 3 years from the date of commercial operations.]* | Management control shall be retained in the concessionaire at least until the expiry of the exclusivity period.<br><br>*[Management control shall mean the power to elect or appoint more than 50% of the directors, managers, partners or other individuals exercising similar authority with respect to the concessionaire.]*<br><br>*[Exclusivity period shall be (i) the period of 5 years from the scheduled project completion date of the project, as provided under the* respective *concession agreement, or (ii) until when the average annual turnover of cargo handled reaches a level of at least 70% of the project capacity for two consecutive years. In cases where an exclusivity period is not provided for, such period shall be till the expiry of 3 years from the date of commercial operations.]* | Management control shall be retained in the concessionaire at least until the expiry of 2 years after the date of commercial operations.<br><br>*[Management control shall mean the power to elect or appoint more than 50% of the directors, managers, partners or other individuals exercising similar authority with respect to the concessionaire.]*<br><br>At any time, after expiry of a period of 5 years from the date of commercial operations, the lead member under the respective concession agreement, can approach Authority for approval proposing a new entity/consortium. |

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| | | intimated to the Authority by the concessionaire. | | | |
| | | | Further, the (i) applicant, or the members of the consortium shall hold not less than 51% of the paid up equity capital in the concessionaire until a period of 3 years from the date of commercial operations and not less than 26% of its paid up equity capital during the balance concession period; and (ii) lead member, as provided under the respective concession agreement, shall hold at any time not less than 50% of the consortium's holding in the paid up equity capital of the concessionaire. | Further, (i) the applicant, or the members of the consortium shall hold not less than 51% of the paid up equity capital in the concessionaire until a period of 3 years from the date of commercial operations and not less than 26% of its paid up equity capital for another three years, provided that the concessionaire shall be entitled to waive the equity holding requirement of 26% during the period of three years after the date of commercial operations; and (ii) the lead member, as provided under the respective concession agreement, shall hold at any time not less than 50% of the consortium's holding in the paid up equity capital of the concessionaire. | Further, (i) the applicant, or the members of the consortium shall hold not less than 51% of the paid up equity capital in the concessionaire until a period of 3 years from the date of commercial operations and not less than 26% of its paid up equity capital for another 2 years; and (ii) the lead member, as provided under the respective concession agreement, shall hold at any time not less than 50% of the consortium's holding in the paid up equity capital of the concessionaire.<br><br>At any time, after expiry of a period of 5 years from the date of commercial operations, the lead member under the respective concession agreement, can approach the Authority for approval proposing a new entity/consortium. |
| | | | Any transfer of shareholding in the concessionaire, and/or direct or indirect change in the management control of the concessionaire shall only be with the prior written approval of the Authority. | Any transfer of shareholding in the concessionaire, and/or direct or indirect change in the management control of the concessionaire shall only be with the prior written approval of the Authority. | Any transfer of shareholding in the concessionaire, and/or direct or indirect change in the management control of the concessionaire shall only be with the prior written approval of the Authority. |

| Sr. No. | Particulars | 1999 MCA – GMB – Minor Ports | 2008 MCA – MoS –Major Ports | 2016 MCA – MoS –Major Ports | 2018 MCA – MoS –Major Ports |
|---|---|---|---|---|---|
| 11. | **Levy and collection of fee/tariff** | The concessionaire shall comply with the provisions of the Indian Ports Act, 1908 relating to tariff. | The concessionaire may charge fees for the project facilities and services tendered in accordance with the specific tariff notification provided under the respective concession agreement published by the TAMP. | The concessionaire may charge fees for the project facilities and services provided in accordance with the specific tariff notification provided under the respective concession agreement published by the TAMP or any such other competent authority under the applicable law. | The concessionaire may charge fees for the project facilities and services provided in accordance with the specific tariff notification provided under the respective concession agreement published by the TAMP or any such other competent authority under the applicable law. |
| | | A comprehensive tariff schedule and the time period from which such tariff shall be in effect, shall be notified to the public by the concessionaire. Any user shall be entitled to avail the port's services at the notified tariffs. A revision in the notified tariff shall be intimated to the Authority and notified as provided under the concession agreement. | The tariff caps shall be revised every year based on a variation in the wholesale price index. Such revision shall be based on indexation against 60% of the variation in the wholesale price index for a relevant year beginning 1st January and ending 31st December. | The aforesaid Tariff caps shall be revised every year based on a variation in the wholesale price index. Such revision shall be based on indexation against 60% of the variation in the wholesale price index for a relevant year beginning 1st January and ending 31st December. | The aforesaid Tariff caps shall be revised every year based on a variation in the wholesale price index. Such revision shall be based on indexation against 60% of the variation in the wholesale price index for a relevant year beginning 1st January and ending 31st December. |
| | | The Concessionaire shall collect all cesses and charges including infrastructure cess, if any, levied on the users as may be requested by the Authority. | The Concessionaire shall collect all cesses and charges including infrastructure cess, if any, levied on the users as may be requested by the Authority. | The Concessionaire shall collect all cesses and charges including infrastructure cess, if any, levied on the users as may be requested by the Authority. | The Concessionaire shall collect all cesses and charges including infrastructure cess, if any, levied on the users as may be requested by the Authority. |
| 12. | **Charge on escrow account in favour of senior lenders** | Not provided for. | Not provided for. | Permitted. | Permitted. |
| 13. | **Dispute resolution** | Disputes are to be resolved through arbitration by an expert committee to be set up by the Authority and the concessionaire. The Authority and the | Failing amicable settlement with the assistance of the 'expert' appointed by the Authority and the concessionaire by mutual consent, the dispute shall be | Failing amicable settlement with the assistance of the 'expert' appointed by the Authority and the concessionaire by mutual | Failing amicable settlement, the dispute shall be referred to the SAROD-PORTS for resolution. |

| | | | | | |
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| | | concessionaire, on failure to agree on one person, each shall each nominate a person, who will then, nominate a third member. | settled through arbitration following the procedure agreed to, by the parties. Unless mutually agreed otherwise, the rules of arbitration prescribed by the International Centre for Alternative Dispute Resolution, New Delhi shall apply to the arbitration. The arbitral panel shall consist of one member nominated by each party, and a third member appointed by the two arbitrators | consent, the dispute shall be settled through arbitration following the procedure agreed to, by the parties. Unless mutually agreed otherwise, the rules of arbitration prescribed by the International Centre for Alternative Dispute Resolution, New Delhi shall apply to the arbitration. The arbitral panel shall consist of one member nominated by each party, and a third member appointed by the two arbitrators. | |
| 14. | **Refinancing** | Not provided for. | Permitted. | Permitted. | Permitted. |

## Issues concerning port concessions

Set out below are notable concerns pertaining to major ports/under the concession agreements for major ports:

### Minimum Guaranteed Cargo (MGC)

The MCAs (**2018 Port MCA**) prescribes that the concessionaire is required to meet a minimum guaranteed cargo, or the 'MCA' as prescribed in the annexure to the concession agreement, annually. If the concessionaire is unable to meet the MCA requirements for a continuous period of 3 years, the concession is liable to be terminated.

It has however been a view of the private operators that the port authority should be concerned with the minimum guaranteed revenue to be achieved by the concessionaire (as the port authority's concern is primarily the revenue earned by the concessionaire which has to be shared with the authority) instead of MGC with regard to a particular type of cargo required to be handled.

The cargo volumes handled at ports is considerably dependent on various factors including changes in international market conditions and government policies. A change in either has significant impact on trade and thereby the MGC requirements. Therefore, flexibility should be provided in the concession agreements regarding MGC, after factoring in such effects. It should be noted that the draft 2018 Port MCA does prescribe that in the event the concessionaire is unable to meet its MGC obligations due to reasons other than a substantial change in economic policies including the policy regarding import/export of a commodity as a result of which the throughput could not be achieved, the same will not be a default of the obligations of the concessionaire.

### Tariff issues

While the TAMP determines the tariffs to be charged by major ports, non-major ports are free to set their own tariffs based on the market conditions. This puts business in the major ports in a disadvantageous position as ports are unable to offer the competitive tariffs. Further, TAMP only fixes the maximum tariffs that can be levied leaving it to the discretion of the port to fix tariffs subject to the maximum ceiling. However, ports usually do not prescribe lower tariffs. There has been a huge debate about the requirement of TAMP and operators have desired that ports/port operators should be allowed to fix the tariffs based on best practices. The MPA Bill aims at providing the ability to the port authority/concessionaire to fix tariffs based on market conditions.

## Foreign Direct Investment (FDI): Ports

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FDI needed to give boost to coastal shipping in India : Director-General (Shipping)

Ch R S Sarma | Visakhapatnam | Updated on August 16, 2019 | Published on August 16, 2019

In India, FDI of up to 100 % is permitted under the automatic route for port and harbor construction and maintenance projects. The GOI has also facilitated a 10-year tax holiday to enterprises that develop, maintain and operate ports, inland waterways and inland ports. In 2016, 19% of PPP projects have attracted foreign investors.

*Snapshot of an article in Hindu Business Line*

# Balancing of Risks of Concession Agreements

“The Leh-Manali Highway is the second highest altitude motor highway in the world…

# Balancing of Risks of Concession Agreements

Although the Government has launched and continues to work with great enthusiasm, many projects end up languishing or distressed. The forms of distress may vary but factors generally include the following:

- Lower than expected revenue
- Higher than expected costs
- Delays
- Variations in contractual specifications
- Disagreements between parties in relation to the cause and effect of their actions/inactions

Improper allocation of risks is identified as one of the key factors that leads to distress in projects, although not all risks can fit within the 4 corners of a concession agreement.

***One of the raisons d'etre of a concession agreement is that it provides for allocation of risks to the party who is most capable of bearing such risks. However, the general view is that Indian concession agreements have a very aggressive risk profile and private parties are not capable of bearing all the risks that are transferred to them.***

It may also be noted that risk positions set out in contracts are only as good as the management thereof by the two parties but in particular, the contracting authority.

*The Delhi Metro Rail Corporation (DMRC) on Tuesday agreed to take over the liability of INR 1,617 crore debt owed to banks by Reliance Infrastructure subsidiary DAMEPL, which pulled out of the Airport Express Line leading to a dispute.*

## Comparison with international projects

The DEA has compared risk allocation under Indian concession agreements against several foreign projects to examine the differences. What was discovered is that apart from allocation of risks to different parties, the way foreign concessions dealt with risks was also quite different. Further, Indian concession agreements also did not account for certain risks that were addressed in these foreign concession agreements.

A table setting out the way some of the risks are addressed in Indian NHAI MCAs as compared to foreign concessions based on the studies carried out by the DEA is set out in the following section.

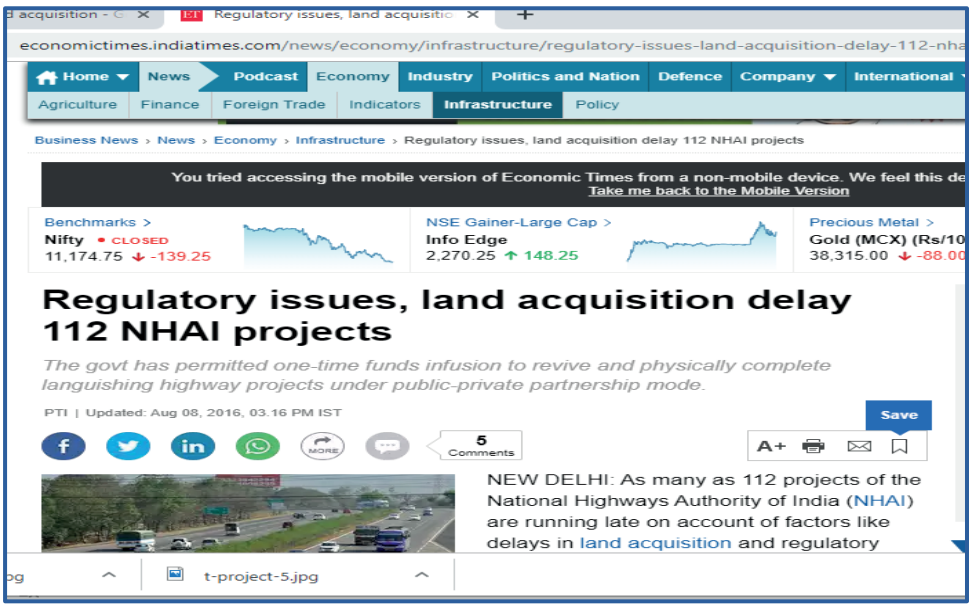
| SR NO. | ISSUES | INTERNATIONAL | | | INDIA |
|---|---|---|---|---|---|
| | | HOW DEALT WITH | PROJECT | CONTRACTUAL FORM | HOW DEALT WITH |
| 1. | **Site unavailable** | Land made available pre-financial close or Compensation Event | Lane Cove Tunnel and Gautrain | Compensation Event | Obligation to provide site within 150 days of agreement or penalty payable |
| 2. | **Regulatory Approvals Delayed** | Compensation Event / Renegotiation | Chapman's Peak Drive/ Lane Cove Tunnel | Compensation Event | Applicable permits is a Condition Precedent to the MCA |
| 3. | **Failure to Reach Financial Close** | Termination – mitigated by requiring underwriting | All projects require firm financial underwriting | Terminate and retender | Damages payable by the concessionaire to the NHAI |
| 4. | **Refinancing** | Refinancing gain share regulated. Prohibition on additional debt. Approval rights for public sector. | Lane Cove Tunnel | Amendments | Permitted with the consent of the NHAI |
| 5. | **Traffic Demand above Forecast** | No trigger unless results in Return of Equity above base case then sharing | Chapman's Peak Drive | Private party risk – no change | For every 1% increase in traffic a 0.75% decrease in concession period with a cap of 10% |
| 6. | **Traffic Demand below Forecast** | No trigger unless loan covenants breached then lender step-in/ liquidation/termination | Sydney Harbour Tunnel and Lane Cove Tunnel | Lender step In and substitution | If actual traffic falls below target traffic, for every 1% shortfall, the concession period, on payment of requisite concession fees will be increased by 1.5% subject to a cap of not more than 20% increase of concession period |
| | | Loan to private company to make good shortfall, repaid once debt service complete | Chapman's Peak Drive | Renegotiation | |
| 7. | **Uninsurable events** | Compensation by public party on no-better-no worse basis measured against base case financial model. This base case financial model is required to be provided by the concessionaire, audited and signed off by its lenders and reviewed by the public authority. | Melbourne Southern Cross Station | Compensation Event | Not Covered |

| SR NO. | ISSUES | INTERNATIONAL | | | INDIA |
|---|---|---|---|---|---|
| | | HOW DEALT WITH | PROJECT | CONTRACTUAL FORM | HOW DEALT WITH |
| 8. | **Changes in WPI pre-completion** | Standby equity used or Government Capital Grant increased by WPI | Gautrain | Private party risk – no change | Not Covered |
| 9. | **Changes in WPI post-completion** | No trigger as revenue WPI indexed | All | Private party risk – no change | Not Covered |
| 10. | **Accurate Reporting** | Audited accounts, inspections and audits, financial statements on 6 months' and year's performance; daily, monthly annual reports on traffic volumes and toll revenues | Sydney Harbour Tunnel and Lane Cove Tunnel and Chapman's Peak Drive | Amendments | Status reports in the form as provided under the MCA to be sent to the NHAI and the relevant IE on a monthly basis. Reports of unusual occurrences to be sent to the NHAI and the relevant IE on a daily, weekly and monthly basis. In BOT Toll projects, the concessionaire must additionally send monthly fee statements to the NHAI and the relevant IE, install electronic/computerized traffic counters and conduct traffic surveys and samplings as the NHAI may require. |
| 11. | **Delay to Completion** | If public party, then compensation for delay to place private party in no-better-no-worse position | Lane Cove Tunnel | Compensation Event | ▪ If fault attributable to the NHAI, the concessionaire will not be obligated to pay damages. COD will be modified accordingly.<br>▪ If fault attributable to a force majeure event, the concessionaire will not be obligated to pay damages. COD will be modified accordingly.<br>▪ If concessionaire fails to achieve a project milestone within 90 days of the contractually specified date, damages at a rate of 0.1% of the amount of Performance Security per day will be payable to NHAI until such milestone is achieved. |
| | | Loan to private company to make good shortfall, repaid once debt service complete | Lane Cove Tunnel | Relief Event | |
| | | If private party fault, then relief on completion granted relief and liquidated damages payable | Lane Cove Tunnel | Private party risk – no change | |

## Improper addressing of risks

Even where it appears that an issue is addressed in an MCA, it may not actually be true, given that the commercial reality flowing from the language of the contract differ from the intention of the persons drafting or because the actual practice on ground does not conform to the requirements of the contract. The DEA itself has acknowledged the issue and provided certain relevant examples of this:

- The NHAI MCA provides for an increase in the concession period in order to address variations in traffic volumes as a manner to address demand risk. However, this solution fails to consider that reduced traffic volumes result in reduced revenues that create an immediate cashflow problem for the concessionaire. Adding a period at the end of the original concession term may have a positive impact on the return on equity but would not ease the stress on the cashflows.
- Even where the risk of land acquisition is placed on the authority, the obligation is expressed in percentage terms i.e. a certain percentage of the extent of the land is required to be provided by a certain date. However, the materiality of the portion of land is not considered. This could result in a situation that a critical piece of land required for the development of the project is not provided by the authority; however, the obligations relating to construction imposed on the concessionaire would commence.




It is evident that the issues around risk allocation need to be addressed to ensure that the private developer is not distressed, leading to the project being stalled. Even from the perspective of the concession authority, if excessive risks are allocated to the private developer, such risks are usually either priced into the bid, thereby affecting its competitiveness, or such risks are not provided for by the developer as the developer may have presented an aggressive bid, thus jeopardizing the project.

It may be noted that issues around obsolescing bargains remain unaddressed. A developer who invests money during the construction period often loses bargaining power related to tariffs and other matters in case there are abrupt changes in the economic or policy environment, which are beyond his control. In such situations the developer is left to the mercy of the relevant government authority, with often very little recourse.

## Changes required

Various stakeholders have espoused their concerns to the DEA and the concession authorities. Common themes emerge as to certain changes that could be considered as desirable to the concession agreements themselves, as well as the framework for their implementation.

Some changes that may be considered to ensure better risk management and better implementation are:

## Change in scope provisions

Change in scope provisions in the concession agreements only provide for change in scope of work of the private developer up to certain percentage of the total project cost. However, for complex projects where the construction period can be quite long drawn out, greater change in scope may be required. A better mechanism for consultation and agreement on change in scope and compensation therefore would be necessary. Further, it is also necessary to clearly define what would amount to change in scope of work of the concessionaire. Concession authorities and concessionaires often dispute as to whether a certain work required to be done is or is not outside the agreed scope of work of the concessionaire.

### Case Study

In a road project in Andhra Pradesh, there was a substantial damage to the road project due to floods. As a result, the concession authority required the concessionaire to repair the damage and bring the project up to speed in accordance with the latest standards of repair and design. The concessionaire argued that the road project has been following earlier prescribed standards and that if the project was to be repaired as per the latest standards the same would be work outside its scope and would entail additional costs. While the authority argued that the repair and upgradation of the project as per the latest standards was within the scope of work of the concessionaire, the concessionaire argued that the concession agreement was not specific on whether the same standards were to be applied (as existed at the time of commencing the project by the concessionaire) while undertaking repairs or the latest standards were to be applied.

## Contract management and review

Contract management and review needs to be institutionalized and written into concession agreements. Currently, there is an inadequate mechanism established for contract management where reliance is placed on IEs appointed through a Government bid process. More focused public contracting agencies with the necessary expertise should be involved.

## Risks and sector specific concessions

Risk and sector specific concessions are the need of the hour. The terms and conditions of the concession agreements across many sectors/industries are common and, in many cases, identical as the MCA prescribed by the government for highway projects seem to have been applied to the same. This is particularly common in projects floated by state government agencies, for instance the desalination projects in the state of Gujarat. In many cases, drafts circulated along with the tender documents have clauses that are irrelevant to the project under consideration and one can identify that such clauses have been picked up indiscriminately from other MCAs. Consequently, project specific risks do not get addressed and lead to implementation as well as contractual issues and disputes between the concessionaires and concession authorities. Due to this, prospective bidders are seen to request numerous modifications of the terms of the concession agreement which is often seen by the bidding authority as request for substantial change in the terms of the concession.

The draft concession agreements which are usually floated with the bid documents should be appropriately modified keeping in mind the industry as well as the factual issues pertaining to the project in question. Consequently, negotiations on the terms of the concession agreements during the bid stage would be minimal and could lead to lesser litigations/disputes among stakeholders.

## Dispute resolution clauses

Dispute resolution clauses in concession agreements prescribe conciliation and arbitration for resolution of disputes between parties. However, the same have often proven to be time consuming. Before a matter is referred to arbitration, the parties are required to resolve their disputes mutually, failing which the dispute is referred to an expert panel prescribed in the concession agreement. Thus, before the matter can be finally submitted to arbitration, a substantial time is lost which may affect the ability of the parties to perform their respective obligations.

Further, the seat of arbitration in Indian concessions is usually within India which could also allow intervention of Indian courts while the dispute is pending the completion of arbitration proceedings. Lack of institutional arbitration leads to further delay and complications. Private parties (especially the ones where the private party is held or controlled by foreign investors) would however prefer the seat of arbitration in more evolved jurisdictions such as Singapore and the United Kingdom. The Pre-New Exploration and Licensing Policy regime oil and gas production and sharing contracts provided for foreign seat of arbitration.

Dispute resolution has been dealt with in detail in our chapter on 'Dispute Resolution in Concession Agreements'.

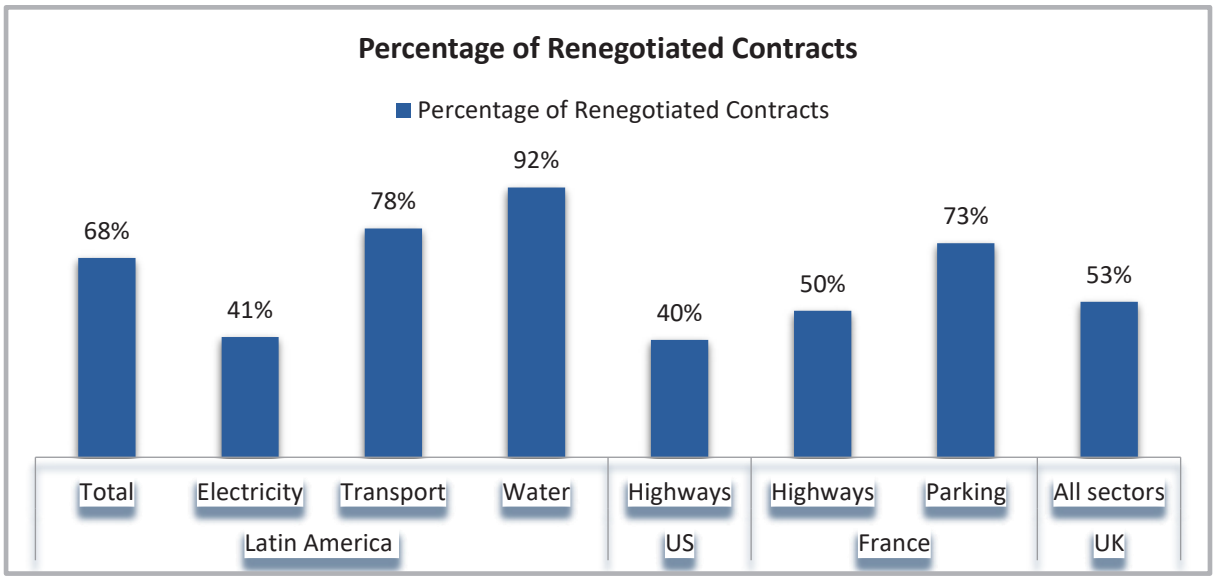
# Renegotiation of Concession Agreements

“India has over 275 billion tons of coal reserves: That’s the equivalent of 1.37 billion blue whales…

# Renegotiation of Concession Agreements

Renegotiation of PPP contracts is a common feature across mature PPP markets. However, Indian authorities have been resistant towards permitting such renegotiations despite numerous demands from the private sector as well as recommendations by the DEA and other advisors.

There are several instances of renegotiation in relation to PPP contracts across the world. A snapshot of the instances of renegotiation of PPP contracts across certain jurisdictions has been provided below as extracted from a report issued by the Organization for Economic Co-operation and Development (**OECD**) in 2014 written by J. Guasch and Others[66] (**Guasch Report**):




*Note: In South Korea, as of 2012, 168 projects were renegotiated*

Although the DEA has published reports recommending adoption of renegotiation within pre-determined frameworks, as mentioned in the previous chapters, presently there is no mechanism in India that would allow for such renegotiation. This despite the changing risk profile of a concession agreement through the passage of time and the life cycle of a project as well as their management. In the implementation of a concession agreement, the risk profile is only as good as the management thereof by both the authority as well as the concessionaire. However, a heavier burden towards such management should necessarily flow towards the authority. Where improper management puts the project at a disadvantage, a potential mechanism to salvage the same could be through contract renegotiations.

Whilst currently there is no framework, the Kelkar Committee Report mentions that the model clauses based on established thresholds for renegotiation were in the process of being drafted. However, the latest MCAs do not contain any such clauses permitting renegotiation.

## What is renegotiation?

Where there is any change in the contractual terms and conditions of an agreement other than revisions in payments in accordance with a mechanism specified in the agreement, a renegotiation is said to have taken place. As per Gausch Report a distinction would need to be made between changes that could be considered as renegotiation (that would require careful consideration) and those that would not as being in consonance with and pursuant to the contractual framework. A tabular summary of this is provided below:

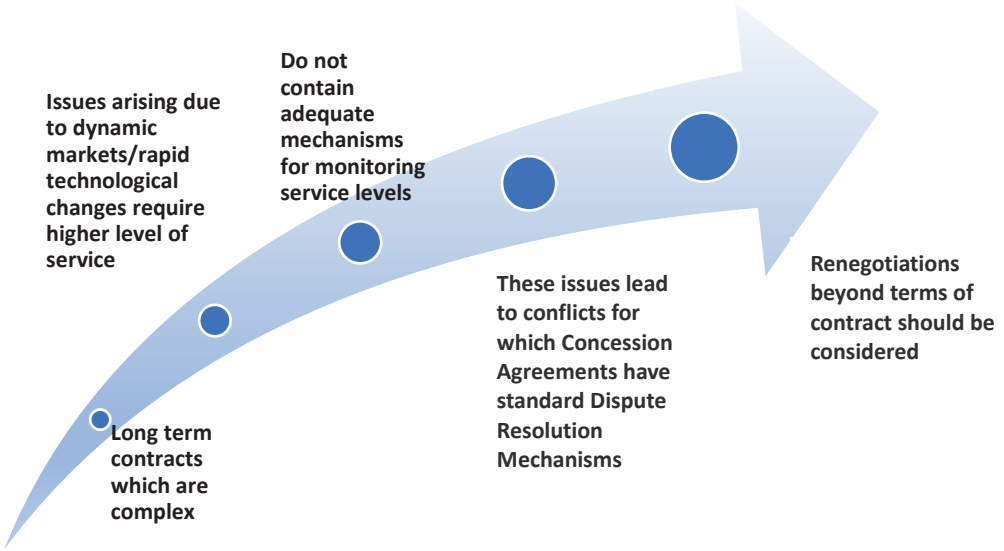
[66] Guasch, J. et al. (2014), "The Renegotiation of PPP Contracts: An Overview of its Recent Evolution in Latin America", International Transport Forum Discussion Papers, 2014/18, OECD Publishing, Paris. https://www.econstor.eu/handle/10419/109159

| Sr. No. | Renegotiation | Examples |
|---|---|---|
| 1. | A change in the risk matrix assignment and/or in the conditions of the contract | ▪ Reduce the level of services (airports, from IATA A to B)<br>▪ Defer or advance investments for several years<br>▪ Extension of the contract term<br>▪ Reduction guarantees (financial bonds)<br>▪ Increase the guarantee of the government (to pay lenders)<br>▪ Delays in the reduction of tariffs (tolls)<br>▪ Reduce the thresholds of the economic equilibrium of the contract, etc. |
| 2. | A change in project scope (if this was not regulated in the contract). | ▪ Government requests new investments<br>▪ Reduction of fees for the government<br>▪ Avoid bankruptcy of the operator<br>▪ Changes on the contract scope, etc. |

However, the following actions would not be considered as renegotiation:

- Tariffs are adjusted with a formula set it by the contractor indexed by inflation or another index
- Triggers are activated and eventual investments become mandatory
- Payments to operator if they are regulated in the contract, etc.
- Corrections of errors in the contract, which do not create obligations, commitments or contingencies (typos, contradictions that affect the implementation for the PPP contract, etc.)

## Need for renegotiation




Typically, concession agreements tend to be long-term contracts with terms spanning 15-30 years. Further, concession agreements tend to be complex and detailed. However, not all post-award scenarios are envisioned at the time of their execution. Often concession agreements do not contain adequate mechanisms for monitoring of service levels. The probability of issues arising due to the dynamic markets due to increases in demand/traffic, rapid technological changes or requirements for higher service levels is certainly high. These issues lead to conflicts for which concession agreements

contain standard dispute resolution mechanisms such as mediation and arbitration. However, renegotiation beyond terms of the contracts is also an avenue that should be considered. This is to ensure that the benefits of the project continue to be made available to the public as well as reduce the burden on dispute resolution apparatus.

Although the DEA in its reports has recommended renegotiation of contracts under a stringent framework, currently there is no such renegotiation in process. However, even then, it is well recognized that there could be a moral hazard in allowing for such renegotiation. The DEA Report 2015 contains an observation that typically such calls arise from the private party and often such requests are premised towards maintaining a required return on investment or preventing a default under financing agreements undertaken by the private party or avoiding certain risks and therefore renegotiations may not be in the best interest of the public concession authority.

## Potential perils and disadvantages

Some of the concerns relating to renegotiations are:

- Often such requests are opportunistic and geared towards ensuring certain financial outcomes for the private party
- Renegotiations could eliminate the competitive effect of the bid process including transparency, especially where they occur in a short time after bidding. This could result in questioning of the credibility of the model/program
- There could be asymmetric information and lack of negotiation skills of public sector and lack of competitive pressures to renegotiate the contract
- Renegotiations could result in the distortion in public tender, in that the most likely winner is not the most efficient operator but the most expert/qualified in renegotiations
- Renegotiations could decrease the benefits/advantages of PPP and the welfare of users
- There would most likely be a fiscal impact by increasing liabilities to the Government

Certain competition law issues in relation to above are set forth in the chapter on 'Competition Law Issues in Concession Agreements'.

## Proposed framework

The DEA in the DEA Report 2014 has suggested a certain framework for renegotiation of concession agreements. Further, the Kelkar Report also contains certain guidelines for adopting such a mechanism. It is important to consider these recommendations as they would likely inform the policy of the government in this regard. Certain key suggestions from both the reports are set out below:

- **Authority Approval.** Given that the concession authority would be interested in the outcomes of a concession agreement renegotiation, it would not be suitable for the same authority to decide on the necessity for renegotiation or to oversee its negotiations or oversee the outcome. Therefore, an independent authority would be better suited to undertake the process.
- **Fiscal Oversight**. As renegotiation can have significant financial outcomes, fiscal oversight commensurate to that involved in the original contract award would be necessary.
- **Technical Panel.** Independent panels for each sector comprising technical sector experts empowered to hear disputes relating to amendments to the concession agreements may be set up similar to existing

regulatory bodies such as the Telecom Regulatory Authority of India (**TRAI**) and the Central and State Electricity Regulatory Commissions (**CERCs and SERCs**).

- **Standardized Benchmarks**. There should be standardized benchmarks to determine whether a case is worthy of renegotiation to promote consistency. These benchmarks should include:
  - Evidence that the project distress is material and likely to result in default under the concession agreement at some future point should the default continue
  - The project distress was not caused by the private party and likely to cause adverse outcomes for the government and/or users of the project
  - Evidence that it is likely that the direct cost implications for the government are less than the financial outcomes of doing nothing if the concession agreement is being renegotiated
  - The renegotiation is likely to have social benefits or avoided costs that provides better long-term outcomes
  - The renegotiation does not involve materially different terms of risk allocation to the Government
- **Disallowed Grounds**. There would be no renegotiation of contracts on the basis of the following grounds:
  - Any event of distress that was foreseeable at the time of financial close
  - Any event that would affect the concessionaire as any other company in its ordinary course of business (for example general changes in law)[67]
  - Any impact arising from assumptions made or risks taken by the concessionaire in preparing its bid
  - Any impact arising directly or indirectly from any act or omission of the concessionaire
  - Any failure of any associated party to the concessionaire to perform or provide finance to the concessionaire
- **Program Perspective**. The DEA in the DEA Report 2014 recommends that a program-wide approach towards renegotiations of concession agreements be adopted to enable the Government to monitor and manage renegotiations across all sectors. Further, if certain issues appear to be widespread, the risk allocation in new concession agreements may be altered from the beginning to obviate the necessity for renegotiation subsequently. Therefore, for each sector, the Government may monitor:
  - Number of projects in distress (so that if above a certain percentage, a program-wide approach rather than a project-by-project approach can be taken)
  - Causes of distress (so that systemic factors can be identified)
  - Adequacy of contractual mechanisms to deal with such distress
  - Adequacy of contract management systems to deal with or avoid such distress

[67] Although this is mentioned in the DEA Report 2014, typically concession agreements in India do have detailed provisions relating to the effects of change in law and the sharing of such risk.

# Broader Issues in Infrastructure Projects

“India is building the world’s highest railway arch bridge in Jammu and Kashmir over the river Chenab (which would be about 35 meters taller than the Eiffel Tower)…

# Broader Issues in Infrastructure Projects

As has been discussed in the previous chapters, concession agreements suffer from several issues by reason of their inflexibility and improper risk allocations. *However, it has become increasingly clear that beyond the risks inherent in the concession agreements and lacunae therein, there exist systemic issues that have led to implementation hurdles and stagnation of infrastructure projects.* It is evident that changes at an institutional level would be required apart from changes to the concession agreements.

Some such changes are:

## Legal framework

As discussed earlier, in India, there is no centralized legislative framework on PPPs, instead, the Ministry of Finance, has issued various guidelines, policies and manuals on procurement of PPPs and other related aspects. PPP for procurement of goods and services is governed by a combination of the Constitution and certain rules, procedures, and manuals as set out below:

- General Financial Rules, 2017
- Delegation of Financial Powers Rules, 1978
- Manual on Policies and Procedures for Purchase of Goods, 2006
- Central Vigilance Commission Guidelines relating to certain matters, including guidelines on prequalification criteria, increasing transparency in procurement process, integrity pact between the procurer and the prospective bidders
- Specific PPP legislations in many states

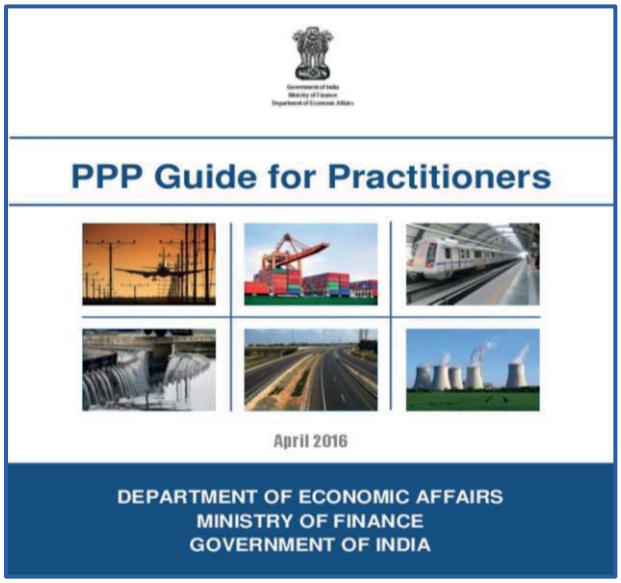
It is often felt that the lack of an overarching legal framework for PPPs leads to institutional issues as currently PPPs function under a patchwork of Central and State laws that do not always work cohesively. Very few States have specific laws that address PPPs.

Although several policies have been put into place, the ability of a private party to actually enforce such policy is quite limited. It may therefore be useful for a clear legal framework to be crafted for PPPs. However, it should be borne in mind that the legislative process is long drawn out and far from certain, therefore any such law could end up bringing inflexibility to the PPP process, if not carefully framed.


*A screenshot of an article in Economic Times (August 29, 2019) on the centre pulling up state governments for not investing in the upkeep of state roads, that have been given "in principle'' approval to be declared as national highways*

## Project preparation

A common complaint is that the projects are not well conceptualized from their inception. There is often no clarity on issues around land availability and permissions or feasibility. Even when the Government employs resources to line this up, given the lead time between bidding and awarding the contract, ground conditions may change, and developer's risk assessment may be skewed. The World Bank has made available a PPP toolkit to help government officials devise PPP projects. The DEA has also issued a 'PPP Guide for Practitioners' in April 2016 recognizes the issue and states "*Practitioners of PPPs within the Government at its different tiers across the country lack the competence and skill set to conceptualize, structure and implement projects.*" It aims to serve as a manual for practitioners to develop projects through appropriate PPP frameworks. However, each project should be viewed individually, and authorities should let go of their ivory tower approach at the inception stage of the project.




Typically, the obligation of acquiring and providing land required for the project, lies with the concession authority (as it is better placed and equipped to do the same). The concession agreements merely provide for extension of the term of the concession agreement or very limited compensatory damages in the event of delay by the authority in acquiring the land. Consequently, the implementation of projects is delayed, and the project suffers heavy cost overruns. This leads to disputes between the concession authority and the concessionaire[68]. It would be preferable that the government acquires a substantial portion of land required for the project before the project is put up for private participation. Also, prior to floating draft contracts, it is advisable that the same be legally vetted to ensure that various conflicts existing within the terms of the draft agreement are upfront addressed and the authorities are also sufficiently apprised of the possible legal risks before committing to such arrangements.

## The issue of 'instrumentality of state'

This issue can be best described via the Flemingo Duty Free Case.

### Case study

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.

[68] A major number of disputes between a concession authority and the concessionaire in the road projects revolve around availability and handing over of possession of the land by the authority to the concessionaire.

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[69] of the Constitution of India (**Constitution**) or even if it was not a 'State' was it amenable to writ jurisdiction under Article 226[70] 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% 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.

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 touchstone of fairness and reasonableness.

[69] 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

[70] 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.

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*[71], 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. In 2011, the Central Information Commission (**CIC**) had vide an order dated May 30, 2011, declared that the MIAL is a 'public authority'. Subsequently MIAL challenged the order in the High Court of Delhi. The Delhi High Court vide an order dated May 17, 2019 set aside the CIC's order and remanded it back to CIC for fresh consideration since the CIC in an earlier case of *Satya Prakash Rathee v. Delhi International Airport Ltd. & Ors,* which related to Delhi International Airport Limited (**DIAL**) held that DIAL did not come under the purview of 'public authority' under the Right to Information Act, 2005. Considering the MIAL was similarly placed to DIAL, the matter was remanded for fresh consideration.

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.

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

## Capacity building

Connected with the above, capacity creation in both the public and private sector for implementation of projects through a PPP scheme is lacking. The Kelkar Committee specifically recommends that the Government undertake capacity building measures including by preparation of knowledge modules for different stakeholders.

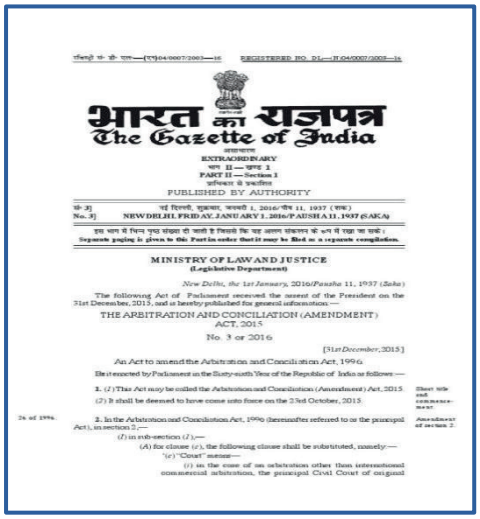
## Knowledge building

The Kelkar Committee recommends that a mechanism for collation of data to help with decision making be developed. Currently, there is no accessible database of projects, issues therein and the manner in which they are/were addressed. Such data would definitely help in identifying systemic issues, making available solutions that worked in earlier projects and gradually introduce consistency in approach.

## Unrealistic bidding

Aggressive bidding by bidders has led to a lot of stagnancy in the sector. Projects often undergo cost overruns with the developers ending up borrowing greatly from banks and financial institutions, tying up money due to inadequate risk assessment by the developer. Demands for renegotiations also arise from such projects. Although, in some cases renegotiations may be justified, in such cases such asks should be discouraged.

## Dispute resolution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EXTRAORDINARY
PART II—Section 1
PUBLISHED BY AUTHORITY

No. 3] NEW DELHI, FRIDAY, JANUARY 1, 2016/PAUSH 11, 1937 (SAKA)

MINISTRY OF LAW AND JUSTICE
(Legislative Department)

New Delhi, the 1st January, 2016/Pausha 11, 1937 (Saka)

The following Act of Parliament received the assent of the President on the 31st December, 2015, and is hereby published for general information:—

THE ARBITRATION AND CONCILIATION (AMENDMENT) ACT, 2015

No. 3 OF 2016

[31st December, 2015]

An Act to amend the Arbitration and Conciliation Act, 1996.

Long drawn out dispute resolution processes. Although a Public Utility (Resolution of Disputes) Bill was mooted, it has yet not been introduced in the Parliament. Usually concession agreements provide for dispute resolution through arbitration. Although arbitration is mooted as a method to avoid a lengthy court dispute, due to jurisprudence developed in India, many awards end up being challenged and unfortunately, arbitration ends up often as a step prior to litigation rather than finally resolving a dispute. Interestingly, the Commercial Courts, Commercial Division and Commercial Appellate Division of High Courts Act, 2015 provides that disputes relating to infrastructure contracts would be considered as commercial disputes. Further, a welcome change has been incorporated in the Arbitration and Conciliation (Amendment) Act, 2015 which mandated that the arbitrator must be independent and impartial. This would bring a lot of confidence in private developers considering that it was not uncommon for the concession authority to mandate that its own employees or officers would act as arbitrators in the case of disputes. Also, a recent amendment to the Specific Relief Act, 1963 prevents courts from granting injunctions in respect of infrastructure projects i.e. transport, energy, communication, water and sanitation, and social and commercial infrastructure and such other projects notified in the schedule of the Specific Relief Act, 1963 where such injunctions would cause impediments or delays in the progress completion of such infrastructure project.

## 3P India

PPPs in India face a plethora of challenges ranging from low equity participation, poor project preparations, limited lending etc. To address many such challenges, the government in its Union Budget 2014-2015 proposed to set up a mechanism to provide support to mainstream projects. This commonly came to be known as the '3P India'. An initial fund of INR 500 crores was also allocated for the purposes of 3P India. News articles reported that 3P India would have no regulatory powers, but will look at a whole gamut of issues obstructing the growth of PPPs in India such as facilitating nuanced and sophisticated MCAs, bidding process, dispute resolution mechanism, project appraisals, looking into finance structure and management contracts etc. However, 3P India has not yet been established.

# 25 Issues to be Considered in M&A Transactions in the Infrastructure Sector

“

**The number of people travelling in the Indian Railways every day is equal to the population of Australia…**

# 25 Issues to be Considered in M&A Transactions in the Infrastructure Sector

While the general issues pertaining to concession agreements have been discussed in the earlier chapters, set forth below are some issues that have been encountered/may be relevant to consider in M&A transactions in the infrastructure sector. The list of issues below is merely indicative and not exhaustive.

## Vires versus Concession Terms

- One would assume that a concession agreement is fully enforceable against the relevant authority. Please do consider the legal framework from which the rights to the relevant authority and that to the concessionaire flow. For example, national highways in India vest in the Union and the enabling statute[72] gives a limited set of powers to the NHAI. Hence, there may be limitations on the powers of NHAI itself to delegate the function of developing, maintain and managing the national highways. Similarly, if the highways are merely 'entrusted' and do not 'vest' in the NHAI, there could be limitations on the delegation to a concessionaire.

## Change in control

- Private sector involvement in infrastructure projects has helped bridge the gap between the available public resources and the required investment. Amongst the numerous considerations taken into account by a private player whilst investing in an infrastructure project, the prospects of exiting from the project is a crucial issue. SPVs are usually floated for investments in the infrastructure sector, either as subsidiaries of a single promoter group or in collaboration with a joint venture partner (who could be a foreign investor). As projects are allocated to pre-qualified bidders having the requisite financial and technical expertise, change in control provisions in concession agreements seek to discourage divestment of stakes in infrastructure projects typically until the project is up and running. Such restrictions (which could be restrictions on change in equity interest, control or management of the project company) usually continue to apply at least up to 18 months from the Project COD.

- In many cases such as the Hyderabad Metro Rail Project, the restriction applies throughout the term of the concession agreement. For instance, under the TOT NHAI MCA of 2017, the aggregate holding of the selected bidder together with (its/their) associates, in the issued and paid-up equity share capital of the concessionaire is prohibited to decline below 51% during the first 2 years of the concession period (which commences from the date of satisfaction of the conditions precedent). Each member of the consortium whose technical and financial capacity was evaluated for the purposes of pre-qualification and short-listing is required to hold at least 26% (along with its associates) of such equity during the first 2 years of the concession period. Identical restrictions are prescribed in the 2018 MCA for major ports in India with an additional obligation on the successful bidder/consortium members to also maintain the 'Management Control'[73] of the project company until expiry of 2 years from the COD. Certain concession agreements (such as the Hyderabad Metro Rail Project)

[72] National Highways Act, 1956 and the National Highways Authority of India Act, 1988.

[73] Under the 2018 Major Port MCA, "**Management Control**" means the possession, directly or indirectly of the power to direct or cause the direction of the management and policies of the Concessionaire, whether through the ownership of voting securities, by contract or otherwise or the power to elect or appoint more than 50% (fifty percent) of the directors, managers, partners or other individuals exercising similar authority with respect to the Concessionaire.

recognize a mere change of 15% in the direct and/or indirect shareholding as change in control/ownership of the project company.

- In most concession agreements, the 'change in control' concept is linked to control as defined under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. However, the concept of 'control' has not yet clearly evolved under Indian jurisprudence. In *Subhkam Ventures (I) Private Limited vs. The Securities and Exchange Board of India*[74], the Securities Appellate Tribunal (**SAT**) delved into whether protective provisions in a shareholders' agreement (i.e. affirmative vote items) amounted to 'control'. The SAT observed that 'control' is a positive power and not a negative power and accordingly held that a person having the power to appoint majority of the directors, control the management or policy decisions, or exercise day to day operation control over the business of a company would be in 'control' of that company. On the other hand, provisions meant solely to ensure standards of good corporate governance and to protect the interests of the shareholders were held to fall short of 'control'. However, upon an appeal by SAT, the Supreme Court[75] ruled that the aforesaid decision would not be a precedent.

- Subsequently, in *the matter of acquisition of shares of Jet Airways (India) Limited*[76], the Securities and Exchange Board of India (**SEBI**) held that the acquisition of shares of Jet by Etihad did not amount to a change in 'control' as both tests, namely right to appoint majority of the directors and the right to control management or policy decisions were not fulfilled. In 2016, SEBI also came up with a discussion paper on 'Brightline Tests for Acquisition of 'Control' under the SEBI Takeover Regulations'. Vide the aforesaid discussion paper, SEBI proposed to distinguish between protective rights (*i.e. veto rights not amounting to control*) and participative rights (*i.e. rights which would amount to control*). Thereafter, SEBI observed that covenants enable the exercise of certain checks and controls on the existing management for the purpose of protecting the interest of the investors rather than formulating policies to run the company would not amount to 'control'. In the latest of the series of decisions on 'control', the Supreme Court[77] relied on the observations of the SAT in the *Subhkam Ventures* case regarding positive and negative 'control', albeit in the context of insolvency law. Accordingly, the issue has still not been put to rest.

- The lack of clarity on the concept of 'control' and ambiguous exit provisions in concession agreements often gives rise to an uncertainty. For instance, concession agreements usually prescribe restrictions on changes in shareholding, control and management of a concessionaire. However, such agreements are silent on whether any approval of the concession authority is required if there is a change in shareholding or management of the holding company (effectively leading in the indirect change in control and/or holding of the concessionaire).

  In such a scenario, the selling shareholders of the holding company could argue that since the concession agreement does not expressly restrict the change in shareholding and/or control of the holding company, no prior consent of the authority would be required. On the other hand, investors while taking a cautious stand could argue that the concession was awarded to the project SPV based on the technical and financial credentials of the bidding consortium/holding company of the concessionaire. Thus, transfer of the stake of existing shareholders of the holding company to a new investor could be construed effectively as the change in control thereby requiring prior consent of the authority. Although, the investors would desire that prior approval of the authority be obtained before investment in the holding company, (i.e. for the proposed indirect investment in the concessionaire), the selling shareholders of the holding company may not want to approach the authority. This is due to the fear of refusal and/or unreasonable delay in receiving response from the authority. Further, once the concessionaire has approached the authority for seeking the approval for an investment, the concessionaire/selling shareholders may be compelled to seek approval from the authority for subsequent investments as the concessionaire/selling shareholder would have set a precedent of approaching authority prior to investments.

[74] Appeal No. 8 of 2009 decided on January 1, 2019.

[75] Securities and Exchange Board of India vs. Subhkam Ventures (I) Private Limited, Civil Appeal No. 3371 of 2010 decided on November 16, 2011.

[76] WTM/RKA/CFD-DCR/17/2014 decided on May 8, 2014

[77] ArcelorMittal India Private Limited vs. Satish Kumar Gupta and Others, 2018(13)SC ALE381

- In due diligences, we often observe that the shareholding and management of the concessionaire changed multiple times over the years without any approvals from the authority (despite the concession agreement expressly requiring the same). More often than not, the selling shareholders do not want to go back to the authority to regularize the non-compliance as the same could be construed by the authority as a breach of the concession agreement and consequently a default thereunder.
- If the selling shareholders are unwilling to approach the authority for seeking its: (i) prior consent for the investment; and (ii) post facto regularization of past non-compliances (as discussed above), the parties may consider intimating the authority of the proposed changes in shareholding and/or control of the project SPV, after execution of the investment agreements. The intimation may also incorporate details of the change in the shareholding and management of the concessionaire from time to time until date. It may be agreed in the investment agreement that the closing of the investment transaction would take place after a mutually agreed period has passed since the intimation to the authority and no objection and/or show cause has been received from authority until the scheduled date for undertaking closing actions. Although this will not be a fool proof mitigation to the issues in question, parties may derive some comfort if the authority has not issued any objections until the date on which the closing actions were to take place.

## Pricing of shares and assured returns

- The Foreign Exchange Management Act, 1999 (**FEMA**) prescribes guidelines for pricing of shares in case of: (i) issuance of shares by Indian companies to persons resident outside India; and (ii) transfer of shares between persons resident in India and persons resident outside India[78]. While parties to a transaction may have certain pricing for investments or exit in mind, the same cannot be agreed upon unless they are in accordance with the pricing guidelines prescribed under Indian foreign exchange laws.
- An obvious expectation of an equity investor would be a post-tax assured return on its investments at the time of exit. However, Indian counter parties have often attempted to avoid their obligations to provide assured returns to non-resident investors despite agreeing for the same under commercial contracts. This is because assured returns on investments in India under the guise of equity investments are not permissible under Foreign Direct Investment policy of the GOI and under the Indian foreign exchange laws. The principle laid down under FEMA is that a person resident outside India should not be guaranteed any assured exit price at the time of making an investment and should exit at the price prevailing at the time of exit. The GOI and the RBI have always discouraged arrangements that even hint of assured returns as the same would otherwise be akin to a debt transaction which is regulated differently under Indian laws. In the past, Indian courts have also struck down innovative investment structures viewing them as colourable devices to circumvent the prohibition of assured returns.
- However, recent judgments of Indian courts seem to have significantly impeded the ability of counter parties to avoid assured payment obligations, by allowing payouts in the form of damages for contractual breach. Indian courts have also held that parties cannot be permitted to derogate from their contractual obligations merely by alleging violation of exchange control regulations at a belated stage.

[78] Issuance of shares of an Indian company to a non-resident or transfer of shares from a resident to a non-resident shall not be lower than the fair market value (**FMV**) arrived at internationally accepted pricing methodology for valuation on an arm's length basis, duly certified by a Chartered Accountant or a SEBI registered Merchant Banker or a practicing Cost Accountant. Cannot be lower than the FMV to be determined in accordance with pre-approved valuation norms. Similarly, any transfer of shares of an Indian company held by a non-resident to a resident Indian cannot be at a price which is more than the FMV to be determined in the same manner. In case the issuance or transfer is of shares of a listed company, the valuation is to be done in accordance with the guidelines prescribed by the Securities Exchange Board of India.

## Case Study

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Telecom News | Telecom Policy

**Tata Sons may have to pay over Rs 1,500 crore GST on Docomo payout**

*The Directorate General of GST Intelligence is probing Tata Sons' $1.2-billion payment to NTT Docomo in 2017.*

ET Bureau | Updated: May 08, 2019, 08.51 AM IST

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15 Comments

A+

*Agencies*

NEW DELHI: Tata Sons may be staring at a tax demand of over Rs 1,500 crore related to its settlement with former telecom venture partner NTT Docomo following an investigation by the Goods and Services Tax authorities, a senior government official told ET.

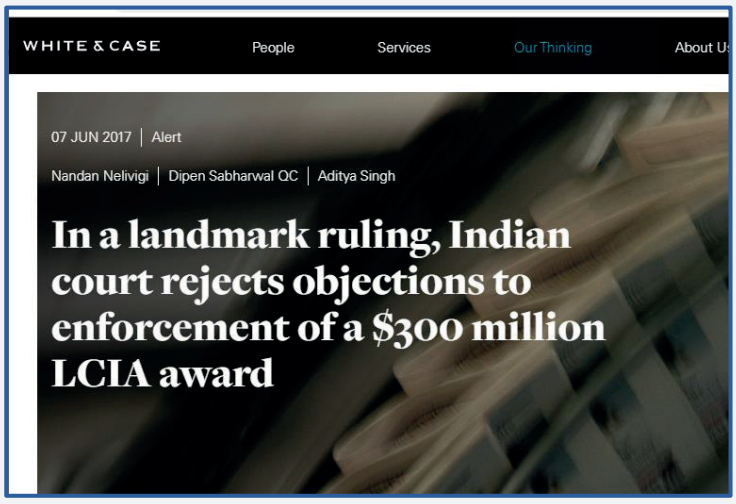
The Directorate General of GST Intelligence is probing Tata Sons' $1.2-billion payment to NTT Docomo in 2017 following the settlement reached in a three-year dispute

*Tax experts said this provision may not be applicable in the Tata-Docomo case because their settlement was*

For instance in *Docomo vs. Tata* (2017) 142 SCL 252 (Del) the shareholders' agreement executed between the parties in respect of investments by Docomo in Tata Tele Services Limited (**TTSL**) provided that if TTSL fails to meet certain performance indicators, upon request of Docomo, Tata will find a buyer for Docomo's shares in TTSL at a price which is the higher of: (i) 50% of the price at which Docomo purchased the shares; or (ii) the FMV of those shares as on March 31, 2014[79]. Tata could not find a buyer at the desired price as a result of which Docomo exercised its 'put option' requiring Tata to acquire its shares at the desired return. The acquisition of shares of Docomo by Tata was disallowed by RBI. This led to arbitration between the parties. The arbitration tribunal held that Tata was in the breach of the terms of the shareholders' agreement as it did not perform its alternate obligations. Hence as per the arbitral tribunal, Tata was liable to pay damages to Docomo. The Delhi High Court allowed enforcement of the arbitral award observing that the award was in the nature of damages and therefore there was no violation of the exchange control regulations. The High Court observed:

> *"The first part of that clause imposed on Tata an unqualified obligation to find a buyer of the Sale Shares on the terms that Docomo received the Sale Price by 3rd December 2014. Tata has admittedly failed to perform this obligation. Tata cannot rely on its purported performance under the second part of the Clause 5.7.2. The alternatives provided for in the second part were only available to Tata if it was able to perform in fact and in law. The FEMA Regulations do not excuse non-performance. It is common ground that there were methods of performance of obligation in question which were covered by general permissions under FEMA."*
>
> *"It was held that the promise was valid and enforceable because sub-regulation 9(2)(i) of FEMA 20 permitted a transfer of shares from one non-resident to other non-resident at any price. The AT held that Tata could have lawfully performed its obligation to find a buyer at any price, including at a price above the shares' market value, through finding a non-resident buyer. Its failure to do so was, according to AT, a breach entitling Docomo to damages."*

[79] The shareholders' agreement between Tata and Docomo was executed in 2009.




In another case of *Cruz City 1 Mauritius Holdings vs. Unitech Limited* 239 (2017) DLT 649, the Delhi High Court in April 2017, has upheld the enforcement of foreign award in India, notwithstanding the FEMA restrictions. It held that violation of FEMA is not a violation of the 'public policy of India'[80] in so far as the question of enforceability of foreign award is concerned.

Cruz City was entitled to exercise a 'put option' on its shares on one of the shareholders of the joint venture company (**JVC**) at a price that yielded a post – tax IRR of 15%, in the event of delay in commencement of construction of an Indian real estate project. It was also separately agreed that in case such shareholder was unable to honor the 'put', Unitech will infuse the required monies in the JVC. The project was delayed, and Cruz City exercised its put option. Upon failure of the shareholder and Unitech to pay, Cruz City invoked arbitration and procured a favorable order. The London seated arbitration tribunal passed awards against Unitech companies to pay an amount of nearly USD 300 million in exchange for Cruz City's shares in the JVC with Unitech. Part of the award was sought to be enforced in India which was challenged by Unitech on many grounds. The Delhi High Court rejected all the objections against enforcement, thus paving the way for Cruz City to take steps to execute the award in India.

Unitech argued that the award as well as the monetary reliefs granted thereunder, were allegedly in violation of the FEMA, the enforcement of the foreign award would result in a violation of the exchange control laws of India (i.e. FEMA). Violation of a national law (FEMA) would be contrary to the public policy of India. The court found that FEMA does not render foreign exchange void in case of any procedural non-compliance (such as failure to seek Government/RBI approval). In fact, FEMA itself permits non-compliance to be addressed through compounding (i.e. monetary penalties) as well as granting of permissions/approvals after the execution of transactions.

Unitech further contended that given the violation of the FEMA, the RBI is not likely to grant its approval for remittance under the award and therefore the enforcement should be declined. The court therefore held that the necessity to seek prior RBI approval before remitting funds offshore from India, is insufficient to refuse the enforcement of a foreign award. In a passing the court observed "*notwithstanding that Unitech may be liable to be proceeded against for violation of provisions of FEMA, the enforcement of the Award cannot be declined*".

The court also observed:

> "*Unitech' s contention that structure contemplated under the Keepwell Agreement read with the SHA provided an assured return at a pre-determined rate to Cruz City and this was a flagrant violation of FEMA and Regulations made thereunder, is also bereft of merit. The Put Option provided to Cruz City under the Keepwell Agreement could be exercised only within a specified time and was contingent on the Santacruz project not being commenced within the prescribed period. This was not an open-ended assured exit option as is sought to be contended by Unitech. Cruz City had made its investment on a representation that the construction of the Santacruz Project would commence within a specified period. Plainly, if the construction of the Santacruz Project had commenced within the specified period – that is, by 17.07.2010 – Cruz City would not be entitled to exercise the Put Option for exiting the investment. Further, the Put*

[80] Enforcement of international arbitration awards in India, can be challenged on the ground that the same is against the 'public policy' of India. However, Indian courts have restrictively interpreted 'public policy' in the context of enforcement of international arbitral award in India.

*Option could only be exercised within a fixed time period of 180 days and the said option would be lost thereafter.*

*The reliance placed by Unitech on the RBI circulars dated 09.01.2014 and 14.07.2014 is also misplaced. In terms of RBI's circular dated 09.01.2014 optionality clauses granting assured returns on FDI are proscribed. However, it is doubtful whether the said circular would be applicable to cases where a foreign investor founds its claim in breach of contract. Plainly, if an investment is made on representations which are breached, the investor would be entitled to its remedies including in damages. The aforesaid circulars proscribe assured return instruments brought in India under the guise of equity. However, in the present case, Cruz City is only seeking to enforce its obligations against Burley, an overseas entity*."

It should however be noted that the above precedents have their own peculiar facts. The investor will need to demonstrate to the courts that the investment terms were not merely a colourable device to circumvent legal restrictions but adequate grounds and bona fides exist for the claim of such damages.

Additionally, it is important to note that Section 67 of the Companies Act, 2013, subject to three specified exemptions, prohibits a public company from giving, whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of, or in connection with, a purchase or subscription made or to be made, by any person of or for any shares in the company or in its holding company.

## Bidding for Projects and Black Listing

- RFPs issued by Government authorities such as the NHAI usually require bidders of projects to confirm whether the bidder or any constituent of the consortium/joint venture has been barred by the Central/ State Government, or any entity controlled by it, from participating in any project (regardless of the mode of implementation of the project). Entities who are so disbarred aren't eligible to submit bids, whether individually or as a member of the consortium. Accordingly, at the time of submission of bid documents, it would be important for entities applying for the project to ascertain whether any of them are prohibited from participating in the project as envisaged in the RFP.
- RFPs also indicate that bidders (including all of their joint venture members) failing to physically submit the original documents would be unconditionally debarred from bidding in NHAI projects for a specified period (which can go upto 5 years from the date of issue of debarment notice). In this regard, questions have arisen as to the authority of NHAI to blacklist or debar entities from bidding in projects.

### Case Study

In *Patel Engineering vs. Union of India and Others* (AIR 2012 SC 2342), the Supreme Court delved into the question whether it was legally permissible for the NHAI to blacklist a company on the ground that it declined to enter into a valid contract after it had been declared as the successful bidder. In this case, the Supreme Court observed that though the NHAI is a statutory body, its authority to blacklist is not based on any express statutory provision. The Supreme Court noted that blacklisting has the effect of preventing a person from the privilege and advantage of entering into lawful relationship with the Government for purposes of gains.

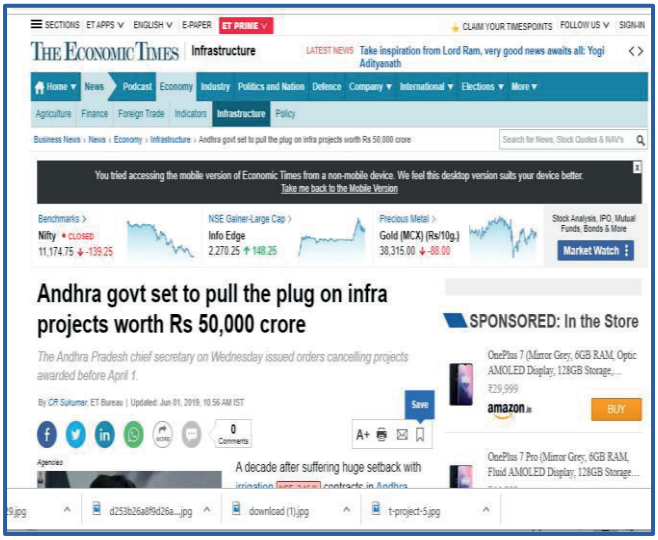
As regards the validity of a debarment by the NHAI on grounds which were not expressly stated in the bid document, the Supreme Court observed as follows:

> "*The 2nd Respondent, being a statutory Corporation, is equally subject to all constitutional limitations, which bind the State in its dealings with the subjects. At the same time, the very authority to enter into contracts conferred under Section 3 of the NHA Act, by necessary implication, confers the authority not to enter into a contract in appropriate cases (blacklist). The 'bid document' can neither confer powers, which are not conferred by law on the 2nd Respondent, nor can it subtract the powers, which are conferred by law either by express provision or by necessary implication. The bid document is not a statutory instrument. Therefore, the rules of interpretation, which are applicable to the interpretation*

*of statutes and statutory instruments, are not applicable to the bid document.* ***Therefore, in our opinion, the failure to mention blacklisting to be one of the probable actions that could be taken against the delinquent bidder does not, by itself, disable the 2nd Respondent from blacklisting a delinquent bidder, if it is otherwise justified. Such power is inherent in every person legally capable of entering into contracts.***"

Generally, as regards the State's power to blacklist, the Supreme Court held that the State can decline to enter into a contractual relationship with a person or a class of persons for a legitimate purpose. The authority of State to blacklist a person is a necessary concomitant to the executive power of the State to carry on the trade or the business and making of contracts for any purpose, etc. There need not be any statutory grant of such power. The only legal limitation upon the exercise of such an authority is that State is to act fairly and rationally without in any way being arbitrary - thereby such a decision can be taken for some legitimate purpose. The Supreme Court further observed that the legitimate purpose that is sought to be achieved by the State in a given case could vary depending upon various factors.

## Renegotiation of contracts by the Government




- Indian PPP contracts do not allow re-negotiation of concession agreements. A project is vulnerable to changes/cancellation if a new government sets different priorities from those set by the previous government. There have been instances in the past where the government has sought to unilaterally amend contracts to safeguard public interest much to the detriment and dismay of the private developers. This could have direct impact on the cash flows and projected revenues of the private developers (who have already made significant investments in the project) leading to defaults under the financing documents and other contractual defaults. Also, given the financial and operational stress in Indian projects space currently, lenders would be apprehensive in providing cushion to the developer under stress.

- During diligences therefore, investors must engage with industry experts to apprise themselves of existing as well as potential policy and regulatory risks affecting the concerned industry. The investor may also consider if seller/promoter should also obtain adequate insurance against political risk events (such as the one mentioned above) to insulate the investor of the losses arising out of such risks.

### Case Study

One of the examples of the instances where the Government has sought unilateral change in the terms of a contract include the attempt of the newly elected Andhra Pradesh Government to re-negotiate renewable PPAs executed with private developers. The AP Government's viewpoint was that compared to other states, the price at which the Government was procuring power from the private developers was steep. The AP Government was also of the view that the actual costs incurred/being incurred by private developers in implementing the project was substantially lower than the parameters considered in fixing tariffs. Thus, citing a loss to the public exchequer, the Government sought to revise the terms of the PPAs.

A similar issue has been faced by a large number of solar power developers in the State of Gujarat (the initial outcome of which has been in favor of the developers) the outcome of which is pending disposal of an appeal before the Supreme Court.

## Change in scope of work

- Disputes between a concessionaire and the concession authority on change in scope of work[81] could have a considerable impact on the developer's financials and consequently on the purchase price modelling of the investor. Obligations of the concessionaire are often broadly worded in the concession agreements thereby creating ambiguity on what would amount to change in scope of work of the concessionaire. Consequently, the concession authority and the concessionaire end up disputing whether a work that the authority has asked the concessionaire to undertake (irrespective the likely cost), is within the scope of the work envisaged at the time of grant of concession or is a change in scope. If determined that such work is within the scope of work of the concessionaire, the concessionaire will need to implement the same at no extra cost to the concession authority. Change in scope related disputes are common in road projects in India.

### Case Study

For instance, in a road project in Andhra Pradesh, there was a substantial damage to the road project due to floods. As a result, the concession authority required the concessionaire to repair the damage and bring the project up to speed in accordance with the latest standards of repair and design. The concessionaire argued that the road project has been following earlier prescribed standards and that if the project was to be repaired as per the latest standards the same would be work outside its scope of work and would entail additional costs. While the authority argued that the repair and upgradation of the project as per the latest standards was within the scope of work of the concessionaire, the concessionaire argued that the concession agreement was not specific on whether the same standards were to be applied (as existed at the time of commencing the project by the concessionaire) while undertaking repairs or the latest standards were to be applied. This led to a long-drawn dispute between the authority and the concessionaire. The matter was finally resolved with the concession authority agreeing to separately bid the requirement of upgradation of the project as per the latest standards, provided the concessionaire would waive its right to claim damages against the authority for certain defaults by the authority including with respect to delay by the authority in providing the required land for the project to the concessionaire within the timelines stipulated in the concession agreement.

In another case, the authority required the concessionaire to create additional toll lanes to ensure faster clearance of the congestion at the toll (as faster clearance of the congestion was one of the responsibilities of the concessionaire). The concessionaire argued that the data provided to the concessionaire by the authority at the time of bidding did not envisage such heavy flow of traffic and thus creation of additional toll was not within the scope of work of the concessionaire and it also involved heavy costs.

It is advisable to assess the merits of a change of scope of work dispute (if any) between the concessionaire and the authority and its likely impact on the financial position of the concessionaire. Communications among various stakeholders such as the concession authority, IE and the concessionaire should be also be reviewed for better understanding of the dispute and evaluation of merits of the dispute (a general scope of legal due diligence may not cover review of such internal communications. Much reliance is usually placed on the seller representations).

Further, at the pre-bid stage, detailed discussions with the concession authority at pre-bid meetings regarding any doubts and ambiguities should be undertaken. Written queries should be submitted in order to receive a written

[81] Concession agreements (such as in road sector) may allow concession authority to require the concessionaire to undertake additional work which is beyond the scope of work originally agreed with the concessionaire, provided that such changes / additions do not require expenditures exceeding a certain percentage (usually 5 %) of the total project cost and do not adversely affect the COD. Upon determination that a particular work is beyond the scope, the concessionaire is required to draw a plan and apprise the authority of the likely cost for implementation of such additional work. Post this, the authority may formally issue a change of scope order to the concessionaire for carrying out such additional work.

response. However, even where the bid documents contemplate such processes, concession authorities may not be as forthcoming as may be desired by the confused bidders.

## Sub-contracting of key obligations and approval of key contracts

- Key obligations under concession agreements such as engineering, procurement and construction, O&M are usually completely sub-contracted by concessionaires to a sister/group company (Related Party). While the concessionaire remains accountable to the concession authority for performance under the concession agreement, the terms and conditions of the sub-contracts do not pass the concessionaire's liabilities (in connection with the sub-contracted work) towards the authority through to its sub-contractor(s). Often the sub-contracts with Related Parties do not impose any obligations on the sub-contractor to provide any performance security or pay liquidated damages to the concessionaire for delay or failure of performance of the part of the sub-contractor.
- It is also seen that the terms of the sub-contracts with related parties are inadequately drafted with minimal checks and balances that one may otherwise typically see. For instance, payments to sub-contractors are not linked to the progress and performance of the sub-contractor during the term of the sub-contract. This allows unrestricted cash flows out of the concessionaire despite delayed and/or poor performance on the part of the related party sub-contractor. This obviously leads to cash shortfall thereby causing additional financial stress on the concessionaire. Consequently, it directly and adversely affects the ability of the concessionaire to complete and operate a project.

  The investor may require re-negotiation of the terms of the sub-contracts to ensure that the agreement is watertight, and the performance of the sub-contractor is adequately secured. The same should be a condition precedent to investment by the investor.
- Further, usually the terms of the concession agreements require that any proposed alterations to project agreements pertaining to the project (which may include sub-contracts) and financing documents of the concessionaire, shall be submitted to the concession authority for its review and comments prior to their execution. In our experience, the concession authority would not normally intervene unless the terms of the revised contracts/financing documents, increase the obligations of the concession authority.

### Case Study

In the case of Delhi Gurgaon Expressway, one of the 3 reasons why the NHAI terminated the concession agreement of the toll road project was because the concessionaire fraudulently obtained a loan of INR 1597 crores in 2010, after the project was completed from IDFC and 4 other banks without seeking prior approval from NHAI. These lenders objected that in terms of the process set forth in the concession agreement, the NHAI should have intimated its intention to terminate the concession to the lenders and afforded an opportunity to the lenders to exercise their substitution rights. However, NHAI was of the view that it did not recognize such lenders as the loans were provided without NHAI's approval and hence NHAI was under no obligation to coordinate with the lenders.

Indian laws prescribe that contracts executed with related parties should be at arms-length terms. It is therefore advisable that the investor should also seek the review of at least the key project agreements/sub-contracts by industry experts to understand if the sub-contracts are compliant with the above-mentioned requirements.

## Regulatory approvals and non-compliances

- Establishment and operation of infrastructure projects entails procurement of wide range of licenses, approvals, consents, registrations and no objection clearances (**Approvals**) from various agencies and authorities at the federal, state and local levels in India. Failure to obtain the required Approvals and/or to comply with the terms and conditions thereof would usually constitute offences under Indian law. Such offences are usually punishable with fines or imprisonment or both. However, violations in respect of some Approvals may have far reaching and severe consequences than what could be commercially assumed in investment transactions. Regularization of serious legal violations such as with respect to environmental clearances would likely be a non-negotiable pre-condition for the investor to put its pen to paper.
- For instance, setting up and/or operations of identified projects without prior environmental clearance is prohibited under Indian law. While the Environment Protection Act, 1986 prescribes fines up to INR 1 lakh or imprisonment of 5 years (of the officials responsible for the affairs of the defaulting company) or both for violations, the Government, judicial and quasi-judicial authorities have wide powers to take all necessary actions for protection and restoration of environment including suspending or shutting down projects.
- Courts in India have adopted a strong activist stand on tackling environmental issues. The Supreme Court has widened the scope of Article 21 of the Constitution (the Right to Life) by stipulating that a clean environment is essential to human survival.

### Case Study

In *Indian Enviro-Legal Action vs Union of India,* the Supreme Court also included the 'Polluter Pays' principle into Indian jurisprudence. The court held that

> *"the absolute liability of harm to the environment extends not only to compensate the victims of pollution, but also to the cost of restoring environmental degradation. Remediation of damaged environment is a part of the process of sustainable development."*

**Thus, in exercise of their powers under the Constitution, there are many instances where courts have imposed exemplary damages on corporations for serious environmental violations.**

In a landmark judgment, the High Court of Himachal Pradesh asked Jaiprakash Associates Limited (JAL) to pay INR 100 crores for flouting environmental laws for setting up its cement plant in Himachal Pradesh. The environmental clearance granted to the 25 MW thermal power plant of JAL was cancelled and JAL was asked to dismantle the same within 3 months from the date of the judgment. As per the court, JAL wrongly showed the project cost as INR 100 crores to circumvent the requirement of environment impact studies under the Environment Impact Assessment Notification, 2006 (under which the environmental clearance for projects are issued). The court found that the actual cost of the project was upwards of INR 500 crores. The court also found that the power plant had been set up without prior environmental approvals from the Government. While imposing damages based on 'polluter pays' principle, the high court allowed the functioning of the cement plant, as in its view the closing of the cement plant would affect the livelihood of the people in local area. However, the high court said that it would not hesitate in recalling the order if JAL does not comply with the conditions prescribed by the expert appraisal committee of Union environment ministry, while granting environmental clearance or is guilty of causing pollution. The damages were to be used in improving the ecology and improvement of the area concerned and to ameliorate the suffering of the people by creating hospitals, schools and other facilities.

- Procuring critical Approvals such as environmental clearance from the MOEFCC, approval for use of forest land for non-forest purposes are usually the obligations of the concession authority in some PPP projects but compliance of the terms and conditions of the same and maintenance of the same during the concession period is the obligation of the Concessionaire. Having said that, we have also seen projects (such as incase of power projects) where the obligation of procurement, maintenance and compliance of the terms and conditions of all Approvals, is that of the concessionaire.
- Following key issues with respect to Approvals are often noted in conducting legal due diligences:
  - Certain approvals have not been obtained
  - The approvals that have been obtained in connection with the project are inadequate i.e. the approvals are not commensurate with the extent of project infrastructure created by the concessionaire or the activities being undertaken by the concessionaire at the project
  - The concessionaire is in default of compliance of the terms and conditions of the approval which often includes failure of the concessionaire in reporting the compliance of the terms and conditions of the approval by the concessionaire with the appropriate authority
  - Show cause notices have been issued by the governing agency to the concessionaire citing non-compliance of the terms and conditions of the approval by the concessionaire and seeking clarifications as to why such approval shall not be cancelled/rescinded
- Unless the above issues are such which if not resolved upfront, are likely to or will adversely impact: (i) the ability of the concessionaire to carry on its business; and/or (ii) interests of the investor, parties would ideally like to go ahead with the envisaged investments while finding solutions to mitigate such risks. Thus, regularization of such violations may be incorporated in the investment agreements as a condition to closing of the investment transaction.

  It should be borne in mind that a legal due diligence would normally not involve an exhaustive compliance review and on ground investigation of whether the project is actually being implemented/operated in accordance with the terms of the Approvals. Serious contraventions (especially environment and forest related) of the terms of the Approvals are often revealed during site visits and asset investigations which could have a material impact on the project. It is advisable to undertake environmental compliance and technical investigations through relevant experts to understand project risks and their likely impact on the proposed investments by the investor.

  Appropriate warranties and indemnification (backed by insurance if possible) should also be taken.

## Change in Law and Force Majeure

- Typically, concession agreements provide for amendments if, as a result of 'change in law', the concessionaire suffers an increase in costs or reduction in returns or any other identified financial burden in excess of certain amount and/or percentage of concessionaire's realizable fee in an accounting cycle. Such provisions are incorporated to bring the concessionaire into same financial position as it would have been, should there have been no 'change in law'. In most concessions, relief is available only if such 'change in law' event has occurred during the construction phase of the project.
- The definition of what constitutes 'change in law' may be limited and/or ambiguous in concession agreements. This often leads to disputes among parties as to whether an incident is a 'change in law' incident or does not qualify to be. The recent case of Adani Power's ultra-mega power plant is a good example of this issue.

**Case Study**

Adani had through its SPV, set up a power plant for supply of power to various state governments/utilities at competitive prices determined through competitive bidding process. Substantial amount of coal was imported from Indonesia and other territories outside India. However, subsequently the Indonesian government said that any export of Indonesian coal could be done only at prices linked to international prices instead of what previously existed in the last 40 years (i.e. any higher realization of price than local, would have to be retained in the country). As a result, the import price of coal turned higher then envisaged and considered by the power producers in submitting their financial bids/tariff leading to higher costs to Adani. Adani argued that such an event is a 'change in law' and 'force majeure' within the terms and conditions of the PPAs and needed to be accordingly addressed including by providing for additional compensatory tariffs in accordance with the terms of the power purchase agreements ( being a result of changing regulations in Indonesia).

The Supreme Court however decided otherwise and said that Adani cannot raise preset tariffs if fuel becomes costlier due to changes in laws overseas. The court further held that change in law in Indonesia would not qualify as change in law under the applicable guidelines read with the executed PPAs, change in Indian law, certainly would[82].

The investor should therefore identify the applicable legal, regulatory and political risks concerning the project (and its various stages) which may not qualify as a change in law or a force majeure event and for consequent reliefs thereof under the concession agreement. Safeguards against commercial and legal implications of such risks would therefore need to be adopted by the investor to insulate itself of such risks/events. For instance, assets such as airports, mines, power have their own specific regulations. A small expected change to permissible noise levels, water discharge and quality requirements can have a huge negative impact on revenues and costs. However, the same may not necessarily qualify as a change in law under the concession agreement. To mitigate this risk, the investor may not be able to lay any claim on the promoter or the concessionaire, however the same can be mitigated by seeking appropriate political risk insurance at the cost of the promoter.

[82] Although in early April 2019, the Central Electricity Regulatory Commission has offered much respite to Adani by allowing revisions in the terms and conditions of the power purchase agreements, the developers and the procurers had to face long drawn battle before the courts and uncertainties around the power project

## Payment delays and defaults by Government counter parties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**Payment Delays in Andhra Pradesh, Telangana, Tamil Nadu Hit Solar and Wind Developers**

While the situation in the industry had improved for the better briefly, things seem to have deteriorated again

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- The terms and conditions of concession agreements do not usually prescribe adequate provisions that deter the concession authority from delaying payments to the concessionaire. Any delay in making payments attracts only minimal liquidated damages which allow such delays to continue inordinately without censure. Also, the authorities often fail to provide payment guarantees (which also exposes a risk) to the concessionaire despite requirements under the concession agreements. For instance, PPAs for procurement of power executed by Government distribution companies of India (**DISCOM**s) require the government to provide payment securities to private developers in the form of letters of credit of an amount equivalent to average monthly invoice amount. However, DISCOMs invariably do not provide such securities to the developers and default in payments are persistent.

- Further, concession agreements envisage inordinately long timelines for payment by the Government to the concessionaire after the invoice has been raised by the concessionaire. The payment receipt cycle of the concessionaire and the above defaults by the authority should be borne in mind by the investor while determining the projected cash flows and receipts of the investee company/concessionaire.

## Changes in investment structure of Captive Power Plants

- Captive power plants (**CPP**s), i.e. power plants established by certain industries primarily for self-consumption, were encouraged by the Government, so as to reduce the burden on the public sector for provision of electricity and freeing up generation and transmission capacities. The growth of CPPs has been broadly attributed to: (i) need for backup power arrangements (ii) requirement of continuing supply (iii) the co-generation benefits of steam and electricity from production process of industries and (iv) need to generate electricity at costs lower than the high industrial tariffs set to cross subsidize other categories of consumers[83].

- No license is required for the construction, maintenance and operation of CPPs (with the dedicated transmission lines, if any). To support captive power supply and consumption, the law allows a CPP the right to open access for the purposes of carrying the electricity to the captive user. An additional advantage of captive consumption of electricity is that cross-subsidy surcharge (**CSS**)[84] is not payable by the captive power consumer to state DISCOMs

[83] Section 9 of the Electricity Act read with Section 2(8) regulates captive generating plants. A captive generating plant has been defined to mean "*a power plant set up by any person to generate electricity primarily for his own use and includes a power plant set up by any co-operative society or association of persons for generating electricity primarily for use of members of such cooperative society or association.*"

[84] Under section 42 (2) of the Electricity Act, the concerned state electricity regulatory commission is under obligation to introduce open access which are subject to certain conditions such as payment of CSS by a consumer as per the rates prescribed by the concerned commission. The idea behind CSS is to provide a favourable price of power to one set of customers at the expense of other categories of customer although the cost of the DISCOM for supplying electricity to all consumers is the same. In India for instance, industrial consumers of electricity pay higher tariff for power compared to rural customers. As per the Electricity Act, CSS were to be gradually reduced and done away with. But the same are so far applicable. The GOI has in its latest union budget mentioned that the tariff policy will be revised and the requirement of payment of CSS may be completely done away with.

for availing open access[85] of the DISCOM's distribution network for supply of electricity to the captive consumer's premises.

- For a power plant to qualify as a captive generating plant, the captive user(s) is/are required to: (i) hold not less than 26% of the ownership in the power plant and (ii) consume not less than 51% of the aggregate electricity generated in such plant, determined on an annual basis. Ownership in relation to a generating station or power plant set up by a company or any other body corporate has been defined as the equity share capital with voting rights. In other cases, ownership means proprietary interest and control over the generating station or power plant. Therefore, any person that holds equity shares of a captive generating company with voting rights, could, if he availed electricity from such power plant, be considered as a captive user, provided that, other requirements as necessary are also fulfilled. It should also be noted that holding of preference shares or equity shares without voting rights, would accordingly, not be considered as holding for the purpose of captive usage.
- However, an amendment to the current captive power related regulations are likely. The Ministry of Power, GOI have proposed certain amendments in this regard on October 6, 2016 and May 22, 2018[86]. The aim of the proposed amendments is to fix a loophole in the current law pertaining to ownership of CPPs. The proposed amendment mandates captive consumers to hold at least 26% of the equity base of 30% of the capital employed in the form of equity share capital with voting rights (excluding preference/equity share capital with differential voting rights). Existing rules for recognizing a group captive company involves ownership accounted by way of number of shares and this has generally been achieved by issuing another class of shares/through shallow equity investments with limited voting rights. The requirement for bringing in the equity in proportion of project cost/capital employed will be onerous as it involves a high upfront commitment. Thus, the aim of the proposed amendments is that economic ownership of shares of the user should commensurate the economic value of the ownership of the plant (which is not the case in the law as it stands today).
- Given the captive status of power plants has to be determined on an annual basis, it remains to be seen how certain existing CPPs which are already commissioned, with alternate structures on capitalization, where project capital and equity have been already deployed, will rework their equity and shareholding structure by the time the draft amendment is implemented[87]. Thus, in the event an investment is envisaged in infrastructure projects with captive power generation plants, or solely in captive power plants, the above sensitivity should be borne in mind by the investor.

[85] *""Open access" means the non-discriminatory provision for the use of transmission lines or distribution system or associated facilities with such lines or system by any licensee or consumer or a person engaged in generation in accordance with the regulations specified by the Appropriate Commission*" - Section 2 (47) of the Electricity Act

[86]https://powermin.nic.in/sites/default/files/webform/notices/Draft_Amendments_in_the_provisions_relating_to_Captive_Generating_Plant_in_Electricity_Rules_2005_0.pdf

[87] We note that the Government is considering further revisions to the proposed amendments. However exhaustive details of the same are not available online.

## Renewable Purchase Obligations

- With an aim to promote generation and purchase of electricity from renewable energy sources, Indian electricity laws require certain designated entities to purchase a certain percentage of their total electricity needs from renewable power sources. These designated entities are distribution companies, captive power consumers and other open access consumers (i.e. consumers using the network of distribution licensees for procurement of energy). Applicable regulations also provide for purchase of renewable energy certificates (**RECs**) in lieu of purchasing renewable power by obligated entities from the National Load Dispatch Centre[88]. The terms of the PPAs executed between the state procurers and private developers in the renewable sector often prescribe that in the event the state procurer is unable to draw electricity from the power plant, the developer can sell such power to any third parties. In the recent past, to arm-twist power developers to renegotiate power tariffs, the State Government of Andhra Pradesh refused to draw electricity from the renewable power plants. In such an event sale of power to designated entities (so as to fulfill their renewable purchase obligations) could be an alternate solution to the power developer. However, the issue lies in the fact that the supply of power from the power plant to such designated entity would be dependent on availability of bandwidth on distribution/transmission networks connecting the power plant and the premises of the designated entities. Further, such arrangements for supply of power from the power plant to the designated entities would be intermittent as the moment the state procurers demand the electricity from the power plant, the power developer is required to oblige in terms of the PPA executed with the state procurer.


- There are often disputes between designated entities and the government implementation agencies whether renewable purchase obligations are applicable when the power is sourced by a captive consumer or any third-party consumer from co-generation plants using non-renewable fuel for generation of electricity. In a number of instances, State DISCOMs have argued that purchase of power from co-generation plants using non-renewable fuel for generation of power need to comply with renewable purchase obligations prescribed by the concerned state electricity regulatory commission. However, there seems to be some clarity on this aspect where the courts/Appellate Tribunal for Electricity (**APTEL**) have held that in addition to generation of power through renewable sources, the function of the state electricity regulatory commissions is also to promote generation of power from co-generation sources. Hence, where the power has been sourced by a designated entity from co-generation power plant, renewable purchase obligations are inapplicable. However, state regulations on this subject may expressly provide otherwise, thus necessitating a review of local laws as applicable.

[88] RECs are issued by the National Load Dispatch Centre towards green power generated by registered developers. The RECs are issued on monthly basis and can be traded over power exchanges by the registered developer.

## Inadequate stamping of project contracts

- Stamp duty is a type of tax and an important source of revenue for the government. Indian stamp laws require payment of stamp duty on instruments executed for a transaction. Simply speaking, any document by which any right or liability is, or purports to be, created, transferred, limited, extended, extinguished or recorded, is an instrument. Depending upon their jurisdiction the Central Government and the State Governments prescribe the rate of stamp duties to be paid on various instruments. The rate of stamp duties may either be fixed amount or *ad valorem* (i.e. in proportion of the estimate value of the goods involved, consideration or the transaction concerned).
- Contracts for infrastructure projects such as EPC contracts, O&M Agreements, Project Implementation and Management Agreements, Guarantees, Share Purchase Agreements, etc., when executed in certain states attract *ad valorem* duty. Hence the amount of stamp duty payable on such instruments is substantial. However, during legal due diligences we often see that such agreements are either under stamped or not stamped at all. Failure to pay required stamp duty on the contract attracts substantial penalties. Failure to adequately stamp instruments does not render a contract invalid, however such inadequately stamped documents are inadmissible as evidence before Indian courts until the shortfall in duty and penalty for such shortfall is duly paid. Under section 34 of the Maharashtra Stamp Act, such penalty can be up to 4X the amount of deficient stamp duty. Inadequately stamped instruments can also be impounded by the concerned revenue authority.
- For an investor, it would be ideal that defaults in payment of stamp duties on the instruments of the investee company are regularized by the selling shareholders/investee company as a pre-condition to investment by the investor. However, negotiations witness a hard push from the sell side to avoid approaching the revenue authorities as the stamp duty that may be adjudicated and penalties that may be imposed by the stamp authorities may be considerably high.

  In order to insulate themselves from any loss or liability as a result of default in payment of stamp duty, investors seek specific indemnities from the selling shareholders. An estimate of the likely penalties for the stamp duty defaults is also drawn by the investor and the same or a portion thereof is also usually considered by the investor in financial modelling for determination of the purchase price.

  Given high stamp duties parties are also seen executing investment agreements outside India as the incidence of tax (i.e. the liability of stamp duty) arises after such document is brought in India. The duty will be payable even if a copy of such document is brought into India physically or electronically.

## Latent defects in construction contracts

- According to Section 16 (2) of the Sales of Goods Act, 1930, if a seller deals in goods of a description and the buyer purchases such goods, then there is an implied condition that the goods will be of merchantable quality. However, the act also provides that if the buyer had also examined the goods, then there shall be no implied condition as regards defects which such examination ought to have revealed. Courts in India have defined 'merchantable quality' at various instances. The Madras High Court has held "*goods are of merchantable quality if they are of such a quality and in such condition that reasonable man acting reasonably would after a full examination accept them under the circumstances of the case in performance of the offer to buy them, whether he buys for his own use or to sell again*[89]".
- As regards the liability of a seller under Section 16(2) of the Sales of Goods Act, the Bombay High Court has held that in case goods of a particular description are sold by a seller who deals in such goods, he is always, in the absence of agreement to the contrary, responsible for the latent defects in the goods which render them non merchantable, whether the buyer examined them or not for all such defects, whether latent or discoverable, on examination in cases where the buyer has not in fact examined the goods. Hence contractors seek a limited defects liability period upon the expiry of which the risks in respect of defects and remedying the same would be

[89] Sorabji H. Joshi and Co. vs. V.M. Ismail, AIR 1960 Mad 520.

borne by the owner. However, latent defects which are inherent in material or construction of the project may not be apparent during the initial operations of the project and may surface after the expiry of the defects liability period. This aspect becomes important where the EPC contracts have been given by a concessionaire to a related party company as such contracts would normally not provide for any defects liability period or even if they provide so, the same would be substantially smaller than the industry standards. Thus, as a part of investment negotiations, the investor may therefore consider if the EPC contracts executed by the concessionaire needs to be re-negotiated to adequately allocate the risks in respect of defects to the EPC contractor.

## Exchange Control – repatriation of award proceeds

- While Indian foreign exchange laws have been relaxed over the last decade, a full capital account convertibility is not permitted. FEMA is the primary legislation dealing with the law applicable to transactions in foreign exchange. Foreign exchange transactions under FEMA are categorized into 2 broad divisions: (i) capital account transactions, and (ii) current account transactions. Payments for all current account transactions can be freely remitted outside India, unless specifically restricted. Conversely, all capital account transactions are restricted, unless specifically permitted.
- A capital account transaction is defined under FEMA to mean a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India. Current account transaction means a transaction other than a capital account transaction and includes, without limitation, the following:
  - Payments due in connection with foreign trade, other current business, services and short-term banking and credit facilities in the ordinary course of business
  - Payments due as interest on loans and as net income from investments
  - Remittances for living expenses of parents, spouse and children residing abroad; and
  - Expenses in connection with foreign travel, education and medical care of parents, spouse and children
- Proceeds of decrees of Indian courts may be considered 'capital account transactions'. Consequentially, repatriation of such proceeds outside India may be restricted under the FEMA regulations. Thus, one typically takes a view that the RBI's prior approval is required for such repatriation of proceeds. The Delhi High Court in the case of Cruz City supra., nevertheless allowed the remittance of award money. The court stated, "n*otwithstanding that Unitech may be liable to be proceeded against for violation of provisions of FEMA, the enforcement of the Award cannot be declined*". The Court further held India's exchange control policy was designed to facilitate flow of foreign exchange subject to reasonable restrictions and not to prohibit the flow of exchange. The court therefore held that the necessity to seek prior RBI approval before remitting funds offshore from India, is insufficient to refuse the enforcement of a foreign award.

## Indemnity obligations

- Indian acquisition transactions are never complete without protracted debates and negotiations on indemnification obligations of the parties. Section 124 of the Indian Contract Act, 1872 (**Contract Act**) defines a contract of indemnity as, "*A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person, is called a "contract of indemnity*". The provisions relating to indemnity are not exhaustive under the Contract Act and the law around indemnity has developed in India through judicial precedents. It should also be noted that apart from the provisions of indemnity, Section 73 of the Contract Act provides right to parties to claim damages in case of breach of contract (i.e. compensation for loss or damage caused due to breach of contract).
- In negotiating indemnity provisions in acquisition transactions, it therefore becomes imperative that the investor should have a clear understanding of the key differences between the right of indemnification and the right to

damages under Indian laws as the parties often confuse the two rights as one. This is because indemnity rights are often found to coincide with the measure of damages. In such cases, whether the right is called a right to indemnity or a right to damage, the result is the same. The 2 concepts are quite distinct from one another and the same should be borne in mind in negotiating indemnity obligations in infrastructure contracts and investments agreements in infrastructure acquisitions.

- For damages, it is essential that there is a breach of contract. However, for a right of indemnification, breach of contract is not essential. It is for this reason that 'specific indemnities' are negotiated for certain events which do not constitute breach of contractual obligations. A comparison of section 73 (damages) and section 124 (indemnity) seems to suggest that while statutory constraints are placed on the right to claim damages such as: (i) the loss should be direct and immediately foreseeable (ii) the party claiming the loss should have taken the measures to limit the loses (iii) the loss is not a consequential loss, etc.; indemnification rights may not be subject to such constraints. However, parties usually require that the aforesaid limitations are incorporated under the contract whilst negotiating indemnity provisions.

- Under the Contract Act, indemnity claims can be brought against third parties. Courts in India stipulated that section 124 deals only with one particular kind of indemnity which is an indemnity arising from loss caused to the indemnified by the conduct of the indemnifier or by the conduct of any other person. It has been clarified that Section 124 does not deal with those classes of cases where the indemnity arises from loss caused by events which do not depend upon the conduct of the indemnifier or any other person, or by reason of liability incurred by something done by the indemnified at the request of the indemnifier[90]. However, courts have also observed that since the Contract Act is not the exhaustive law of indemnity, equitable principles that have been applied by Courts of England could be applied by Indian courts. Further, an indemnity can be enforced without the occurrence of an actual loss (while a suit for damages lies upon occurrence of loss/damage) in cases wherein the promisor incurs an absolute obligation/liability, and the contract of indemnity covers that obligation/liability. Thus, on the happening of an indemnification event, a party (indemnified party) can compel the indemnifying party to set aside a fund for meeting its indemnity liabilities or to pay the indemnity amounts directly to a third party.

- While a court may order damages more than the actual loss that has been incurred (in the form of special or pre-estimated liquidated damages), and in some instances less than the actual loss incurred, indemnification generally puts a person in the same position as he was before the loss.

**Case Study**

Although the above position in case of indemnities have been reiterated by Indian courts from time to time, the Supreme Court in the case of *State Bank of Saurashtra vs Ashit Shipping* in 2002, held whilst considering an indemnity bond that the question of making good a loss arises only when there is proof that the loss is suffered. In another case of insurance (which is an indemnity in a broader sense) the Supreme Court held that it is only upon the proof of actual loss, that the assured can claim reimbursement of loss to the extent it is established. This is quite important from the perspective of indemnity insurance (indemnifying the acquirer) in acquisition contracts.

The observations in these cases raise a concern whether in the event of enforcement the effect of indemnification right would be procedurally or substantially different from the contractual right to damages.

- The advantages of right of indemnification cannot however be ignored particularly where a party wishes to seek recourse from the indemnifying party for losses beyond a breach of contract. Also, even in cases of a breach of representations and warranties, or other breaches of contract, the right to indemnification can potentially be more advantageous, given the prospective scope of claiming an amount which is higher than what would be claimed as

[90] *Gajanan Moreshwar Parelkar vs. Moreshwar Madan Mantri*, AIR 1942 Bom 302

damages. However, as stated above, it is quite possible that in cases of breach of contract, a court may view the right to indemnity as coinciding exactly with the right to claim damages.

- Clarity is also required on few questions surrounding right of recourse of the acquirer, such as: (i) does the limitation on liability in an indemnity clause preclude a party from claiming damages for breach in excess of the indemnity limits, outside of the indemnification clause? (ii) does a loss to the investee company always amount to a loss to the investor for the purposes of seeking indemnification? and most importantly (iii) where damages and indemnity coincide, to what extent are the limitations relating to damages claims relevant to indemnification claims?

## Non-compete provisions

- Restrictive non-compete provisions are fairly common in definitive investment documents in India (such as share purchase agreements and share subscription agreements). Standard provisions would include restriction on promoters and shareholders in engaging from business activities which directly or indirectly compete with the business of the target company after acquisition. From a legal standpoint, enforcement of the same is problematic as Section 27 of the Contract Act provides that every agreement by which anyone is restrained from exercising a lawful profession, trade or business is void. However, such restrictions are permitted where the transaction involves sale of goodwill provided such limits are reasonable (including in respect of period and area/location of operations).
- Typically, a share acquisition transaction does not give an acquirer the interest in goodwill of a company. Since there is no sale of goodwill, it can be argued that non-compete provisions in investment agreements are unenforceable under section 27 of the Contract Act[91].
- Additionally, the Competition Commission of India (**CCI**), vide a non-binding note titled 'Guidance on Non-Compete Restrictions' (**Guidance**) recognized that non-compete restrictions may arise in various types of combinations, including the acquisition of a business or an enterprise, formation of a joint venture or acquisition of controlling/ non-controlling interest in an enterprise. Under the Guidance, the CCI indicated that the necessity of a non-compete restraint indicates that in the absence of such restrictions, the combination could not be implemented or could only be implemented under more uncertain conditions, at substantially higher cost, over an appreciably longer period or with considerably higher difficulty. Further, as per the Guidance, the geographical scope of a non-compete clause in case of acquisitions is to be limited to an area in which the seller has offered the products or services before the transfer. Such protection from competition may also extend to those territories that the seller was planning to enter at the time of the transaction, provided that the seller has already invested in such a move. It is pertinent to note that the Guidance stipulates that an acquirer does not need to be protected against competition from the seller in other territories where the latter had not previously operated.
- The jurisprudence on the non-compete issue seems to be evolving in India with certain courts adopting a much liberal outlook on enforceability of non-compete provisions (although conflicting views are also present).

### Case Study

In one case of share purchase transaction[92], the seller sold his company at a huge premium to the buyer. The seller also agreed to not undertake any business that competes with the target's business in India and abroad for a period of 5 years. The single judge bench of the Delhi High Court held that Indian law prescribes complete embargo on such restrictions (with the sole exception of sale of goodwill). The court held that the sale of the shares did not tantamount to the sale of business and goodwill. The court further held that even if the parties intended to sell goodwill, the non-compete restrictions were very wide as they imposed a complete embargo on seller's employment and were therefore unreasonable.

However, a single judge bench of the Delhi High court disagreed with the above decision in another case[93].

[91] Bacha F. Guzdar v. CIT AIR 1955 SC 74 - An acquirer who buys shares of a company does not buy interest in the property (and hence, goodwill) of the company.

[92] *Le Passage to India Tours & Travels (P) Ltd. v. Deepak Bhatnagar* (2014) 209 DLT 554.

[93] *Lal Pathlabs (P) Ltd. v. Arvinder Singh* 2014 SCC OnLine Del 2033.

In this case, 2 doctors (pathologists and radiologist) sold their entire shareholding in their diagnostic business. The investment agreement prohibited these sellers in engaging in any business which competes directly or indirectly with the business of the target. While the term and geographical limit of the non-compete were not specified in the investment agreement, the seller did agree in the agreement that the non-compete restrictions were fair and reasonable, and their experience would enable them to work gainfully in a non-competing business. Despite being retained in the target, the sellers started undertaking competing business in the same city during the term of their retainership. The single judge bench of the Delhi High Court held that non-compete restrictions are enforceable where the transaction involves sale of all shares of a company as with the shares, the goodwill of the company also passes to the acquirer. Although the transaction documents were silent on the term and location for non-compete, the court held that 5-year restriction within the city would be a reasonable restriction. The above judgement was affirmed by a Division Bench of the Delhi High Court with one disagreement from the view of the single judge. The Division Bench held that the sellers cannot be restrained from carrying out their activities as professionals. As per the Divisional Bench restriction would however prevent the doctors from corporatizing their business.

A decision of the European Commission (**EC**)[94] indicates that the duration of post-joint venture non-compete is not more than 3 to 5 years in Europe. In this case, Siemens and Areva created a full-function joint venture, Areva NP (**Areva JV**). The shareholders' agreement included a non-compete clause which covered not only the lifetime of the Areva JV but also, a period of 8 to 11 years after loss of joint control by Siemens over the Areva JV. The post-joint venture duration was later reduced by an arbitral award to 4 years.

In assessing the post-joint venture non-compete, the EC found that the 4 year duration could not be justified and the parties committed to reduce it to 3 years. The EC primarily relies on the duration for which confidential information acquired by the parent would continue to be relevant. The EC order clarifies that the assessment of permissible duration of the non-compete will vary across sectors. Impact of access to confidential information, duration of customer/supplier contracts and customer loyalty are some factors which would be relevant to determine duration of non-compete.

The aforesaid decision is largely consistent with CCI's Guidance which also clarifies that, "*Where the transfer includes both goodwill and know-how, the non-compete clause is justified only for a period of up to 3 years and up to 2 years if the transfer of goodwill only is involved. Longer durations may still be justified in a limited range of circumstances where, for example, in certain industries and sectors, customer loyalty to a seller will persist longer durations or the nature of the know-how transferred justifies an additional period of protection*."

Although, the first two examples go to show that some courts are of a view that the non-compete restrictions would be enforceable as goodwill passes where there is a 100% sale of shares, other High Courts may opine otherwise. The ambiguity around non-compete clauses in acquisition transactions will remain until the issue is finally laid to rest by the Supreme Court.

Another issue that arises as regards non-compete provisions is whether payment of a non-compete fees by a person resident in India to a person resident outside India would amount to a 'current account transaction' or a 'capital account transaction' under FEMA. Such determination may also vary on the manner in which the non-compete fees is payable. If the non-compete fee is treated as a 'capital account transaction', then prior approval of the RBI would be required in such case.

Taking cues from the observations, non-compete restrictions in share acquisition transactions should be carefully drafted with specific considerations in mind that: (i) the restrictions should be reasonable in terms of their duration and geography (ii) the investment agreements should clearly set out that goodwill is pertinent to the investment transaction and (iii) the post-closing restrictions should be linked to sale considerations instead of employment agreements with individuals.

[94] *EC decision dated June 18, 2012 addressed to Areva SA and Siemens AG.*

## Subsistence of representations and warranties

- Acquisition transactions have protracted negotiations on the representations and warranties that an investor would like the seller to provide. To limit their liabilities, sellers often negotiate provisions to limit their exposure to liabilities against breach of representations and warranties. As such, the seller would seek to incorporate:
  - Timelines within which an investor may bring a claim for breach of representations and warranties; and/or
  - Period after which identified representations and warranties may fall
- From a careful reading of Section 28 (b) of the Contract Act[95] one can note that clauses which seek to extinguish the contractual rights of any party or discharge any party from any liability under a contract on the expiry of a specified period so as to restrict any party from enforcing his rights are void .
- There are numerous judicial precedents which confirm the position. *The Madras High Court in Oriental Insurance Co Ltd v Karur Vyasya Bank Ltd* reported in *AIR 2001 Mad 489* held

  *"… its is clear that by the Indian Contract (Amendment) Act, 1997, the original Section 28 has been replaced by a new paragraph in which such extinction of right unless exercised within a specified period of time, if not beyond the period of limitation, is also rendered void. As observed earlier, in the absence of any specific reference in the amended Act, it is prospective in nature and the same cannot affect the contract made earlier. However, the law as it now stands after this amendment not only the curtailment of limitation period is impermissible, but also the extinction of right, if sought to be brought by the agreement within a specific period, which period is less than the period of limitation prescribed for the suit under the contract in question is also rendered void*"[96] .
- It should be noted that Section 28(b) seems to prohibit only extinguishment of contractual rights or liabilities after a specified time period so as to restrict any party from enforcing his right i.e. restricting the right to sue. It still needs to be analyzed as to whether this should be read to mean that clauses in a contract which limit the validity of representations and warranties to a specified period are also invalid under Section 28(b). While Section 28 (b) prohibits the restriction on extinction of right of the aggrieved and of the liability of the breaching party if the former does not bring a claim within a specified period, <u>there is nothing in Section 28(b) which prohibits parties from restricting the tenure of representation or warranty i.e. period for which the warranty subsists</u>.
- *In Pearl Insurance Co v Atma Ram* reported in *AIR 1960 Punj 236*, the Punjab and Haryana High Court had held that a contract which did not limit the time within which the insured could enforce his rights, but only limited the time during which the contract would remain alive was not hit by section 28.

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[95] *"Section 28 – Agreements in restraint of legal proceedings, void-*

*Every agreement,*

*(a) by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract, by the usual legal proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights; or*

*(b) which extinguishes the rights of any party thereto or discharges any party thereto, from any liability, under or in respect of any contract on the expiry of a specified periods so as to restrict any party from enforcing his rights,*

*is void to that extent.*

*Exception 1: Saving of contract to refer to arbitration dispute that may arise. This section shall not render illegal contract, by which two or more persons agree that any dispute which may arise between them in respect of any subject or class of subject shall be referred to arbitration and that only and amount awarded in such arbitration shall be recoverable in respect of the dispute so referred.*

*Exception 2: Saving of contract to refer question that have already arisen – Nor shall this section render illegal any contract in writing, by which two or more persons agree to refer to arbitration any question between them which has already arisen, or affect any provision of any law in force for the time being as to reference to arbitration*

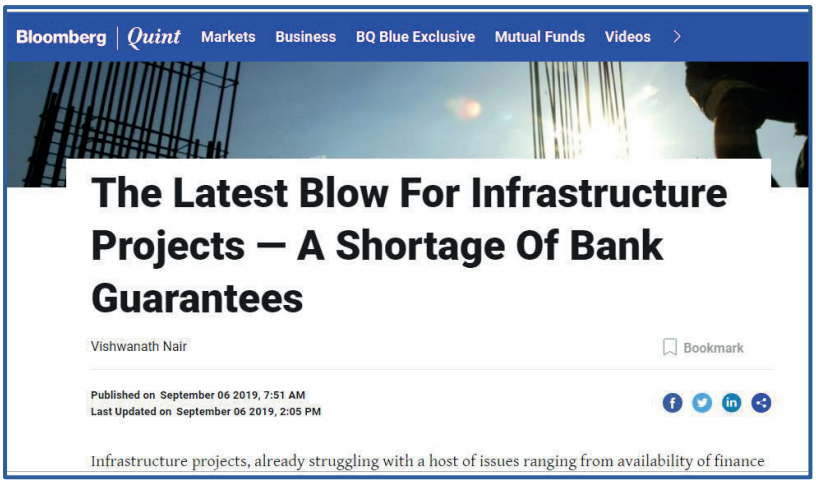
*Exception 3- Saving of a guarantee agreement of a bank or a financial institution:*

*This section shall not render illegal a contract in writing by which any bank or financial institution stipulate a term in a guarantee or any agreement making a provision for guarantee for extinguishment of the rights or discharge of any party thereto from any liability under or in respect of such guarantee or agreement on the expiry of a specified period which is not less than one year from the date of occurring or non-occurring of a specified event for extinguishment or discharge of such party from the said liability.*

[96] Another precedent is Union of India (UoI) through Textile Commissioner v Bhagwati Cottons Ltd, G P B Fibres Ltd And Indusind Bank Ltd reported in *2008 (5) Bom CR 909*.

- Clauses which require a claim for breach of representations and warranties to be asserted in a specified period of time or which prescribe a period for the operation of the contract have to be distinguished from conditions imposed in a contract which put an embargo on the right of enforceability of the claim after a specified time period. The former can utmost be construed as a condition precedent for filing of the suit – that violation of right should be asserted within the period agreed to between the parties[97]. Whereas, in the latter case, if agreements provide for a time period for filing suit (after occurrence of the cause of action within the validity of the contract) lesser than that in the Limitation Act, 1963 (**Limitation Act**), the same would be void.
- Thus, if the cause of action arises during the validity of the contract, the right to bring a claim cannot be restricted to a time period lesser than that prescribed under the law of limitation. However, there is nothing in law to prohibit a contract which prescribes a time period for its validity after which all rights and liabilities thereunder stand extinguished if no cause of action arises during such time.
- Accordingly, although it may not be possible to restrict the time period within which a claim for breach is to be brought, it may be possible to restrict the tenure of a representation or warranty under a contract and avoid claims which arise after the expiry of the same. This should be borne in mind by the investor during its negotiations of representations and warranties.

## Difficulties of borrowers vis a vis bank guarantees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The Latest Blow For Infrastructure Projects — A Shortage Of Bank Guarantees

Vishwanath Nair

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Infrastructure projects, already struggling with a host of issues ranging from availability of finance

- From the above, one may note that the first part of Section 28 i.e. sub-section (a) deals with restriction on enforcement of rights or limiting the time of enforcement of rights while second part of Section 28 i.e. sub-section (b) deals with extinguishment of rights or discharge of liability leading to restriction on enforcement.
- *Section 28 of the Contract Act provides for certain exception to the above restriction. One of these being Exception 3* which was introduced vide Banking Law (Amendment) Act, 2012 which came into force on 18th January 2013. The said Exception 3 deals with guarantee agreements of a bank or a financial institution.
- *As per the said Exception 3, a contract in writing by which any bank or financial institution stipulate a term in a guarantee or any agreement making a provision for guarantee for extinguishment of the rights or discharge of any party thereto from any liability under or in respect of such guarantee or agreement on the expiry of a specified period which is not less than one year from the date of occurring or non-occurring of a specified event for extinguishment or discharge of such party from the said liability, shall not be illegal under Section 28 of the Contract Act.*
- Due to the *said* Exception 3 and in view of Circular dated 10.02.2017 (**IBA Circular**) issued by Indian Bank's Association, banks in India are:
  - Incorporating a minimum claim period of one year in bank guarantees even in case of bid bonds or performance guarantees where the underlying contract/transaction is valid for a much shorter period
  - Demanding payment of guarantee commission for the entire claim period of one year

[97] The Food Corporation of India v. The New India Assurance Co. Ltd., AIR 1994 SC 1889

- Not releasing the cash margin/security until the expiry of claim period of one year

- The aforesaid action of the banks is leading to various difficulties being faced by borrowers/applicants, viz:
  - Based on commercial and business requirements, bank guarantees are issued for various tenors. Bid-bond guarantees for example requires a small tenor of few days such as 7-15 days. The IBA circular and the issuing bank's interpretation now makes it mandatory for the borrowers/applicants to keep their liability open for one year.
  - This causes severe hardships as the borrowers/applicants are forced to keep the bank guarantees alive for such period. In this regard, the issuing banks are charging guarantee commission till the expiry of the claim period.
  - The government, government entities and many other beneficiaries neither return the original bank guarantees nor issue a release letter to discharge the guarantee obligations of the issuing bank. This in turn keeps the underlying obligations of the borrower/applicant open till such time the beneficiary does not return the original bank guarantees or issue a release letter.
  - This limits the borrowing powers as the liability of the borrower/applicant continues to show as a contingent liability in the books of both the bank and the borrower/applicant, though in reality the performance/payment obligations no more subsist under the bank guarantee.
  - Further, security offered by the borrower/applicant by way of cash or collateral also get stuck thereby creating a huge stress on the liquidity.
- Investors must take into consideration the above practical difficulties while investing in a project concessionaire.

## Deemed Public Companies

- Under Indian corporate law, a private company which is a subsidiary of a public company is a 'deemed public company'. Consequently, all exemptions otherwise available to a private company under the Companies Act, 2013 (**Companies Act**) (including in respect of various compliances) would not apply to such deemed public companies.
- This is relevant where an investor proposed to ultimately invest in a private company and intends to benefit from private company exemptions. If, pursuant to such investment, there is a change in control/shareholding of such investee private company at its holding company level, basis which it becomes a deemed public company, such a deemed public company would no longer be entitled to any private company exemptions.
- To illustrate, under the Companies Act, from a financing perspective, companies are restricted from financing a purchase of their own/holding company's shares. While private companies are exempt from such restriction, this exemption would cease to be available once the investee company becomes a deemed public company. Likewise, from a corporate governance perspective, interested directors of public companies are not permitted to vote on matters while in private companies, 'interested directors' can vote so long as they disclose their interest in a particular transaction. This exemption would not be available to a deemed public company. Investors should be conscious of these provisions given the key impact on their investment from governance, administration, financial and investment structuring perspective.

## Employee Claims: Non-compliance of social security legislations


- Employee claims, especially those that arise from non-compliance of social security legislations such as the Employees' Provident Funds and Miscellaneous Provident Act, 1952 (**EPF Act**), continue to expose the target company to risks, which should be adequately addressed by the investor in the definitive documents in any M&A transaction. Generally, the investor would seek representations relating to the target company being in compliance of, and having paid, all statutory contributions fully and regularly.
- In terms of the EPF Act read with the Employees' Provident Funds Scheme, 1952, employers are required to contribute, depending on the nature of the establishment, 10% or 12% of the 'basic wages' of the employees to the employees' provident fund (**Fund**) maintained by the Employees Provident Fund Organisation. It is not uncommon for employers in India to structure the compensation package of their employees by segregating the compensation into various heads, in addition to 'basic wage' (such as education allowance, conveyance allowance, medical allowance etc.), with a view to reducing their liability to make contributions to the Fund (which is required to be determined on the basis of 'basic wages').

### Case Study

In the recent judgment of *The Regional Provident Fund Commissioner (II) West Bengal vs. Vivekananda Vidyamandir & Ors* (the **Vivekananda Decision**), the Supreme Court reiterated the test laid down in its earlier decisions in *Bridge and Road Co Ltd* [(1963) 3 SCR 978] and *Manipal Academy of Higher Education vs. Provident Fund Commissioner* [(2008) 5 SCC 428], and held that 'basic wages' would not take within its ambit any special incentive or production bonus given to more meritorious workmen who put in extra output which has a direct nexus and linkage with the output by the eligible workmen. However, wage which is universally, necessarily and ordinarily paid to all across the board, are basic wages, and should therefore be included in the calculation of contribution to be made to the Fund. A review application which was filed in relation to the Vivekananda Decision was dismissed by the SC on August 29, 2019.

## Higher period of limitation for the Government/Concession Authority

- The Indian law of limitation viz. the Limitation Act prescribes the time limit which is given for different suits, appeals and applications to an aggrieved person within which it can approach a court for redress or justice. It has a very wide range, considerably, to include almost all the court proceedings. However, where any special or local law prescribes any period of limitation for any suit or proceedings other than what is prescribed under the Limitation Act, the limitation prescribed under such local or special law will prevail.

- A limitation period commences when the cause of action arises, that is, when a party becomes entitled to make a claim[98]. The Limitation Act prescribes a higher period of limitation for Government for pursuing a claim as compared to a private party. The fact that the government is given 30 years to bring certain claims against private parties as opposed to private parties who are given usually 3 years under the Limitation Act, is a legal testimony of the fact that government machinery moves very slowly. The same may apply in case of a concession agreement enabling the Government/concession authority to bring in a claim against the concessionaire after the passing of a considerably long period since the occurrence of the cause of action.
- Delay in referring a claim is not curable and can result in its dismissal unless such delay is condoned by the court having required jurisdiction. The court may condone the delay if it is convinced that there was a 'sufficient cause' in referring of such claim. Determination whether there exists sufficient cause, is subject to discretion of the courts. Traditionally, the Indian courts have been lenient in condoning delays by the Government in preferring claims. However, in some instances, the courts have expressed that delay in preferring a claim by the Government due to procedural red tape should not be a sufficient cause.

**Case Study**

Section 120 of the Major Ports Trusts Act, 1963 (**MPTA**) provides that no suit or other proceeding can be commenced against a Board of Trustees or any member or employee thereof, for anything done, or purporting to have been done, in pursuance of the MPTA, until expiration of 1 (one) month after notice in writing has been given to the Board of Trustees or him stating the cause of action, or after 6 (six) months after the accrual of the cause of action.

As per Section 79 of the Mines Act, 1952 (Mines Act) no court can take cognizance of any offence under the Mines Act unless the complaint has been made:

(i) within 6 months from the date on which the offence is alleged to have been committed, or

(ii) within 6 months from the date on which the alleged commission of the offence came to the knowledge of the Inspector (*as defined under the Mines Act*), or

(iii) in cases where the accused is or was a public servant and previous sanction of the Central Government or State Government or of any other authority is necessary for taking cognizance of the offence under any law for the time being in force, within 3 months from the date on which the sanction is received by the Chief Inspector (*as defined under the Mines Act*), or

(iv) in cases where a court of inquiry has been appointed by the Central Government under Section 24 of the Mines Act within 1 year after the date of the publication of the report.

## Liquidated damages and penalty

- As is common practice worldwide, construction contracts provide for contractor to pay liquidated damages to the employer for various non-performances such as the failure of the contractor to perform its obligations within the time prescribed in the agreement. In India, provisions for contractual damages are enshrined of the Indian Contract Act, 1872 (**Contract Act**). Section 73 and 75 deal with compensation for loss or damage arising on account of breach and compensation for damage that a party suffers on account of non-fulfilment of a contract after such party rightfully rescinds the contract. Section 74 on the other hand, is available when the contract provides for a pre-determined amount as compensation, or where there is any other stipulation by way of penalty[99].
- Often in contractual disputes one is forced to delve into the questions such as the extent of jurisdiction of Indian courts to award compensation on a clause on liquidated damages; the measure of damages under section 74 of the

[98] The question as to when a cause of action has arisen may vary from case to case and has been a matter of judicial interpretation in numerous cases.

[99] While liquidated damages are such damages as have been agreed upon and fixed by the parties in anticipation of breach, un-liquidated damages (such as under Section 73) are such damages as a required to be assessed.

Contract Act; and when the clause provides for a genuine pre-estimate of loss or damages is there still a need to prove it?

- Firstly, it would be prudent to understand that there is a stark difference of the position in English law in respect of liquidated damages vis a vis Indian law which was clarified by the Supreme Court in *Fateh Chand v. Balkishan Dass*[100]. In this case, the Supreme Court considered section 74 as it stands and contrasted it with the position under English common law. It found that under English common law, a mutually agreed genuine pre-estimate of damages is considered by courts as liquidated damages and claims thereon are sustained. Stipulations in a contract in 'terrorem' are treated as penalty and courts refuse to enforce such clauses, awarding only a reasonable sum as compensation[101]. According to the Supreme Court, section 74 is a conscious attempt by the legislature to move away from complex rules and presumptions under English common law, to distinguish between stipulations providing for liquidated damages and those in the nature of penalty. Section 74 provides uniform principle which apply to named sums as well as any other stipulation in the nature of penalty. Thus, if a stipulation is found to be a genuine pre-estimate of the damages, the court shall award the amount decided by the parties. However, if the stipulation is found to be in the nature of a penalty then, unlike the English Law, where the clause becomes void and irrecoverable, as per the Indian law, the court shall assess the extent of the loss or damage suffered by the aggrieved party and shall award reasonable compensation to it. The focus of the section thus is on reasonable compensation. Compensation is said to be reasonable if it is awarded in accordance with settled principles of law. Though, the court has unqualified jurisdiction to award such compensation as it deems reasonable, it is subject to the maximum amount that has been stipulated by the parties within the contract.
- While the principles laid down in the case of Fateh Chand *supra*. have endured for over half a century, the latest precedent is the 2015 decision of the Supreme Court in *Kailash Nath Associates v Delhi Development Authority and Another*[102].
- In India, the clear principles that emerge from the line of precedents on the subject can be summarized as:
  - legal injury is an absolute essential for award of compensation under section 74;
  - section 74 merely dispenses with the proof of 'actual loss or damage', it does not justify award of compensation when no legal injury results as a consequence of breach;
  - the party complaining of a breach can receive a named amount as compensation in instances where exact loss or damage is difficult to prove, provided it is a genuine pre-estimate of damage, fixed by both parties and found to be so by court;
  - in other instances, the measure for damages is 'reasonable compensation', subject to the limits set out in the clause on liquidated damages. Such compensation is to be fixed on settled principles found, inter alia, in Section 73;
  - while awarding compensation due regard is to be given to conditions existing on the date of breach;
  - jurisdiction of courts to award compensation is unqualified except as to the limit stipulated; and
  - the provision applies with equal force to amounts already paid or those payable in future.
- The bone of contention in almost all cases has been the use of the expression 'whether or not actual damage or loss is proved to have been caused thereby' in section 74. The question uppermost in the minds of people dealing

[100] AIR 1963 SC 1405

[101] In English Law if the stipulation in the contract specifying the amount of money required to be paid by a defaulting party to the other for breach is a genuine pre-estimate of damages likely to be caused, it is called liquidated damages and are recoverable under law. If there is no genuine pre-estimate of loss, the same will be termed penalty and the said penal clause would be considered void. The enforceability of penalty i.e the detriment imposed in the provisions of the contract is disproportionately excessive in comparison with the legitimate interest of the innocent party (such as monetary loss) is not recognized under English Law. The House of Lords in *Dunlop Pneumatic Tyre Co., Ltd. v. New Garage and Motor Co., Ltd.* 1915 AC 79 had laid down that if a stipulation is such that it operates "in terrorem" of the offending party to secure the performance of contract and if such sum is extravagant, unconscionable and disproportionately large then it shall operate as a penalty. Penalty clauses are void and irrecoverable in nature. Though the penal sum operates as a form of punishment on the defaulter irrespective of any loss, the liability of the defaulter is restricted only for those damages which can be proved against him. The English Law thus is said to impose the requirement of proving actual damage in case a stipulation is by way of a penalty.

[102] (2015) 4 SCC 136

with clauses on liquidated damages is: 'What is the reason for courts to delve into the issue of reasonable compensation when an amount, which is termed as a "genuine pre-estimate" is already stated in the contract?' This is usually followed by: 'Is it not counterintuitive to seek to fix compensation by reference to section 73 despite there being a named sum in the contract?'

- In *Maula Bux v Union of India*[103], the Supreme Court explained that the expression is intended to cover different classes of contracts. In case of breach of some contracts it may be impossible for the court to assess compensation arising from the breach. It is in these circumstances that the sum named by parties may be taken into consideration as the measure of reasonable compensation, provided it is a genuine pre-estimate and not in the nature of a penalty. Where loss in terms of money can be determined, the party claiming compensation has necessarily to prove the loss suffered and, in such instances, the courts are bound to assess the reasonableness of compensation claimed. It is while doing so that the courts will apply the principles under section 73. It is important to understand that the courts are reluctant to countenance a position that is predicated on making a windfall out of a contractual breach. Therefore, unless damage or loss is shown to have been suffered, and the extent thereof measured and assessed, the courts will refuse to enforce a clause on liquidated damages. What also needs to be borne in mind is that this principle applies to both named amounts in contract as liquidated damages as well as any other stipulation in the nature of a penalty. Further in either case, the liquidated amount or penalty is the upper limit and the courts cannot grant compensation beyond that amount.
- One of the other tests to sustain a clause on liquidated damages is to ascertain whether it was mutually agreed upon by the parties possessing equal bargaining power. In *Phulchand Exports Limited v O O O Patriot*[104], the Supreme Court considered section 74 of Contract Act and held that the clause for reimbursement for the seller's failure to deliver the shipment and of the amount paid by the buyer, was neither in the nature of threat, nor was it in the nature of penalty and even in the absence of such a clause, where the seller has breached their obligation at the threshold, the buyer is entitled to the return of the price paid plus damages. The seller sought to set aside the arbitral award granted earlier on the grounds that it was punitive and, therefore, contrary to public policy, to which the court held that when experienced business people enter into commercial contracts and have equal bargaining power, the agreed terms of contract must be respected as the parties may have taken into regards, matters of their knowledge. Further, in *ONGC vs. SAW Pipes Ltd.*[105], the Supreme Court further held that that if the parties knew when they made the contract that a particular loss is likely to result from such breach, they can agree for payment of such compensation. In such a case, there may not be any necessity of leading evidence for proving damages, unless the court arrives at a conclusion that no loss is likely to occur because of such breach. However, when the terms of the contract are clear and unambiguous, then its meaning is to be gathered only from the words of the contract. The Supreme Court also stated that where an agreement is executed by experts in a field, it would be difficult to hold that the intention of the parties was different from the language used. In such a case, it is for the party who contends that the stipulated amount is not reasonable compensation to prove the same.
- Parties committed to reducing litigation and providing commercial certainty opt for a liquidated damages clause in commercial contracts, particularly when the sector is subject to regulatory regimes such as telecommunications. While determining the nature and enforceability of liquidated damages clause contained in an interconnect agreement, the Supreme Court in *Bharat Sanchar Nigam Limited v Reliance Communication Limited*[106], clarified that before demarcating a damages clause as liquidated damages or penal, the loss was measured based on costing, pricing and maintenance of a level playing field. Since the amount represents a pre-estimate of reasonable compensation, section 74 was not violated. Moreover, when the damage is difficult to calculate, it enhances the

[103] (1969) 2 SCC 554

[104] (2011) 10 SCC 300

[105] (2003) 5 SCC 705

[106] (2011) 1 SCC 394

presumption that the agreed sum is a genuine attempt to estimate the loss and overcome difficulties of proof at the time of trial.

- Another point of consideration is with the implications of Goods and Service Tax (GST) on the payment of such damages under a contract, and that among other factors, contractual terms are relevant to judge whether the payment of liquidated damages would attract taxation. It is relevant to consider the decision of the Appellate Authority for Advance Authority in the case of *Maharashtra State Power Generation Company Limited*[107], where it was held that liquidated damages falls under clause 5(e) of Schedule II attached to CGST Act liable to payment of GST at the rate of 18% payable as per Section 13 of CGST Act, when the same is imposed on the defaulting subcontractor by the principal.
- In conclusion, to ensure that an enforceable claim of liquidated damages arises at the end of a hard-fought litigation, it is necessary to spend some time on the clause on such damages when it is being drafted. The principles outlined above, come from some of the most important decisions on this point in the jurisdiction and, if followed assiduously, will assist in ensuring enforcement of a decree/award of amount as liquidated damages before the Courts in India.

## Enforceability of Take or Pay Provisions

- Take or pay contracts/clauses[108] are common in the energy industry and in particular for gas sales. Take or pay provisions are also common in electricity sales agreements in India particularly because they were permitted in the context of supply of electricity under Indian electricity laws. However, take or pay clauses which fall outside the scope of a prescribed law (such as in a contract for gas sales/supply), have not been often litigated and the law on such clauses is therefore not yet certain in India. In the case of *ONGC v. Association of NGC Industries* of Gujarat AIR 1990 SC 1851, the Supreme Court briefly seems to have approved a take or pay clause in a gas purchase agreement, despite the absence of a statutory provision of law. However, the Supreme Court did not examine or opine on the rationale for upholding the same. Thus, the law relating to take or pay is not free from doubt.
- There is a risk that a take or pay clause may not have its intended effect under Indian law as the payments for the deficiencies towards taking a product could be construed by the Indian courts as liquidated damages and the payments to be made under a take or pay clause could be taken to be an upper limit of the amounts actually to be paid and could therefore be subject to the challenge of reasonable approximation in courts (kindly refer our comments in the section on liquidated damages). Further, one may also argue before the courts that the amount of damages are not commensurate to the actual damage that may have been suffered by the supplier on account of failure of the buyer to take the product. This is because, upon payment of the damages, the product remains in the hands of the supplier and may not be available for supply to the buyer at a future date. In such case, sale of the product by the seller to a third party would be an unjust enrichment on the part of the seller.
- It however seems that internationally, take or pay does not necessarily qualify to liquidated damages – particularly in the oil and gas industry. We note that courts in USA have found that so long as the purchaser either buys the gas or makes the deficiency payment no breach has occurred and therefore there are no liquidated damages because the payment of the deficiency amount is not a remedy but instead a second alternative means of performance. Failure to take and pay for gas merely constitutes a decision not to perform the first alternative obligation and is not a repudiation of contract. Repudiation of contract does not occur until the buyer refuses to make the required deficiency payments. Hence the deficiency payment obligation is not a provision designed to provide the measure of damages when the buyer fails to take or pay for the gas under the contract. We also note that courts in England have maintained that the rule in respect of penalties will only apply where there is a breach of contract. If a sum

[107] 2018 (17) GSTL 451

[108] Broadly, in a take of pay contract/ clause, a company either takes the product from the supplier or pays the supplier for the deficiency. Typically, upto an agreed upon ceiling, the company has to pay the supplier even for the products it did not take. This payment is usually lower than the usual price for supply of gas.

has to be paid (under take or pay) for making service available, the same would be regarded as a primary obligation (debt) and not a secondary obligation (damages).

- Thus, contrary to the argument to liquidated damages, it could be argued that the take or pay amount is merely a pre-determined amount payable by the buyer to the seller on a specific omission and is not in the nature of damages clause/penalty provision. However, in the absence of any decided case law, the ability of the Seller to recover the entire contracted take or pay amount (refuting Section 74 of the Contract Act) is not free from doubt.
- Although we have not come across any case law where the courts have upheld the obligation for payment of minimum fixed charges in long term agreements for supply of goods/services (as a primary obligation and not as an amount payable on breach within the meaning of Section 74 of the Contract Act), some relevant decisions (in addition to the NGC Industries case supra.) may be worth highlighting:
  - The obligation for payment of minimum guaranteed amounts pursuant to long term electricity supply contracts has been upheld by the courts. In *Amalgamated Electricity Co. v. Jalgaon Borough Municipality*[109], the respondent contested the validity of an obligation for consumption of an agreed minimum quantum of electricity, pursuant to a five-year electricity supply agreement. Under the agreement, the respondent had agreed to a minimum consumption of electricity for 16 hours a day. The Supreme Court held that such obligation embodies *"what is known in common parlance as the doctrine of minimum guarantee i.e., the Company*[110] *was assured of a minimum consumption of electrical energy by the Municipality*[111] *and for the payment of the same whether it was consumed or not. That was the reason why the Company was prepared to charge a minimum rate of … (which was) was actually the consideration for the minimum guarantee allowed to the plaintiff …"*
  - The Supreme Court largely based its decision on the proviso of Section 22[112] of the Indian Electricity Act, 1910 which states as follows:

    "***Obligation on licensee to supply energy***: *Where the energy is supplied by a licensee, every person within the area of supply shall, except insofar as is otherwise provided by the terms and conditions of the licence, be entitled, on application, to a supply on the same terms as those on which any other person in the same terms as those on which any other person in the same area is entitled in similar circumstances to a corresponding supply.*

    *Provided that no person shall be entitled to demand, or to continue to receive, from a licensee a supply of energy for any premises having a separate supply unless he has agreed with the licensee to pay to him such minimum annual sum as will give him a reasonable return on the capital expenditure, and will cover other standing charges incurred by him in order to meet the possible maximum demand for those premises, the sum payable to be determined in case of difference or dispute by arbitration."*
  - The Supreme Court further justified the levy of the minimum charges by observing that in order for the electricity supplier to supply electricity to the consumer at the concessional rates "*it had to lay down lines and to keep the power ready for being supplied as and when required. The consumers could put their switches on whenever they liked and therefore the plaintiff had to keep everything ready so that power is supplied the moment the switch was put on. In these circumstances, it was absolutely essential that the plaintiff should have been ensured the payment of the minimum charges for the supply of electrical energy whether consumed or not so that it may be able to meet the bare maintenance expenses."*

[109] AIR 1975 SC 2235

[110] i.e. the Electricity Supplier

[111] i.e. the Consumer

[112] Section 22 stated as follows: *"**Obligation on licensee to supply energy :** Where the energy is supplied by a licensee, every person within the area of supply shall, except insofar as is otherwise provided by the terms and conditions of the licence, be entitled, on application, to a supply on the same terms as those on which any other person in the same terms as those on which any other person in the same area is entitled in similar circumstances to a corresponding supply."*

- The above observation appears to lay down some rationale for a *prima facie* justification of the levy of a minimum charge under a long-term supply contract involving the establishment of some infrastructure and facilities and keeping them in a state of readiness for performance de hors a statutory backing for such levy. The Supreme Court has relied on this case while giving its decision on the NGC Industries case supra – which did not have any applicable statutory legislation analogous to the aforementioned Section 22. It stated that *"If any authority regarding the rationale of such a clause is needed, it is to be found in the decision of this Court in Amalgamated Electricity Co. Ltd. V. Jalgaon Borough Municipality".*

- Another case that may of relevance is *Mahavir Khandsari Sugar Mill v. MSEB*[113]. The purchaser agreed to consumption of a minimum guaranteed power from MSEB in a long-term electricity supply agreement of 7 years. The value of the same was pre-determined pursuant to which minimum monthly charge was payable. The agreement also provided that the purchaser will, *inter alia* be *"additionally liable to continue to pay the minimum charges and the minimum guarantee payable thereunder" in the event of suspension of supply by MSEB due to breach or default of the purchaser*.

- MSEB discontinued electricity supplies due to recurring defaults by the purchaser in payment of its electricity dues and claimed payment equivalent to charges the minimum guaranteed amount for the prior periods and for the residuary unexpired period of the contract. The purchaser contended that the obligation to pay the minimum guaranteed amounts was in the nature of a penalty and therefore unenforceable. The Court upheld the obligation to pay the minimum charges on the basis of the decision of the High Court in *Gujarat Electricity Board v. Shree Rajaratna Naranbhai Mills Co. Ltd*.[114] wherein the court had apparently held that : *"… the provision of minimum charge in the agreement between a consumer and a licensee is but one of the modes of providing for reasonable return to the licensee for the investment that it has made and on the capital outlay that it has made and merely because the agreement provides for a minimum charge, it cannot be said that the terms are unreasonable or that a monopoly concern has taken undue advantage over the consumer in the area of supply … the agreement did not come to an end nor was the Board disentitled to levy minimum charges during the period of discontinuance of supply."*

  Similar arguments were raised by the purchaser that the MSEB had not spent a large amount in installing the supply lines and therefore the minimum charges are unconscionable. The court rejected this argument and said there may be other arrangements required to be undertaken by MSEB which may also be of a recurring nature.

- The Court further upheld the levy of the minimum guaranteed charge for the unexpired period of the contract and stated that MSEB *"expected some reasonable profit from the investment it was making and from the facility that it was giving to defendant No. 1. Plaintiff bound itself to supply energy for a period of 7 years and in consideration of its commitment expected the 1st defendant to consume a certain minimum of units … Where the parties themselves fixed the liquidated damages payable in the event of a breach of the agreement, Court will be slow to interfere with the terms of the agreement reached between them."*

- From an investor's perspective, take or pay contracts provide a degree of certainty of revenue and hence are protective of its investment. Therefore, the enforceability of such obligations is significant.

[113] AIR 1993 Bom 279

[114] (1975) 16 Guj LR 90

# Insolvency and Bankruptcy

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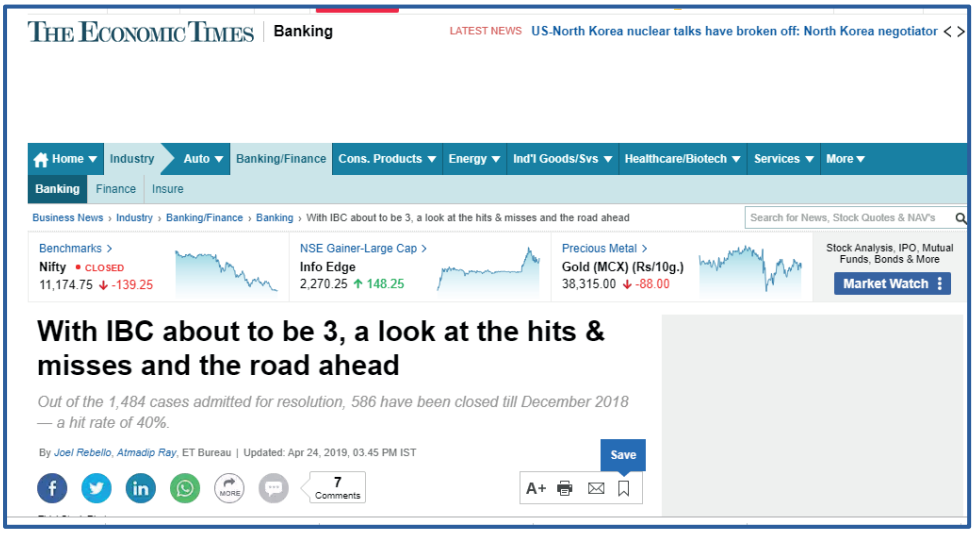
Ladakh has the world’s highest motorable road in the world…

# Insolvency and Bankruptcy

Before financing of infrastructure project (PPPs or otherwise), it is important to understand insolvency laws by all parties concerned especially the lenders.

Key issues that will need to be considered when financing an infrastructure project are:

- What happens if the project company becomes insolvent?
- Whether it is possible to revive the project prior to liquidation and appoint administrators/resolution professional (**RP**) to try and get the business back to being viable?
- Are there clear procedures for appointment of liquidators?
- Is there a clear prioritization between different creditors?
- What will happen to project assets?




The Insolvency and Bankruptcy Code, 2016 (**IBC**) was introduced and enforced in December 2016. The IBC answers the above questions and is intended to assist lenders by providing a uniform, comprehensive and efficient insolvency legislation, with an emphasis on revival as a first avenue for debt recovery.

Under IBC, both operational creditors and financial creditors (in addition to the debtor company (**Corporate Debtor**) itself) have been allowed to file an application, on occurrence of a 'default', with the adjudicating authority, *i.e.*, National Company Law Tribunal (**NCLT**). In case the NCLT approves the application, a corporate insolvency resolution process (**CIRP**) is initiated and moratorium is imposed over *inter-alia* proceedings and alienation of assets of the Corporate Debtor. The board of the Corporate Debtor is suspended and a RP takes over the responsibility to run the company. There is a 330 day period within which the committee of creditors (**COC**) has to approve a resolution plan and the corporate insolvency resolution process shall mandatorily be completed within the said period including any extension of the period of corporate insolvency resolution process granted under Section 12 of IBC and the time taken in legal proceedings in relation to the resolution process of the corporate debtor. In case no resolution plan is approved or in case the same is rejected, then the Corporate Debtor is to be mandatorily liquidated. In case of liquidation, clear provisions are incorporated in the IBC as to order of priority for distribution of proceeds from the sale of liquidated assets.

The COC may approve a resolution plan by a vote of not less than 66% of voting share of the financial creditors, after considering its feasibility and viability. The manner of distribution proposed, may take into account the order of priority amongst creditors as laid down in sub-section (1) of section 53 of IBC, including the priority and value of the security interest of a secured creditor and such other requirements as may be specified by the board.

Therefore, COC can only consider "*the manner of distribution proposed*". The proposal however has to be made by the resolution applicant. Therefore, the resolution applicant can propose distribution, including the priority and value of the

security interest of a secured creditor and also the priority amongst creditors as laid down in sub-section (1) of section 53 of IBC.

So, priority to each secured financial creditor is based on the value of security interest of the creditor. Even if such creditor enforces his/her right in a liquidation, he/she may only get relief to the extent ad value of security interest created in its favor.

In case of liquidation, the liquidator may sell-:

a. An asset on a standalone basis

b. The assets in a slump sale

c. A set of assets collectively

d. The assets in parcels

e. The corporate debtor as a going concern

f. The business(s) of the corporate debtor as a going concern

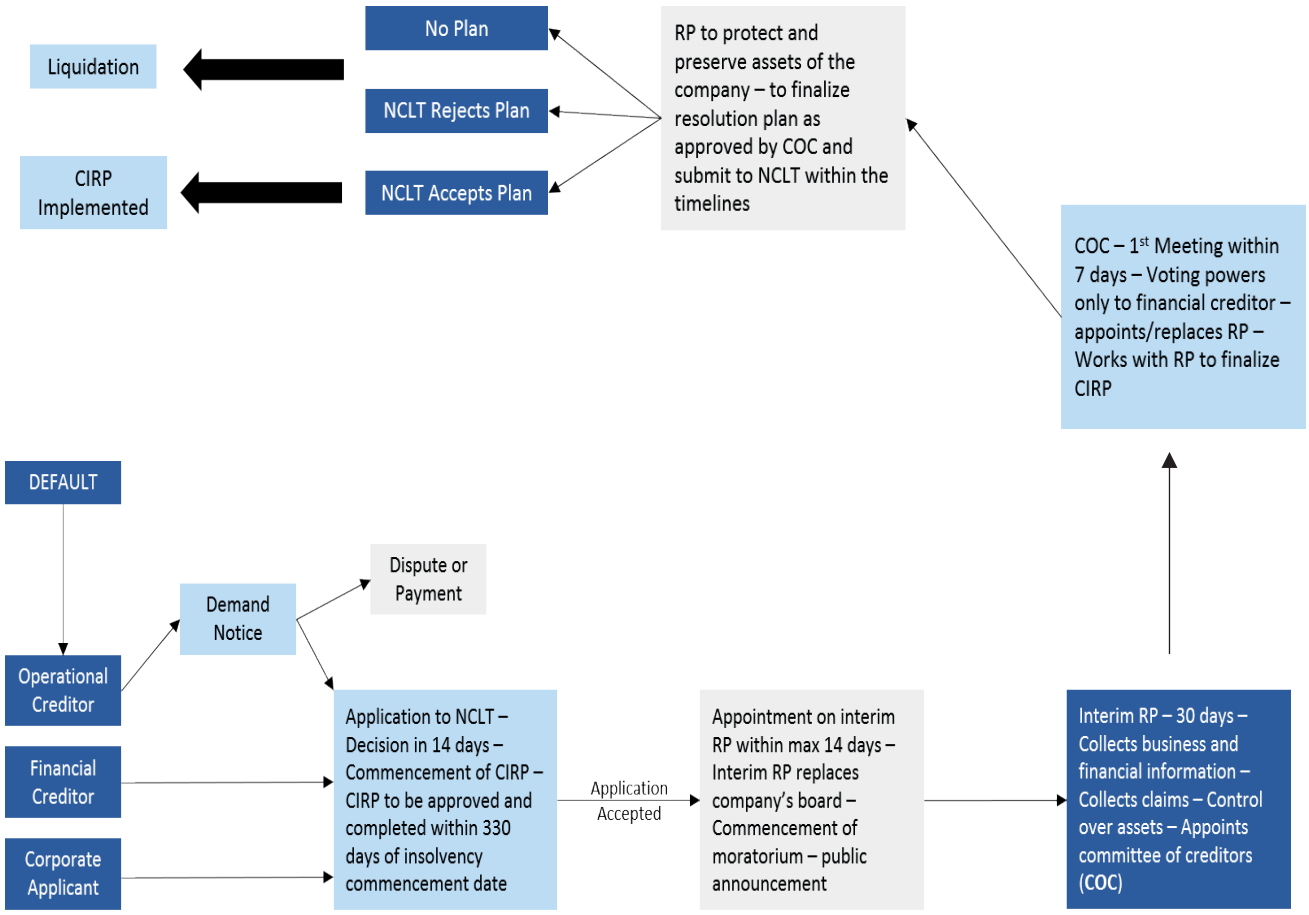
An asset shall not be sold under any of the clauses (a) to (f) unless the security interest therein has been relinquished to the liquidation estate.

As per sub-section (1) of section 53 of IBC, the proceeds from the sale of the liquidation assets are required to be distributed in the following order of priority, namely: -

- The insolvency resolution process costs and the liquidation costs paid in full
- The following debts which shall rank equally between and among the following
  - workmen's dues for the period of 24 months preceding the liquidation commencement date
  - debts owed to a secured creditor in the event that such secured creditor has relinquished his security in the manner set out in IBC
- Wages and any unpaid dues owed to employees other than workmen for the period of 12 months preceding the liquidation commencement date
- Financial debts owed to unsecured creditors
- The following dues ranking equally between and among the following: -
  - any amount due to the Central Government and the State Government including the amount to be received on account of the Consolidated Fund of India and the Consolidated Fund of a State, if any, in respect of the whole or any part of the period of 2 years preceding the liquidation commencement date
  - debts owed to a secured creditor for any amount unpaid following the enforcement of security interest
- Any remaining debts and dues
- Preference shareholders, if any; and
- Equity shareholders or partners, as the case may be.

It may be noted that Insolvency and Bankruptcy Board has sought for special a regulatory regime for PPPs. However, there is no such regime notified yet.

## IBC process




## IBC from the lens of the infrastructure sector

Under IBC, **debt** is defined to mean a liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt.

**Financial Debt** is defined to mean a debt along with interest, if any, which is disbursed against the consideration for the time value of money and includes:

a. Money borrowed against the payment of interest

b. Any amount raised by acceptance under any acceptance credit facility or its dematerialized equivalent

c. Any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument

d. The amount of any liability in respect of any lease or hire purchase contract which is deemed as a finance or capital lease under the Indian Accounting Standards or such other accounting standards as may be prescribed

e. Receivables sold or discounted other than any receivables sold on non-recourse basis

f. Any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing

For the purposes of this sub-clause, - (i) any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing; and (ii) the expressions, "allottee" and "real estate project" shall have the meanings respectively assigned to them in clauses (d) and (zn) of section 2 of the Real Estate (Regulation and Development) Act, 2016 (**16 of 2016**)

g. For calculating the value of any derivative transaction, entered into in connection with protection against or benefit from fluctuation in any rate or price only the market value of such transaction shall be taken into account

h. Any counter-indemnity obligation in respect of a guarantee, indemnity, bond, documentary letter of credit or any other instrument issued by a bank or financial institution

i. The amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in sub-clause (a) to (h) of this clause

**Operational Debt** is defined in the IBC as, "*"Operational Debt" means a claim in respect of the provision of goods or services including employment or a debt in respect of the payment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority."*

**IBC a game-changer, but delays a concern: Srei Infra**

"The Indian judiciary should facilitate infrastructure development by providing speedy resolutions. Our country's economic progress hinges on this," Bhutoria said.

*A screenshot of an article in Money Control (May 11, 2019). The above quote is by the CEO of Srei Infrastructure on how the delay in decision making during the IBC process is a cause for concern*

## Key considerations

Having dealt with IBC from a lenders perspective, it is also important to consider that in an infrastructure project apart from the project company or project SPV other parties are also involved such as contractors for (i) EPC, (ii) operation and maintenance (**O&M**), (iii) supply of capital goods and raw materials, etc., depending on the nature of an infrastructure project.

**In this background following question may crop up from IBC perspective:**

- **Whether advance money paid by the project company or project SPV to the contractor would be considered as a financial debt or operational debt in case the contractor becomes subject of proceedings under IBC before completion of the work (or a portion of work for which advance money is paid)?**

  The opening words of the definition of financial debt (given above) would indicate that a financial debt is a debt along with interest which is disbursed against the consideration for the time value of money and it may include any of the events enumerated in sub-clauses (a) to (i) which are self-explanatory. Therefore, the first essential requirement of financial debt has to be met viz, that the debt is disbursed against the consideration for the time value of money and which may include the events enumerated in various sub-clauses. The current definition of 'financial debt' under IBC uses the words "includes", thus the kinds of financial debts illustrated are not exhaustive.

  The phrase *"disbursed against the consideration for the time value of money"* has been the subject of interpretation only in a handful of cases under the IBC. The words "*time value*" have been interpreted to mean compensation or the price paid for the length of time for which the money has been disbursed. This may be in the form of interest paid on the money or factoring of a discount in the payment.

The concept of time value of money is that money available at the present time is worth more than the identical sum in the future due to its potential earning capacity. This core principle of finance holds that, provided money can earn interest, any amount of money is worth more the sooner it is received. In Black's Law Dictionary (9th edition) the expression "time value" has been defined to mean *"the price associated with the length of time that an investor must wait until an investment matures or the related income is earned".*

**Case Study**

In *Nikhil Mehta v. AMR Infrastructure*[115] the claim of the applicants was made in pursuance of various agreements/memorandums of understanding entered into with the corporate debtor, whereby the applicants had agreed to purchase certain units in a real estate project against the payment of substantial portion of the total sale consideration upfront and the corporate debtor had undertaken to pay a particular amount to the applicants each month as "committed returns/assured returns" till the time the actual physical possession of the units was handed over to the applicants.

The corporate debtor had in turn started to make payments of such amounts for a while before it defaulted on payment of the "committed returns/assured returns" to the applicant, as per the memorandum of understanding. In the light of the factual matrix, National Company Law Appellate Tribunal (**NCLAT**) vide an order dated July 21, 2017 *observed that ''since the corporate debtor had agreed to pay 'monthly committed returns' to the applicants, the amount disbursed by the applicants was 'against the consideration of the time value of the money''* .

From the above analysis it could be concluded that advance money paid by the project company or project SPV to such contractors (as mentioned above) would not amount to be a financial debt since no interest or return is paid for such advance payment (though it was paid against the consideration that the contractor would perform its contract). Consequently, it would not pass the test of 'time value of money'.

**It is also important to analyze whether advance money paid by the project company or project SPV to the contractor (as mentioned above) would be considered as an operational debt**.

**Case Study**

In *Overseas Infrastructure Alliance (India) Pvt. Ltd. Vs. Kay Bouvet Engineering Ltd*[116]., the Hon'ble NCLAT, New Delhi held that *"there should be no difficulty in holding that the Tripartite Agreement provided for supply for goods and rendering of services and the Appellants claim was in respect of such provision of goods and services. Viewed in this perspective, it can be stated without any hesitation that the Appellant having advanced 10% of the contract value to Respondent – sub-contractor as advance payment had a claim in respect of provision of goods or services bringing him within the definition of 'Operational Creditor', to whom an 'Operational Debt' was owed by the Respondent – 'Corporate Debtor''.*

In the above case Overseas Infrastructure Alliance (India) Pvt. Ltd. was awarded an engineering construction contract by Mashkour Sugar Mills, Sudan for a sugar plant in the state of Sudan. This project was to be financed under the GOIs line of credit through Export-Import Bank of India in two tranches. Kay Bouvet Engineering Ltd. was appointed as sub-contractor. Thereafter, the parties entered into a tripartite agreement whereby Overseas Infrastructure Alliance (India) Pvt Ltd. subcontracted the whole of the works in relation to the said project to Kay Bouvet Engineering Ltd.

In furtherance of the same, Overseas Infrastructure Alliance (India) Pvt. Ltd. advanced a sum equivalent to 10% of the contract value to Kay Bouvet Engineering Ltd. as advance payment. However, since Exim Bank did not release the second tranche of the payment, Mashkour Sugar Mills, Sudan terminated the contract with Overseas Infrastructure Alliance (India) Pvt Ltd. Consequently, the tripartite agreement came to an end. Overseas

[115] (Company Appeal (AT) (Insolvency) No. 07/2017), NCLAT, New Delhi.

[116] (Company Appeal (AT) (Insolvency) No. 582 of 2018 )

Infrastructure Alliance (India) Pvt Ltd. demanded the refund of the sums advanced to the Kay Bouvet Engineering Ltd. under the tripartite agreement. Subsequently, the Overseas Infrastructure Alliance (India) Pvt Ltd. sought to initiate insolvency proceedings against the Bouvet Engineering Ltd for the refund of the advance paid pursuant to the tripartite agreement.

From the above order of Hon'ble NCLAT, New Delhi, it may be concluded refund for the advance paid as consideration for the goods and services will fall within the definition of the Operational Debt and a person claiming the same will be an operational creditor under IBC. **However, it may be noted an appeal (being Civil Appeal No(s). 1137/2019) against the above order of Hon'ble NCLAT, New Delhi has been filed and pending in Hon'ble Supreme Court**.

- **Whether retention money that a project company or project SPV keeps from such contractors would be considered as a financial debt or operational debt in case such a project company or project SPV becomes subject of proceedings under IBC?**

Retention money is an amount held back from a payment made under a construction contract. It is generally held to ensure that a contractor performs all of its obligations under the contract and is then released either on practical completion or after the end of a notification period. Hence, if the contractor has performed all his obligations under the contract then the retention money held back by project company or project SPV would be a claim against such a project company or project SPV in respect of the **provision of services. Consequently, such retention money would amount to be an operational debt under IBC**. It will not amount to a financial debt for the reasons discussed/mention in reply to the above question.

- **Whether the use of retention of title clauses is one option to mitigate loss for a supplier of capital goods and raw materials?**

A 'retention of title' clause is a clause that allows the supplier to retain ownership over the goods supplied until such time as certain conditions are met (e.g. receipt of full price/consideration in case the price/consideration is agreed to be paid in instalments).

As per section 4 (Sale and agreement to sell) of Sale of Goods Act, 1930 — (i) A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. There may be a contract of sale between one part-owner and another. (ii) A contract of sale may be absolute or conditional. (iii) Where under a contract of sale, the property in the goods is transferred from the seller to the buyer, the contract is called a sale, but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell. (iv) An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred.

As per Section 19 of Sale of Goods Act, 1930, where there is a contract for the sale of specific or ascertained goods the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred. Further, as per this section, for the purpose of ascertaining the intention of the parties, regard shall be given to the terms of the contract, the conduct of the parties and the circumstances of the case.

The distinguishing feature between 'an agreement to sell' and a 'sale' is that in the former the property in the goods is transferred from the seller to the buyer at some subsequent time or subject to some conditions thereafter to be fulfilled, while in sale the property in the goods passes to the buyer the moment the sale is made. Section 4(3) of the Sale of Goods Act, 1930 states that "*Where under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale, but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell*"; and Section 4(4) of the Sale of Goods Act, 1930, states that "*an agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred*."

It follows that until the property in goods has been transferred from the seller to the buyer there is no sale. The contract of sale remains merely executory till then; and it becomes executed the moment the property has passed to the buyer. The section recognizes the rule that in case of an agreement of consideration; whether the consideration consists in some actual performance, as the payment of the price, or in a promise, express or implied, the time of the transfer of property (wherever such transfer is possible) depends upon the intention of the parties, however indicated. And the word `intention' means expressed intention. The governing principle which should determine as to the passing of the property in the goods must be to find out what is the intention of the parties. The question of passing of property is normally a question of intention and the intention of the parties must be gathered from the terms of the contract.

**Case Study**

In *Amies v. Jal*[117] an agreement for the sale of a motor-car, of which the price was paid in monthly instalments, contained, amongst others, a term that in default of payment of any one instalment the seller should be at liberty to terminate the agreement and take possession of the car without being liable to refund to the buyer the instalments paid by him. It was held that intention of parties, as expressed in the conditions, was that the property in the car should not pass until full price is paid.

In view of the above, retention of title clause may be incorporated in the contract of sale of goods allowing the supplier to retain ownership over the goods supplied until such time as certain conditions are met (e.g. receipt of full price/consideration in case the price/consideration is agreed to be paid in instalments). However, until such condition (e.g. receipt of full price/consideration in case the price/consideration is agreed to be paid in instalments) is met such contract will not amount to be a sale but will be considered as an agreement to sell.

As already mentioned above, under IBC **operational debt** is defined to mean a claim in respect of **the provision of goods or services** including employment or a debt in respect of the payment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority.

Hence, if the price or consideration amount of a supplier of capital goods or raw materials is not paid by the project company or project SPV then such unpaid price or consideration amount will be an operational debt under IBC and such unpaid supplier will be an operational creditor under IBC. In such a case, if a corporate insolvency resolution process has been initiated against such project company or project SPV, the operational creditor can submit claim with proof to the interim resolution professional in person, by post or by electronic means in Form B of the Schedule to the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016. The said Form B also requires the operational creditor to provide details of "any retention of title arrangements in respect of goods or properties to which the claim refers".

Further, if a corporate insolvency resolution process has been initiated against such project company or project SPV then the interim resolution professional is required to, inter-alia, take control and custody of any asset over which the corporate debtor has ownership rights as recorded in the balance sheet of the corporate debtor, or with information utility or the depository of securities or any other registry that records the ownership of assets.

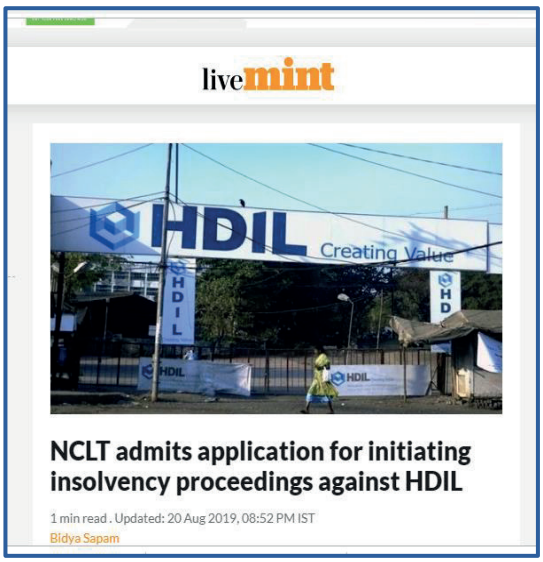
Further, for the purpose of liquidation, the liquidator is further required to form an estate of assets (called as liquidation estate) in relation to the corporate debtor. Such assets include any assets **over which the corporate debtor has ownership rights**, including all rights and interests therein as evidenced in the balance sheet of the corporate debtor or an information utility or records in the registry or any depository recording securities of the corporate debtor or by any other means as may be specified by the board, including shares held in any subsidiary of the corporate debtor.

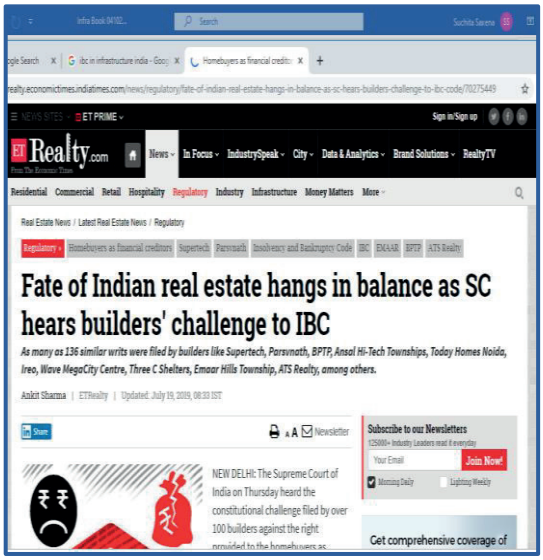
In view of above, if the considerations or price of the supplier of capital goods or raw materials is not paid by the project company or project SPV then such supplier may claim its title over and return (as long as the goods or

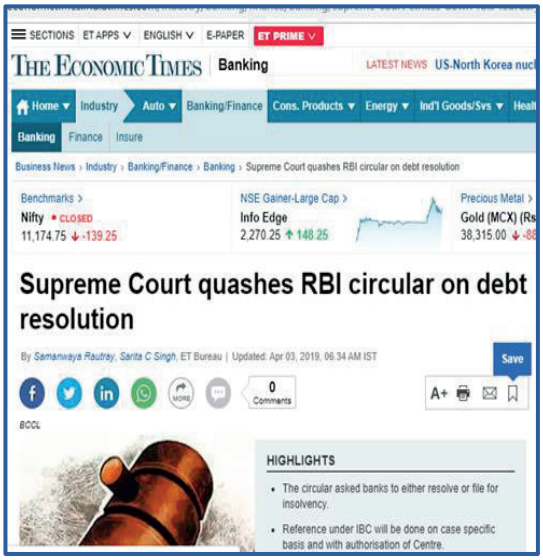
[117] AIR 1924 BOM 41

material is in possession of project company or project SPV or are not converted into finished product e.g. raw material converted into finished product) of the goods or raw material supplied in case the supplier is not paid in full after filing its claim under the IBC regime.

## Snapshots of various news articles on IBC in recent times

# Dispute Resolution in Concession Agreements

“The world’s highest bridge, Bailey Bridge, was built by the Indian Army in Ladakh…

# Dispute Resolution in Concession Agreements

## Trigger points for disputes

For the purposes of this section, we have considered the key issues that give rise to disputes in road projects. Disputes arising out of concession agreements in road projects are fairly complex and high stakes. Some of the factors that give rise to such disputes are:


- Delays in Land Acquisition and in providing ROW
- Construction delays by concessionaire
- Rejection of price escalation claims
- Rejection of change orders pertaining to scope of work
- Rejection of time extension claims
- Withholding of amounts payable to the concessionaire
- Premature termination and offloading of work to third party
- Faulty construction

## Typical claims

Continuing with the case study on road projects in India, the following claims are usually raised:

### Claims raised by a concessionaire

a. Amounts withheld or not realized

b. Interest on amounts paid belatedly

c. Interest on debt taken by concessionaire (From SCOD to COD) provided the delays in completion are attributable to the authority

d. Interest on additional promoter funding (From SCOD till date of arbitration notice)

e. Financial/administrative costs (From SCOD till date of arbitration notice)

f. Direct costs (From SCOD till date of arbitration notice)

g. Expenses incurred on additional rental of plant and machinery (From SCOD till Actual COD)

h. Price escalation

i. Claim for change of scope

j. Maintenance cost (From SCOD till Actual COD)

k. Expenses incurred for rectification of damage to works

l. Liquidated damages for delay

m. Interest on various heads, pendent lite interest and post award interest

n. Costs

This is also seen in the draft shelf prospectus filed by NHAI[118].

It is observed that:

- Claims under heads (a) to (c), (g), (j) and (l) are generally awarded if there is proof of delay caused in acquiring land or providing ROW to the concessionaire, supplemented with supporting proof of claim amounts under these heads
- Claim under heads (d) to (f) are generally not awarded as they are either barred by the contract or overlap with claims made in other heads
- Claims under heads (h), (i) and (k) are awarded if there is substantial proof of the same and more so if there is certification by the IE in this regard
- Claims under head (m) and (n) are awarded on a discretionary basis

### Claims raised against a concessionaire

a. Liquidated damages for delay

b. Difference in cost of getting work completed by third party

c. Recovery of advance

d. Revenue loss

e. Interest

f. Costs

From our experience, we observe that:

- Claims under heads (a), (b) and (c) are awarded if there is evidence buttressing the same
- Claims under head (e) and (f) are awarded on a discretionary basis
- Claim under head (d) is not awarded unless permitted by the contract or by way of an implied term

## Modes of dispute resolution

Dispute resolution in the infrastructure sector has always been a multi layered mechanism with a wide array of options often made available, including negotiation, mediation, conciliation, arbitration, dispute adjudicating boards, commercial courts, etc.

### Negotiation, mediation and conciliation

Parties to a concession agreement are often required to undertake negotiation, i.e. good faith high level talks, before resorting to other modes of dispute resolution. In some model agreements there is also the requirement of mediation or conciliation, involving the Independent Consultant/Engineer as pre-arbitration process for resolving disputes. Conciliation is statutorily recognized in India under the Act. Mediation has recently picked up traction considering the legislative encouragement offered in this regard through the Commercial Courts Act, 2015. India has also recently signed the United Nations Convention on International Settlement Agreements Resulting from Mediation, indicating a strong intent towards this mode of dispute resolution.

Interestingly, the model agreement in respect of ports even provides for reference of disputes for purposes of resolution to experts, provided parties agree to the same.

[118] https://www.sebi.gov.in/filings/debt-offer-document/nov-2018/national-highways-authority-of-india-draft-shelf-prospectus_41047.html

Majority of the contracts which involve private and public interest, provide for pre-arbitration clauses which indeed is even more necessary in the Indian scenario where the resolution of a commercial dispute can be a prolonged process. It may, however, be more advisable to have only a single round of amicable discussions towards resolving disputes, presided over by a pre-designated authority and with specific timelines, as opposed to the tiered clause which can be both time consuming and expensive as parties will invariably take legal advice right from the inception of any dispute.

## Dispute resolution boards

Dispute Resolution Boards or Adjudicatory Boards have been quintessential part of dispute resolution mechanisms in infrastructure sector. Theoretically, they are supposed to comprise of independent, impartial experts who are appointed specifically for the given project and are given regular reports and access to the project so that they provide early resolution to issues. However, it is seen that the findings of such boards are invariably challenged[119]. This has led to serious doubts on the efficacy of this mode of dispute resolution, although it is possibly the most suitable mechanism to nip issues in the bud and lead to successful project completions. The courts have often reprimanded recalcitrant parties in failing to abide by the findings of such authorities which are often upheld by the arbitral tribunal and by the courts. Recently, the Delhi High Court[120] *inter alia* stated that a policy level decision deserves to be taken at the highest quarters in the NHAI to ensure that recommendations of the Dispute Resolution Board are evaluated before matters proceed to arbitration.

This inability of authority and/or concessionaire to abide by the findings of such boards has led to arbitration being the preferred mode of dispute resolution.

## Arbitration

If parties are unable to reach an amicable settlement through the modes mentioned above, the MCAs mandate that parties shall resolve their disputes through arbitration.

Arbitration clauses are oft overlooked in infrastructure projects. Contractors must ensure that there is clear waterfall mechanism for dispute resolution with civil courts' jurisdiction being made subject to the arbitration clause except for the purposes of any injunctive relief. Arbitrator appointment rights must be balanced or alternatively delegated to an independent arbitral institution. As infrastructure projects in India are likely to have an Indian seat, and further since the government is moving towards an institutional arbitration regime, it may be prudent to consider established Indian arbitral institutions such as MCIA, ICA and NPAC. Although the rules of some of these institutions are not as advanced as those of SIAC and other international arbitral institutions, for example in relation to complex issues such as joinder of parties, consolidation of arbitrations, emergency arbitrations, etc., nonetheless, they are more efficacious than ad hoc arbitration.

Arbitration is the preferred mechanism not being as time consuming as litigation and that which respects confidentiality. Furthermore, it allows parties to nominate adjudicators who have the expertise, skillset and technical knowhow of the subject matter of the dispute unlike civil courts. It endows such adjudicators the liberty to determine the procedure for resolution of disputes without strict adherence to rules of evidence and court procedure.

While the Arbitration Act enacted with the aim of achieving expeditious resolution of disputes, a brewing cause of concern for litigants was the surge in court intervention in arbitration proceedings in India, particularly ad hoc arbitrations. These concerns were eventually addressed by the legislature through the Arbitration and Conciliation (Amendment) Act, 2015 (**Amendment Act 2015**) and indeed over the past few years there have been catena of pro arbitration judgments passed by the various High Courts and the Supreme Court of India which further complement the legislative intent behind the amendment act. Take for example, that it was not uncommon for the authority to mandate that its own employees or officers would act as arbitrators in the case of disputes. However, with amendments to the

[119] Second Report of The Committee under the Chairmanship of Shri B K Chaturvedi, Member, Planning Commission Government of India

[120] OMP 265 of 2009, Delhi High Court, decided on 2 July 2019

Arbitration Act[121], courts have now held that this is no longer permissible[122]. The courts are also proactively implementing provisions such as deposit requirements[123] before permitting challenges to arbitral awards, even though under the provisions[124] of Code of Civil Procedure, 1908 (**CPC**) the government had pled exemption from such requirements[125]. This evolving law on arbitration in India has led to more equitable dispute resolution provisions being incorporated into government contracts.

Further changes have been recently brought in through the Arbitration and Conciliation (Amendment) Act, 2019 (**Amendment Act 2019**). However, these changes, while brought in with good intentions have the potential of upsetting the balance that was achieved through the Amendment Act 2015. One, they loosen the timelines that had tightened the otherwise lax approach often taken by ad hoc arbitrations. Second, while they give a major stimulus to institutional arbitration, they also set up an oversight body in the form of Arbitration Council of India which is to comprise of governmental officials. This seems antithetical as the government is one of the major litigants in India. Nonetheless, the exact impact of such a council can only be determined in due course of time.

As can be seen, the move towards institutionalized arbitration seems to be gathering steam. The MCA for road projects envisages arbitration under the Rules of Arbitration of the Indian Council of Arbitration (**ICA**). Additionally, arbitration may also be conducted in accordance with the arbitration rules of SAROD-PORTS. In the ports sector, a similar institutional arbitration model has been mooted.

Although, arbitration itself is conducted in a time bound manner, with the easing up of timelines by the Amendment Act 2019, our view is that the arbitral process will take between 12 months to 24 months to complete, considering that the documentation and expert evidence in relation to the arbitral proceedings is extensive. Ensuing court proceedings that drag the resulting award through various stages of appeals before the issues are finally concluded makes dispute resolution a long-drawn affair. In our experience and estimates, the disputes take anywhere between 2 to 6 years to be finally resolved. Consider the case of NHAI, which is one of the largest highway contractors of the country with an annual spend of almost INR 90,000 crore and has claims worth INR 38,000 crore against it. Reportedly, NHAI has agreed to honor 67 out of 151 arbitral awards. The rest have been challenged in court and have been either upheld or set aside[126]. As per NHAI's own disclosure last year, 1014 arbitration cases were pending at various stages[127].

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[121] Fifth Schedule, entry 1 read with section 12 of the Act

[122] In *TRF Ltd. v. Energo Engineering Projects Ltd.*, 2017 (8) SCC 377, the arbitration agreement between the parties provided for the appointment of a party's Managing Director as the sole arbitrator, and further provided that should the MD be indisposed, he could nominate another arbitrator to adjudicate the disputes between the parties. The Supreme Court held that as per the Amended Act, the MD would be ineligible to act as an arbitrator, and therefore he was consequently precluded from nominating another arbitrator.

[123] Section 36(3) of the Act –

> *Upon filing of an application under sub-section (2) for stay of the operation of the arbitral award, the Court may, subject to such conditions as it may deem fit, grant stay of the operation of such award for reasons to be recorded in writing:*
>
> *Provided that the Court shall, while considering the application for grant of stay in the case of an arbitral award for payment of money, have due regard to the provisions for grant of stay of a money decree under the provisions of the Code of Civil Procedure, 1908 (5 of 1908)*

[124] Order XXVII, Rule 8A, CPC –

> *No such security as is mentioned in rules 5 and 6 to Order XLI shall be required from the Government or, where the Government has undertaken the defence of the suit, from any public officer sued in respect of an act alleged to be done by him in his official capacity.*

[125] *PAM Developments Pvt. Ltd. v. State of West Bengal,* CA No. 5432 of 2019, Supreme Court of India, decided on 12 July 2019

[126] https://indianexpress.com/article/india/highway-dispute-resolution-committee-in-a-month-nhai-chief-4627921/ Last accessed on 18 August 2019

[127] https://nhai.gov.in/writereaddata/Portal/NHAI/WhatsNew/123_CompressedNHAIAnnualReportEnglishcorrected.pdf Last accessed on 18 August 2019

For a concessionaire, this time spent in litigation could be a period fraught with financial instability. However, as mandated by the CCEA, NHAI permits 75% of the arbitral award to be released in favor of the concessionaire, subject to the outcome of any legal challenge to the award and which amount is to be secured by a bank guarantee[128].


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Increasing hurdles: Arbitration claims against NHAI on the rise

The NHAI's latest available annual report, for FY18, shows the authority had 1,014 cases of arbitration

Amritha Pillay | Mumbai
Last Updated at September 12, 2019 00:34 IST

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*Snapshot of an article in Business Standard, September 2019*

Furthermore, with a view to reduce the costs involved in arbitration, NHAI had been instrumental in setting SAROD, essentially an arbitral institution for inexpensive and expedited arbitral proceedings. NHAI has also set up the Conciliation Committee of Independent Experts to resolve disputes whether prior to or at any stage of the arbitral proceedings. Reportedly, only claims worth approx. INR 3100 crores had been referred to Conciliation as on October 2017[129].

While the data in this regard is yet to be updated, one would hope that the same becomes the preferred mode for speedy and amicable settlement of disputes, which would expedite the completion of the affected projects.

It would also be relevant to note that the courts have also done their bit by deterring frivolous challenges to arbitral awards and adopting a stricter approach to challenges. In *Ssangyong Engineering & Construction Co. Ltd. v. NHAI*[130] while setting aside the award that was issued in favor of NHAI cautioned that the ground of "public policy of India" would be available only in very *"exceptional circumstances, such as the fact situation in the present case. Under no circumstance can any Court interfere with an arbitral award on the ground that justice has not been done in the opinion of the Court. That would be an entry into the merits of the dispute which, as we have seen, is contrary to the ethos of Section 34 of the 1996 Act, as has been noted earlier in this judgment"*.

## A landmark case study: Hindustan Construction Company Limited and Anr. v. Union of India and Ors[131]

### Background

On 27 November 2019, the Supreme Court of India (**SC**), delivered a seminal verdict in the case of *Hindustan Construction Company Limited & Anr. v. Union of India & Ors.* wherein, inter alia[132], the constitutional validity of Section 87 of the Arbitration and Conciliation Act, 1996 (Act) was challenged.

Award holders in India have historically had an arduous time realizing the proceeds of an award when awards are challenged by award debtors and the enforcement proceedings are automatically stayed. **By the present decision, the SC, under the Act, has given means to an award holder to secure a part or whole of the award amount pending the outcome of the petition to set aside the award under the Act.** The award debtor, pending the outcome of the challenge to the award, is compelled to file an application for stay against the enforcement of the award wherein it may be required to deposit the award amount in court. This position which was made available through the Arbitration and Conciliation (Amendment) Act, 2015 (**2015 Amendment Act**) has now been extended to even those matters which commenced prior to 23 October 2015.

[128] NITI Aayog's office memorandum dated 5 September 2016 - https://cpwd.gov.in/WriteReadData/NITIAyogDocuments/MeasurestoReviveConstructionSectorArbitration.pdf Last accessed on 18 August 2019

[129] http://www.nhai.org/conciliation-mechanism-independent-expert.htm Last accessed on 27 August 2018

[130] CA No. 4779 of 2019, Supreme Court of India, decided on 8 May 2019

[131] WP (Civil) No. 1074 of 2019

[132] At the outset, this decision involved other facets including a challenge to the provisions of the Insolvency and Bankruptcy Code, 2016. However, we will not venture into that realm in the present discussion.

### 1996

A key issue under the Act was that a petition for setting aside the award, filed under section 34 by an award debtor, meant an automatic stay against the enforcement of the award[133]. This seemed antithetical to the nature of arbitration, i.e., a speedy and efficacious alternate dispute resolution mechanism. Therefore, an award holder could not realize the amounts under an award, until the setting aside petition was finally disposed.

### 2015

The above dichotomy, amongst others, was sought to be rectified by 2015 Amendment Act whereby under section 36(3) the award debtor was now required to make a specific application seeking a stay against the enforcement of the award. The said stay could be granted by the court subject to conditions including deposit of the award amount. Soon after the 2015 Amendment Act came into force, questions arose as to the applicability of the 2015 Amendment Act i.e. whether it was applicable retrospectively or prospectively. In the ensuing months companies that had received arbitral awards in their favor were unsure if the awards were enforceable or would suffer the fate of an automatic stay. Thus, section 26 of the 2015 Amendment Act, which dealt with the applicability thereof came under judicial scrutiny in various courts across the country.

### 2017

In the meanwhile, the ambiguity was noted by the Srikrishna Committee Report[134] in 2017. The said report recommended that certainty ought to be brought about by clarifying that the 2015 Amendment Act was prospective in nature.

### The Supreme Court's decision in BCCI[135]

Before a legislative clarification on the applicability of the 2015 Amendment Act could be made, the SC in *BCCI v. Kochi Cricket Private Limited (BCCI*) clarified that while the 2015 Amendment Act was prospective in nature, the change brought about in the position vis-à-vis the erstwhile automatic stay against enforcement, was retrospectively applicable. Thus, even for arbitrations pre-dating October 23, 2015, the award holder could not be simply shut out by a pending setting aside petition against the award.

### 2019

Unfortunately, despite the observation of the SC in *BCCI*, the legislature, enacted the Arbitration and Conciliation (Amendment) Act, 2019 (**2019 Amendment Act**), repealing section 26 of the 2015 Amendment Act and clarifying through section 87 that the 2015 Amendment Act was prospectively applicable only. This meant that those companies which (in pending matters) had relied upon the *BCCI* decision to claim benefit of the section 36(3) of the Act and the provisions for enforcement, were forced to reevaluate their positions.

### The Issue before the SC

These companies (**Petitioners**) hence moved the SC, by way of a writ, challenging the constitutionality of section 87 introduced by the 2019 Amendment Act, the repeal of section 26 of the 2015 Amendment, as also certain provisions of IBC.

The SC agreed with the Petitioners that the reading of the unamended Act leads to the conclusion that there was a conscious deviation from the UNCITRAL Model Law by not allowing two bites at the cherry to an award debtor, i.e., one during setting aside proceedings under section 34 and one during enforcement proceedings under section 36.

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[133] *National Aluminum Company Ltd. (NALCO) v. Pressteel & Fabrications (P) Ltd. and Anr.,* 2004 1 SCC 540 – While the judgment held that the mere filing of an application under Section 34 of the Act operates as an automatic stay on the operation of the award, the judgment also observed that a recommendation had been made by the relevant Ministry to the Parliament to amend the language of Section 34 because an automatic stay would be against the principles of an efficient alternate dispute resolution system.

[134] Report of the High Level Committee to Review the Institutionalisation of Arbitration Mechanism in India – available at http://legalaffairs.gov.in/sites/default/files/Report-HLC.pdf

[135] *BCCI v. Kochi Cricket Private Limited*, (2018) 6 SCC 287

The SC read section 35 (which deals with finality of an award) along with section 34 and 36 to state that it was never intended that a setting aside petition would automatically stay enforcement.

This obviously was a complete departure from the earlier position that had been stated by the SC itself. In *NALCO*[136], *Fiza*[137] and *National Buildings*[138] the SC had held that a setting aside petition would inherently stay the enforcement of an award. Thus, in the decision under discussion, while coming to its conclusion as above, the SC expressly overruled these decisions[139] .

The SC also relied upon section 9, which enables a party to apply for interim reliefs after making of the award but before it is enforced, in support of the conclusion that the award is enforceable and there is no automatic stay against enforcement upon the filing of a setting aside petition. The SC clarified that even under the Act, there was never any automatic stay intended and that the 2015 Amendment Act was merely clarificatory in this regard. By extension, the SC implied that the 2015 Amendment Act was therefore retrospectively applicable.

The SC clarified that having held that there was no automatic stay under the unamended Act, the 2015 Amendment Act was only introduced to clarify such position. Therefore, section 87 was contrary to the object sought to be achieved by the 2015 Amendment Act as it sought to make the 2015 Amendment Act only applicable from 23 October 2015. Further, the legislature without referring to the *BCCI* decision which had pointed out the pitfalls of introducing such a provision, had brought into play a provision that was manifestly arbitrary, without adequately determining principle, and contrary to public interest. The SC agreed with the Petitioner that the introduction of section 87 resurrects the mischief sought to be corrected by the 2015 Amendment Act and was therefore unconstitutional. The SC hence found the introduction of section 87 and the repeal of section 26 of the 2015 Amendment Act to be violative of Article 14 of the Constitution of India.

The SC then clarified that the position in *BCCI* continues to hold good as on date, i.e., by filing a setting aside petition there would be no automatic stay against the enforcement of any arbitral award, irrespective of when the arbitration was commenced.

## Conclusion

It is well known that over INR 38,000 crores is held up in litigation in the roads sector itself as the sums due under arbitral awards have not been deposited on account of automatic stay available to the award debtor by simply filing a setting aside petition under section 34. This malady is spread across various other sectors as well and not just limited to cases where the governmental agencies are award debtors. The decision of the SC will therefore provide much needed relief to award holders who no longer need to wait the average six to seven years before realizing the awarded amounts. In the short term, this would perhaps inject much needed liquidity in strained sectors and alleviate the balance sheets of several companies. However, the key takeaway is the paradigm shift in the attitude and approach of the judiciary towards arbitration in India which bodes well for the future of arbitration in India.

[136] *National Aluminum Company Ltd. (NALCO) v. Pressteel & Fabrications (P) Ltd. and Anr.*, (2004) 1 SCC 250

[137] *Fiza Developers and Inter-trade Pvt. Ltd. V. AMCI (India) Pvt. Ltd.*, (2009) 17 SCC 796

[138] *National Buildings Construction Corporation Ltd. V. Lloyds Insulation India Ltd.*, (2005) 2 SCC 367

[139] The SC clarified that the said decisions were only overruled on this limited aspect.

## Other case studies

In *Gammon India Ltd. v. NHAI*[140] the Delhi High Court recently observed as under:

> *… there is a need for NHAI to not mechanically and casually challenge arbitral awards, especially where objections to the award are not strong or substantial. The challenge being raised to awards in this manner also results in derailment of infrastructural projects. On the one hand NHAI deprived the Contractor of timely payments and added to that additional amounts are payable on account of interest, that too compounded monthly.*
>
> *…*
>
> *There is an urgent need for the NHAI to take a policy decision on the manner in which disputes with contractors need to be resolved. The entire mechanism of DRB and Arbitral Tribunal would be set at naught if every recommendation of the DRB and every award of the Tribunal is challenged. The large number of NHAI disputes pending before the Court are evidence of the fact that most awards are challenged.*
>
> *…*

In 2018, the Delhi Court had in the case of *NHAI vs M/S. BSC-RBM-PATI Joint Venture*[141] while dismissing NHAI's appeal and upholding the award against NHAI observed as under:

> *"…factual findings, in respect of which the learned Arbitral Tribunal is the final authority, are being successively challenged, under Section 34 and thereafter, under Section 37 of the Act. This has effectively reduced the exercise of arbitration to the civil trial, and petitions under Sections 34 and 37 of the Act to first appeals and second appeals. In fact, while second appeals under Section 100 of the CPC, would lie only on questions of law, we find that arbitral awards are being challenged, even on facts, under Section 37 of the Act. Despite wealth of judicial authority on this point, and repeated disapproval voiced by the Supreme Court and as well as several High Courts including this Court thereon, it is almost invariably seen that every award passed by the arbitrator/Arbitral Tribunal, especially, where the awards are commercial in nature, are challenged, first before the Single Judge and thereafter before the Division Bench merely because the "aggrieved party" possess the financial wherewithal to do so. It is a matter of concern that the majority of such challenges are by public sector undertakings, the appellant before us being one of the main contributors thereto. Such attempts contribute, in a great deal to the menace of "docket explosion", which plagues our Courts and consumes valuable time which could be used for settling more important disputes. We unhesitatingly deprecate this practice.*

In infrastructure projects, while entering into a contract with the relevant authority, it is important to understand the scope of the dispute resolution clause. There have been several decisions in the past on the subject wherein excepted matters have not been permitted to be referred to arbitrations. Take for example the line of decisions wherein "non-notified claims" were excluded from the scope of arbitration. Recently, the Supreme Court of India in *Mitra Guha Builders (India) Company v ONGC* recognized that where a clause specifically excluded the issue of levy of Liquidated Damages from the arbitration agreement, a dispute in relation thereto could not be referred to arbitration. In the aforesaid matter the Superintending Engineer's decision on Liquidated Damages was to be final and binding and was carved out from the scope of the arbitration agreement. Contractors must therefore examine these microscopic details while negotiating dispute resolution clauses as the same are often overlooked.

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[140] OMP 265 of 2009, Delhi High Court, decided on 2 July 2019

[141] Case No - FAO (OS)(COMM)--107/2017, Delhi High Court, decided on 24 January 2018

## Statutory Adjudication

The concept is quite well established in countries such as the UK[142], Malaysia[143] and New Zealand[144]. It is akin to a court litigation but involves expedited decision making minus the strict procedural formalities. Also, because it is sector specific, the adjudicating authority has the necessary expertise and legal know how to enable efficient adjudication.

Recently, the government has thrown open for discussion, the provision of a statutory Adjudicatory Board in the proposed Major Ports Bill, 2019. The same has thrown concessionaires in a tizzy as the MCA provides for an option to proceed with arbitration or have disputes adjudicated by such statutory Adjudicatory Board. The current preference to submit disputes to arbitration is not wholly out of place as the concessionaires' reservations on the composition of the Adjudicatory Board, the extent of its jurisdiction and non-appealable character of its decision are not put to rest by the government. However, in its current form as mooted in the MCA, reference of disputes to the Adjudicatory Board is optional and only to be made on a mutually acceptable basis.

In conclusion, the Indian infrastructure sector is well endowed with various dispute resolution mechanisms which are built into the MCAs. However, there is no common tenor in the dispute resolution clauses in the agreements prescribed for the various sub-sectors. Invariably, it is a medley of modes of dispute resolution that are deemed suitable for that particular sub-sector. Perhaps it is time that a thorough analysis is carried out and a simpler common dispute resolution mechanism be adopted, one which enables early resolution of disputes and the product of which is honored by both parties.

There is enough and more discussion in the corridors of the various ministries for the need of a legislation along the lines of the Housing Grants, Construction and Regeneration Act 1996 and to incorporate some of its key features such as expedited mandatory adjudication. The urgency is evident as several concessionaires, contractors and developers have been dragged before the National Company Law Tribunal under the Insolvency and Bankruptcy Code, 2016 on account of inability to manage cash flows on account of delay in realizing amounts payable by the authority under the awards. A remarkable astute few have managed to tide over their immediate problems by resorting to third party litigation funding which we deal with in our next section. However, the fact remains that there is a dire need for a concrete step towards resolving disputes in an expeditious and efficient manner.

[142] Housing Grants, Construction and Regeneration Act 1996

[143] Construction Industry Payment & Adjudication Act 2012

[144] Construction Contracts Act 2002

# Third Party Litigation Funding (TPLF)

“The most expensive home in India cost $1 billion to make, about the same as Somalia’s GDP…

# Third Party Litigation Funding (TPLF)

## TPLF: An overview

Third-party Litigation Funding or TPLF, as the term suggests, is the financing extended by a non-disputant to a disputant such that the disputant can litigate without having to pay for the whole or part of the costs of such litigation. Such third person, who is not a party to the dispute, in consideration for providing funding, acquires a share in the proceeds, if any, awarded to the disputant.

TPLF is not new. Its ancestry can be traced as far back as the Athenians and Romans, where if one habitually stirred up quarrels, one was honored with the epithet of a *sycophant*. This transformed into the medieval concept of maintenance which was considered an offence under common law as it was intermeddling in a suit in which the person has no interest[145] . An extension thereof, champerty, was considered to be an offence of greater atrocity, being a bargain to divide the land or other subject in dispute, on the condition of the dispute being carried on at the champertor's expense[146]. The treatment of the same as an offence stemmed from the concern that if such disputes were permitted to be funded by wealthy barons, who could with impunity push their ways through the corridors of justice, they could pave the way for voluminous frivolous litigation. Another connected concept is that of barratry which, simply put, is a serial maintaining of suits; in the event such serial maintainer is a lawyer, he is often termed, pejoratively, an 'ambulance chaser'. Champerty, maintenance and barratry were declared to be offences in England in 1275 [147]. However, with time, maintenance and champerty drew criticism as the judiciary gained credibility as to its independence and its inherent powers to administer justice.

In the words of Bentham[148],

> *"A mischief, in those times it seems but too common, though a mischief not to be cured by such laws, was, that a man would buy a weak claim, in hopes that power might convert it into a strong one, and that the sword of a baron, stalking into court with a rabble of retainers at his heels, might strike terror into the eyes of a judge upon the bench. At present, what cares an English judge for the swords of a hundred barons? Neither fearing nor hoping, hating nor loving, the judge of our days is ready with equal phlegm to administer, upon all occasions, that system, whatever it be, of justice or injustice, which the law has put into his hands."*

## Types of third party litigation funding

### Public interest litigation/legal aid

In plain sight, but away from the blinkered understanding of TPLF, is the concept of Public Interest Litigation. The force behind such litigation may be a person or an organization that is attempting to vindicate the infringed rights of a set of impecunious litigants. While this may fall within the parameters of maintenance, it is judicially sanctioned, being a philanthropic service aimed to protect and deliver prompt social justice. Furthermore, it finds widespread public acceptance, being a not-for-profit enterprise. Nonetheless, courts do not permit frivolous litigations for pecuniary gains. Even legal aid *prima facie* falls afoul of the literal interpretation of maintenance, and yet it finds judicial[149] and legislative

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[145] Blackstone's Commentaries on the Laws of England: Book 4 – Public Wrongs, at 134.

[146] Blackstone's Commentaries on the Laws of England: Book 4 – Public Wrongs, at 135.

[147] Statute of Westminster (1275) (3 Edw. I, C 25, 28 and 33).

[148] J. Bentham, *'A Defence of Usury, Letter XII, Maintenance and Champerty'*, 3(1) The Works of Jeremy Bentham (Bowring ed., 1843) *available at* https://oll.libertyfund.org/titles/bentham-the-works-of-jeremy-bentham-vol-3

[149] *Alabaster* v. *Harness,* [1895] 1 QB 339 at 343; "*Maintenance is permissible if given by a man on behalf of a poor man, who but for the aid of his rich helper could not assert his rights or would be oppressed and overbourne in his endeavour to maintain them*".

approval[150]. Even legal aid *prima facie* falls afoul of the literal interpretation of maintenance, and yet it finds judicial[151] and legislative approval[152].

### Conditional fee agreements

In these agreements, the advocate charges a standard fee during the course of the proceedings. If the result is favorable to the client, the advocate can charge a multiple of this standard fee. Strictly speaking, this model may be partly champertous as the lawyer may get paid for his services in part, but a balance of his payment is dependent upon/ deferred pending the outcome of the case.

### Damages based agreements/contingency fee agreements

These agreements tie the lawyer's fees to the sum receivable by his client which in turn is dependent upon the outcome of the litigation. Here, the advocate bears the risk of remaining unpaid in exchange for a percentage of the sums, if any, received by his client from the other party. Damages-based arrangements can be said to be directly champertous, as they involve the purchase of an interest in the outcome of the case and are profit driven.

### Insurance

In several jurisdictions, insurance covers are provided to litigants to cover the costs incurred by them and/or the costs payable if the litigation is unsuccessful. After-the-Event insurance typically involves the insurer entering into some form of a damages-based agreement in order to recoup the premium, while taking on the risk of being out of pocket if the outcome is unsuccessful. While this can be said to be champertous, it finds judicial and legislative endorsement even in jurisdictions such as Ireland, where champerty is an offence. It may be noted that such defence costs are covered by insurance provided that the insured is not convicted and challenges the charge not without admitting guilt.

### Traditional third party litigation funding

Traditional TPLF involves an impecunious litigant or one who does not wish to pay for the litigation, the lawyers, and a third-party funder that has no relation or connection with the dispute or the litigant. Here, the third party finances the costs of the litigation and, in consideration thereof, takes a measure of the winnings. This is plainly champertous and may even envisage a large amount of control by the funder over the litigation. However, this enables otherwise disadvantaged persons to litigate their claims, and falls within the parameters of access to justice.

## Third party litigation funding across jurisdictions

### England

It was not until 1967, through section 13 of the Criminal Law Act enacted that year, that English law finally abolished maintenance and champerty as offences. However, under English law, TPLF still needs to cross the threshold of public policy requirements[153]. Thus, funding arrangements that tend to 'undermine the ends of justice'[154] may be hit by maintenance and champerty. Following the judgments in *Arkin*[155], *Essar Oilfields*[156], and *Excalibur Ventures*[157], TPLF has received judicial sanction but to a circumscribed extent. Furthermore, the Court and Legal Services Act, 1990 permits

[150] The Legal Services Authorities Act, 1987.

[151] *Alabaster* v. *Harness,* [1895] 1 QB 339 at 343; "*Maintenance is permissible if given by a man on behalf of a poor man, who but for the aid of his rich helper could not assert his rights or would be oppressed and overbourne in his endeavour to maintain them*".

[152] The Legal Services Authorities Act, 1987.

[153] Section 14(2), Criminal Law Act, 1967.

[154] *R (on the application of Factortame and others)* v. *Secretary of State for Transport, Environment and the Regions*, [2002] EWCA Civ 932.

[155] *Arkin* v. *Borchard Lines Ltd & Ors.,* [2005] EWCA Civ 655.

[156] *Essar Oilfields Services Limited* v. *Norscott Rig Management,* [2016] EWHC 2361 (Comm).

[157] *Excalibur Ventures LLC* v. *Texas Keystone Inc & Ors.,* [2016] EWCA Civ 1144.

conditional fee agreements[158] to be entered into between advocates and their clients, including a success fee capped, in certain class of cases, at 100% of the normal fees payable[159]. Damages based agreements are also recognized[160] with a cap of 50% of the sums ultimately recovered by the client[161]. Although third-party litigation funding is recognized[162], it is not yet fully regulated.

## Ireland

The Irish have not chosen to follow their neighbors in embracing maintenance and champerty, which are still considered unlawful under their Statute of Conspiracy (Maintenance and Champerty). In *Persona Digital*[163] the Irish Supreme Court declared TPLF, by an entity having no independent interest in the underlying proceedings, illegal. However, the court has subsequently[164] urged the legislature to reconsider the law to improve access to justice. Furthermore, 'After-the-Event' insurance has gained acceptance in *Greenclean*[165].

## France

The French law does not *per se* bar payment of legal fees by a third party[166]. Also, the equivalent rules of conduct for legal practitioners provide that a French attorney may accept funds from the agent of his client. However, settling a fee that would solely depend on the result of the case, is prohibited. Barring these few aspects, the French do not currently have any regulation permitting or disallowing TPLF.

## New Zealand

In New Zealand, maintenance and champerty are considered to be torts. However, courts have become more permissive towards TPLF[167]. Yet, the funding may be disallowed, if it can be shown that the claim is made to deceive the court or is fictitious, or if there is misuse of the court process towards an ulterior motive, or if the claim is vexatious, oppressive or groundless. Courts also require disclosure as to the identity of the funder and further mandate his/her amenability to their jurisdiction. Thus, each case of funding is assessed on its unique facts and circumstances. Conditional fee agreements entered into with lawyers are regulated by the Lawyers and Conveyancers Act, 2006[168].

## Australia

Australia on the other hand does not, for the most part, treat maintenance and champerty as torts or crimes. Instead, it tests TPLF on the grounds of public policy. While there is no regulation in this regard, TPLF has found acceptance[169] on a widespread basis, with some funders even being listed companies. Lawyers in Australia are also permitted to use conditional billing arrangements. However, lawyers are not permitted to have a significant financial interest in the third-party funder[170].

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[158] Section 58, The Court and Legal Services Act, 1990.

[159] The Conditional Fee Agreements Order, 2013.

[160] Section 58AA, The Conditional Fee Agreements Order, 2013.

[161] The Damages-Based Agreements Regulations, 2013.

[162] Section 58B, The Court and Legal Services Act, 1990.

[163] *Persona Digital Telephone Ltd. and Sigma Wireless Networks Ltd.* v. *The Minister of Public Enterprise & Ors.*, [2017] IESC 27.

[164] *SPV Osus Ltd* v. *HSBC Institutional Trust Services (Ireland) Ltd & Ors.*, [2018] IESC 44.

[165] *Greenclean Waste Management Ltd.* v. *Leahy,* [2014] IEHC 314.

[166] Article 1342-1, French Civil Code.

[167] *Saunders* v. *Houghton*, [2010] 3 NZLR 331; *Waterhouse* v. *Contractors Bonding Ltd*, [2014] 1 NZLR 91; *Strathboss Kiwifruit Ltd* v. *Attorney-General*, [2015] NZHC 1596.

[168] Sections 333 to 336, Lawyers and Conveyancers Act, 2006.

[169] *Campbells Cash and Carry Pty Ltd* v. *Fostif Pty Limited,* [2006] HCA 41.

[170] *Bolitho v. Banksia Securities Ltd.*, [2014] VSC 582

## Singapore

Singapore has developed a commercial approach to TPLF. Champerty and maintenance were not considered as torts or crimes in Singapore[171]. However, contracts affected by the same continued to be contrary to public policy or otherwise illegal. In 2017, through amendments to the Civil Law Act, 1909, Singapore carved out an exception in this regard with respect to permitted categories, namely international arbitration proceedings, and all court, conciliation, mediation or insolvency proceedings connected therewith.

This was a major legislative attempt to enhance Singapore's growing reputation as a preferred seat for international arbitrations. However, disclosure of any funding so obtained for an international arbitration proceeding, is mandatory[172]. Notably, Singapore amended the Legal Profession Act, 1967, to permit lawyers to introduce/refer third-party funders to their clients, provided no direct financial benefit is received by way of such introduction/referral. However, lawyers cannot purchase any interest in any suit or determine a fee contingent on success. Furthermore, lawyers cannot directly or indirectly hold any share or other ownership interest in a third-party funder, when the same is introduced/referred by them to their clients or when there exists a contract between the said third-party funder and their client[173].

## Third party litigation funding in India

Despite adopting Common Law principles to a large extent, champerty and maintenance in India have surprisingly not found the same treatment as in England[174]. However, section 23 of the Indian Contract Act, 1872 (**Contract Act**) provides that the consideration or object of an agreement is unlawful, if:

- *It is forbidden by law; or*
- *It is of such nature that, if permitted, it would defeat the provisions of law; or*
- *Is fraudulent; or*
- *Involves or implies, injury to the person or property of another; or*
- *The Court regards it as immoral, or opposed to public policy*

### Whether agreement is extortionate and unconscionable

Thus, while agreements which may be champertous are not directly opposed to public policy[175], Indian courts have attempted to ascertain whether the transaction is merely the acquisition of an interest in the subject of litigation *bona fide* entered into, or whether it is an unfair or illegitimate transaction for the purpose merely of spoil, or of litigation, disturbing the peace of families, and carried on for a corrupt or other improper motive[176]. When found (i) to be extortionate and unconscionable, so as to be inequitable against the party; or (ii) to be made, not with the bona fide object of assisting a claim believed to be just, and of obtaining a reasonable recompense therefor, but for improper objects – as for the purpose of gambling in litigation or of injuring or oppressing others by abetting and encouraging

[171] *"Third Party Funding – Reinforcing Singapore as a Premier International Dispute Resolution Centre"*, A note from Indranee Rajah S.C., Senior Minister of State for Law, *available at* https://www.mlaw.gov.sg/content/dam/minlaw/corp/News/Civil%20Law%20Amendment.pdf

[172] Rule 49 A, Legal Profession (Professional Conduct) Rules, 2015.

[173] Rule 49 B, Legal Profession (Professional Conduct) Rules, 2015.

[174] *Chedambara Chetty* v. *Renga Krishna Muthu Vira Purchaiya Naickar,* [1874] 1 Ind. App. 241.

[175] *Ram Coomar Coondoo* v. *Chunder Canto Mookerjee,* [1876] L.R. 2 AC (PC) 186, at 210; *"A fair agreement to supply funds to carry on a suit in consideration of having a share of the property; if recovered, ought not to be regarded as being, per se, opposed to public policy. Indeed, cases may be easily supposed in which it would be in furtherance of rights and justice, and necessary to resist oppression, that a suitor who had a just title to property, and no means except the property itself, should be assisted in this manner".*

[176] *Ram Coomar Coondoo* v. *Chunder Canto Mookerjee,* [1876] L.R. 2 AC (PC) 186, at 264.

unrighteous suits – so as to be contrary to public policy[177], Indian courts have declined to give effect to such agreements[178].


Indian courts, in determining whether the agreement is extortionate and unconscionable, have stated that though it is clearly not conclusive, the proportion to be retained by the claimant is an important factor to be considered when ascertaining the fairness of a bargain made at a time when the litigant is in a disadvantaged position. Indian courts have held that the uncertainties of litigation are proverbial; if the financier risks losing his money, he may well be allowed some chance of exceptional advantage[179]. There are also rulings to the effect that upside demanded on a lumpsum basis would not be extortionate and unconscionable[180], and several cases that have held a return of up to 50% share in suit property valid[181].

Contrastingly, in several cases where a third party sought recovery of sums lent plus interest, and further sought an upside which was disproportionate and hence opposed to public policy[182], the court held that the contract was void under section 23 of the Contract Act. However, in spite of this, the court awarded to the financiers, in those cases, all legitimate expenses incurred by them with interest, after refusing to give effect to the agreements[183]. This was presumably done in consideration of section 65 of the Contract Act, which mandates that any person who has received any advantage under a void contract is bound to restore the same or make compensation for it[184].

### Statutory evidence of permissibility of TPLF

Order XXV of the CPC empowers Indian courts to order security for costs. The same has been amended by various states in India such as Maharashtra, Gujarat and Madhya Pradesh. Rule 3 thereof, as inserted by Maharashtra, Gujarat and Madhya Pradesh is titled "*Power to implead and demand security from third person financing litigation*". The amendment

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[177] *Ram Coomar Coondoo* v. *Chunder Canto Mookerjee,* [1876] L.R. 2 AC (PC) 186, at 210.

[178] See also *Kunwar Ram Lal* v. *Nil Kanth and Ors.,* [1893] L.R. 20 Ind. App. 112 at 115; *Lal Achal Ram* v. *Raja Kasin Husain Khan*, (1905) 32 I.A. 113; *Rajah Rai Bhagwat Dayal Singh* v. *Debi Dayal Sahu,* (1908) 35 IA 48; *Sri Rajah Vatsavaya Ventaka Subhadrayyamma Jagapati Bahadur Garu* v. *Sri Poosapati Venkatapati Raju Garu,* (1924) 26 BomLR 786.

[179] *Lala Ram Sarup* v. *The Court of Wards,* (1940) 42 BomLR 307.

[180] *Navaneethakrishnaswami Devasthanam v. Rukmani and Co.*, (1955) 2 Mad LJ 339; *Pandrangi Gopalam v. Chidamana Chinnayya*, AIR 1958 AP 630

[181] 33% of net profits of suit in *Ram Coomar Coondoo* v. *Chunder Canto Mookerjee*, [1876] L.R. 2 AC (PC) 186; 50% of suit property in *Lal Achal Ram* v. *Raja Kasin Husain Khan*, (1905) 32 I.A. 113; 18.75% of decretal property in *Lala Ram Sarup* v. *The Court of Wards*, (1940) 42 BomLR 307; 50% of the claim in *Unnao Commercial Bank Ltd.* v. *Kailash Nath and Ors.,* AIR 1955 All 393; 25% of the suit property in *Marina Viranna* v. *Valluri Ramanamma*, AIR 1928 Mad 437, upheld in appeal in (1931) 33 BomLR 960 (PC).

[182] *Raja Mohkam Singh* v. *Raja Rup Singh*, ILR 15 All 352 (PC) where a quadruple return over investment was found to be unconscionable; 50% of decretal amount sought which equated to a return of 10x was held to be gambling in litigation in *Suganchand And Ors.* v. *Balchand and Anr.*, AIR 1957 Raj 89; 75% share in the decretal property as consideration was considered not to be a fair and reasonable bargain in *Nuthaki Venkataswami* v. *Katta Nagireddy and Ors.,* AIR 1962 AP 457; 100% share in the decretal property as consideration was considered not to be a fair and reasonable bargain in *Kamrunnisa* v. *Pramod Kumar Gupta,* AIR 1997 MP 106; 40% share in the decretal property as consideration was considered not to be a fair and reasonable bargain in *Sri Khaja Moinuddin Khan and Ors.* v. *S.P. Ranga Rao and Ors.*, AIR 2000 AP 344; See also *Harilal Nathalal Talati* v. *Bhailal Pranlal Shah*, AIR 1940 Bom 143; See also *Pannalal Gendalal and Anr.* v. *Thansing Appaji and Anr.,* AIR 1952 Nag 195, where the financiers being moneylenders and because the value of the property sought as recompense was disproportionately high, the court struck down such transaction.

[183] *Pandrangi Gopalam* v. *Chidamana Chinnayya*, AIR 1958 AP 630; *Kamrunnisa* v. *Pramod Kumar Gupta,* AIR 1997 MP 106.

[184] *Suganchand and Ors.* v. *Balchand and Anr.*, AIR 1957 Raj 89.

made by the state of Uttar Pradesh allows the court to demand security where the "*plaintiff is being financed by another person*". It is thus evident that there is no outright legislative disapproval of TPLF.

## Can advocates in India engage in TPLF?

As far back as 1874, the Calcutta High Court, in *Moung Htoon Oung*[185], condemned an advocate for having entered into a contract which was contrary to public policy: an agreement to receive professional fees in the form of a fixed share in the subject-matter of the suit. The full bench of the Calcutta High Court in another case[186], observed that it is professional misconduct for an advocate to agree with his client to accept as his fee a share of the property, fund or other matter in litigation for his services as advocate in such litigation upon the successful issue thereof.

However, the Legal Practitioners (Fees) Act, 1926, through section 3 thereof, provides that any legal practitioner who acts or agrees to act for any person may, by private agreement, settle with such person the terms of his engagement and the fee to be paid for his professional services. Courts have read such contracts to be fettered by public policy constraints as applicable to any ordinary contract. In *R an Advocate*[187], the advocate agreed to maintain the client and carry on the litigation, and to receive for his fees a certain share in the proceeds of the litigation. The Full Bench of the Madras High Court termed the agreement as *'No cure, no pay'* and reprimanded the advocate for professional misconduct.

In *K.L. Gauba*[188] an advocate entered into a damages-based agreement wherein, apart from a fixed sum, he agreed to render legal services in consideration for 50% of the decretal amount. The Bombay High Court held such contract to be void under section 23 of the Contract Act. It suspended the concerned advocate while holding as under:

> *"An agreement which makes the payment of lawyer's fees conditional upon the success of the suit and which gives the lawyer an interest in the subject-matter of the suit itself would necessarily tend to undermine the status of the lawyer as a lawyer. It would not be difficult at all to imagine how in such a case a conflict between self-interest and duty would immediately arise. A search for shortcuts to secure the speedy termination of the litigation would in many cases be a necessary consequence of such an agreement. The amount of fees stipulated is in terms of a certain percentage of the realisation from the suit and the longer the litigation is protracted, the more irksome would it be for the lawyer who acts under such an agreement. A desire to compromise the cause may also overtake the lawyer in such cases. Temptation to adopt doubtful or devious means in order to win the case would be difficult to resist, because the lawyer becomes personally interested in the subject-matter of the suit and is no better than the litigant himself. In fact, a lawyer, who is in part a litigant in such cases, ceases to be a lawyer properly so called. A person arguing a case in such circumstances is in many respects a litigant masquerading as a lawyer in professional robes. In our opinion, there is no doubt whatever that such agreements are bound to affect the detachment of the lawyer and to impair his status as an officer of the Court to a very large extent. That is why an agreement between a lawyer and his client which creates in the lawyer a financial interest in the subject-matter of the cause, & that too on a successful determination of the suit, has always been condemned as unworthy of the legal profession."*

The Supreme Court similarly penalized the concerned advocate in *"G" A Senior Advocate*[189]:

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[185] *In the matter of Moung Htoon Oung,* 21 WR 297 (Cal).

[186] *In the matter of an Advocate,* 4 Cal LJ 259 (D); See also *'In the matter of a Pleader of the Chief Court of the Punjab'*, 69 Pun Re 1904 (F); *Ganga Ram* v. *Devi Das*, 61 Pun Re 1907 (PB) (G); Stipulating 'Inam' or success fee amounted to professional misconduct in *Advocate General* v. *Rustamji B. Sunawalla*, 14 Bom LR 691 (L); and in *Kathu Jairam Gujar* v. *Vishvanath Ganesh Javadekar*, (1925) 27 Bom LR 682.

[187] *R an Advocate, In re*, AIR 1939 Mad 772.

[188] *K.L. Gauba, In re,* 1954 Cri LJ 1954.

[189] *"G" A Senior Advocate, In re,* AIR 1954 SC 557.

> *"However much these agreements may be open to other men what we have to decide is whether they are permissible under the rigid rules of conduct enjoyed by the members of a very close professional preserve so that their integrity, dignity and honour may be placed above the breath of scandal. That is part of the price one prays for the privilege of belonging to a kind of close and exclusive "club" and enjoying in it privileges and immunities denied to less fortunate persons who are outside its fold."*

Under the Bar Council of India Rules, 1975 (**BCI Rules**) – Part IV, Chapter II, Standards of Professional Conduct and Etiquette, various rules can be read to disallow lawyers to be part of any form of litigation funding:

- **Rule 9** – An advocate should not act or plead in any matter in which he is himself pecuniarily interested
- **Rule 18** – An advocate shall not, at any time, be a party to fomenting of litigation
- **Rule 19** – An advocate shall not act on the instructions of any person other than his client or his authorized agent
- **Rule 20** – An advocate shall not stipulate for a fee contingent on the results of litigation or agree to share the proceeds thereof
- **Rule 21** – An advocate shall not buy or traffic in or stipulate for or agree to receive any share or interest in any actionable claim
- **Rule 32** – An advocate shall not lend money to his client for the purpose of any action or legal proceedings in which he is engaged by such client

Recently, in *B. Sunitha*[190], the Supreme Court dismissed a cheque bouncing case filed by an advocate who was seeking to enforce a damages-based agreement for the recovery of 16% of the decretal amount in a motor accident claims case.

However, a recent decision of the Bombay High Court in *Jayaswal*[191] has thrown a new angle to this debate. In this case, a law graduate, who was a partner in a law firm, entered into a damages based agreement with a client for consultancy services in relation to arbitration proceedings. It would appear that the concerned individual was not a registered advocate under the Advocates Act, 1961 (**Advocates Act**). The outcome of the arbitration being favorable, the client did not pay the fee, which was expressed in terms of a percentage of the proceeds. The law firm partner succeeded in the lower court for recovery of the said success fee. In appeal before the Nagpur Bench of the Bombay High Court, the client sought to argue that the damages based agreement was void in view of the provisions of the Contract Act, the BCI Rules and the decisions in *"G" A Senior Advocate*[192] and *B. Sunitha*[193]. The law firm partner argued that (i) the contract was not void as champertous agreements were not afoul of section 23 of the Contract Act, (ii) that he was not a registered advocate and thus not barred under the Bar Council of India Rules from entering into a damages based agreement, and (iii) that the ground was only raised in oral arguments for the first time by the appellant. The court held that the law firm partner was only acting as a 'counsel' and did not represent his client as an advocate. Towards this end, the court delved into the definition of counsel, advocate, pleader, vakil, and attorney in legal dictionaries and the provisions of CPC. The court further held that representation before the arbitrator could not be said to be a representation before the court. Considering the *obiter dicta* in *"G" A Senior Advocate*[194], the court held that there was nothing morally wrong, nothing to shock the conscience, nothing against public policy and public morals in a champertous transaction not involving a legal practitioner, and further opined that the fact that the concerned individual was a partner in a law firm was by itself

[190] *B. Sunitha* v. *The State of Telangana and Anr.,* (2018) 1 SCC 638.

[191] *Jayaswal Ashoka Infrastructures Pvt. Ltd. v. Pansare Lawad Sallagar*, F.A. No. 106 of 2015, decided on 07 March 2019, Nagpur Bench, Bombay High Court

[192] *"G" A Senior Advocate, In re,* AIR 1954 SC 557.

[193] *B. Sunitha* v. *The State of Telangana and Anr.,* (2018) 1 SCC 638.

[194] *"G" A Senior Advocate, In re,* AIR 1954 SC 557.

not sufficient to render such an agreement void. It remains to be seen if this tightrope reasoning adopted by the Bombay High Court will find approval if and when brought before the Supreme Court of India.

## The case for TPLF in India

It is thus abundantly clear that a member of the legal profession in India, unlike his English brethren, cannot enter into Conditional Fee Arrangements, Damages Based Arrangements, Third Party Litigation Funding Arrangements, or the like.

### Examination of the agreements by courts

However, as discussed above, this does not bar persons other than members of the legal profession from entering into such arrangements. As maintenance and champerty are not considered as offences in India, such agreements are valid, albeit they must not be opposed to public policy grounds under section 23 of the Contract Act. The courts scrutinize such contracts closely, in order to determine if the same are opposed to public policy and examine if:

- The contracts amount to gambling in litigation; or
- The contracts are aimed at injuring or oppressing others by abetting and encouraging unrighteous suits; or
- The contracts are unfair or illegitimate transaction got up for the purpose merely of spoil, or of litigation, disturbing the peace of families, and carried on for a corrupt or other improper motive; or
- The recompense is unconscionable or disproportionate to the expense incurred.

### Factors to be considered by third-party funders

While entering into such agreements with a disputant, third party litigation funders may thus need to *inter alia* consider the following:

- Is the service resulting in access to justice of a righteous claim that otherwise would not have been litigated upon?
- Is the claim made to deceive the court; is it fictitious; is there a misuse of the court process for an ulterior motive; or is the claim vexatious, oppressive or groundless?
- Is the disputant being funded under terminable terms?
- The upside and/or the multiple of return over investment must be reasonable and not unconscionable so as to amount to gambling in litigation.
- The extent of control by the financier over the litigation must be minimal.
- The lawyers involved in the litigation must be excluded from such agreements.

### Benefits of TPLF

In our opinion, TPLF in the Indian context can yield the following benefits:

- Access to justice;
- Fostering nascent class action claims;
- Reduction in litigation through early settlements or pruning of unmeritorious claims through exhaustive pre-litigation analysis;
- Social welfare.

### Overcoming potential concerns

However, there are valid concerns as under:

- Fomenting of unmeritorious litigation may topple an already overburdened judicial system

- Over commercialization may lead to increase in costs of litigation
- Ethical dilemmas for a dignified profession
- Unregulated funding may lead to racketeering
- The sanctity of the judicial system may be affected by speculative gambling in litigation
- No real access to justice as funding will only be made available to what is 'commercially viable'

To overcome these fears, the government may be well advised to regulate TPLF. Increasingly, we see that there is a need for the same. However, as the industry is in its embryonic stages, it might be judicious to begin with tiny steps. Possibly, the government could think of statutorily permitting and regulating TPLF with respect to arbitrations, and then extend the same, if successful, to litigation before the civil courts in India.

The rationale behind this suggestion begins with the general trepidation that arbitration is an expensive affair, and thus litigation funding would possibly be suited thereto. In *Singh Builders*[195] the Supreme Court observed that it is necessary to find an urgent solution to this problem to save arbitration from the arbitration cost[196]. It also bodes well that the Indian legislature through its recent amendments in 2015 to the Arbitration and Conciliation Act, 1996 (**1996 Act**) has encouraged shorter periods for completion of arbitral proceedings[197] while enhancing costs provisions[198]. This enables third party funders to have reasonable timelines within which the arbitral award will be rendered, and also permits actual costs to be recovered.

However, before the legislature follows the path taken by Singapore, it would be well advised to look at some of the issues that may crop up if third party litigation funding is permitted in arbitrations. These include:

- ***Disclosure***

  If a party to an arbitration is availing TPLF, the identity of the funder must be disclosed. This is crucial because, while the arbitrator(s) may be independent and impartial towards the parties, there may be conflict of interests with the third-party litigation funder under section 12 of the 1996 Act. Transparency norms are thus suggested in this regard to prevent conflicts of interest, with disclosure to be made at the inception of the proceedings or at the earliest feasible stage.

- ***Confidentiality***

  There are obvious confidentiality issues with respect to the involvement of a person not being a party to the dispute. It is therefore advisable that any prospective funder be made to sign a Non-Disclosure/Confidentiality Agreement.

- ***Extent of Control and Transfer of Mere Right to Sue***

  The legislature should also be mindful that the funder does not take over the litigation and step into the shoes of the party to the dispute as the same could amount to a transfer of a mere right to sue which is disallowed under section 6(e) of the Transfer of Property Act, 1882. Furthermore, the funder should not be permitted to conduct the litigation or give directions/commission to the lawyers which would be detrimental to the interests of the party being funded.

[195] *Union of India* v. *Singh Builders Syndicate*, (2009) 4 SCC 523.

[196] See also, *Sanjeev Kumar Jain* v. *Raghubir Saran Charitable Trust and Ors.,* (2012) 1 SCC 455.

[197] Section 29A of the 1996 Act.

[198] Section 31A of the 1996 Act.

- ***Costs and Security for Costs***

  English courts suggest that the funder should be liable for the defendant's costs, if the claim fails. However, they limit the same to the extent of the funding provided[199]. In our view, the legislature may look beyond such cap that English courts propose, and require the funder to be liable for the whole of the defendant's costs, as this would ensure proper vetting of the prospects of litigation subject to contract. Although not explicit, section 31A of the amended 1996 Act read with section 9/section 17 thereof, permits the court/arbitral tribunal to order a party to furnish security for costs. With the involvement of a third-party funder, it is imperative to ascertain whether he can be ordered to furnish such security on behalf of the party that he is funding and to what extent. Guidance in this regard may be taken from the existing amendments made by the states of Maharashtra, Gujarat and Madhya Pradesh to Order XXV of the CPC.

- ***Public Policy considerations***

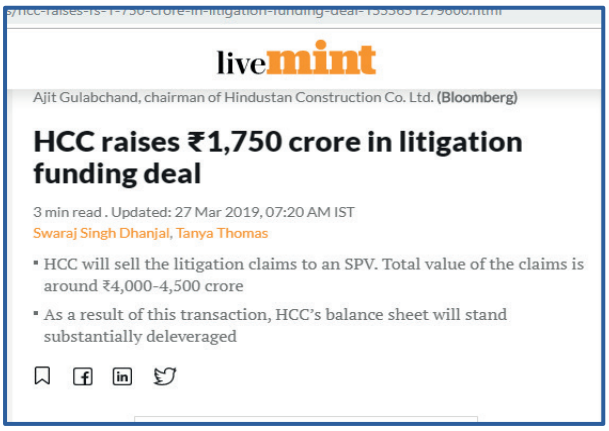
  Considering that the law in India permits third party funding but is still constrained by the public policy principle, the legislature may, albeit with some difficulty, define the parameters where such funding may not run afoul of section 23 of the Contract Act. The legislature may also lay down norms to prevent such funding from becoming a pure speculative trade.

- ***Regulating the Third-Party Funder***

  The legislature would also be well advised to structure and regulate funders, and address issues such as capital adequacy norms, internal and external governance, audits, risk assessment norms, code of conduct and ethics and the like.

## Conclusion

Recently, in relation to stressed assets in the infrastructure sector in India, we have seen several opportunities for TPLF to play a beneficial role. Hindustan Construction Co. Ltd. monetized a pool of arbitration claims and awards for an upfront cash payment to permit the company to meet its debt obligations[200]. While it was also reported that Patel Engineering has entered into similar arrangements[201], we are informed that the said transaction is not strictly a TPLF arrangement.


livemint

Ajit Gulabchand, chairman of Hindustan Construction Co. Ltd. (Bloomberg)

**HCC raises ₹1,750 crore in litigation funding deal**

3 min read . Updated: 27 Mar 2019, 07:20 AM IST

Swaraj Singh Dhanjal, Tanya Thomas

- HCC will sell the litigation claims to an SPV. Total value of the claims is around ₹4,000-4,500 crore
- As a result of this transaction, HCC's balance sheet will stand substantially deleveraged

As we see it, TPLF has yet to find its feet in India, due to various legislative, judicial, socio-economical and public policy concerns surrounding it. Nonetheless, it is not impermissible, except in so far it involves members of the legal profession. Contrary to popular belief, there is TPLF occurring in India, albeit executed discreetly until now. Legislative regulation in this regard may thus be the awaited dawn, one which pulls the activity from the shadows, and shapes and fashions it into a regulated system for greater access to justice

[199] *Arkin* v. *Borchard*, [2005] EWCA Civ 655; however, *see* Stephen Innes, '*Are the Days of the Arkin Cap Numbered?*', *available at* http://www.mondaq.com/uk/x/745898/trials+appeals+compensation/Are+The+Days+Of+The+Arkin+Cap+Numbered

[200] "HCC raises Rs. 1,750 crore in litigation funding deal", LIVEMINT (27 March 2019), *available at* https://www.livemint.com/companies/news/hcc-raises-rs-1-750-crore-in-litigation-funding-deal-1553651279600.html.

[201] "Infrastructure companies eye litigation funding to settle claims", BUSINESS STANDARD (18 February 2019), *available at* https://www.business-standard.com/article/companies/infrastructure-companies-eye-litigation-funding-to-settle-claims-119021800035_1.html.

# Investor State Dispute Settlement Mechanism (ISDS) in the Infrastructure Sector and Model BIT

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Sardar Sarovar Dam is the second-biggest concrete gravity dam in the world…

# Investor State Dispute Settlement Mechanism(ISDS) in the Infrastructure Sector and Model BIT

The Investor State Dispute Settlement Mechanism (**ISDS**) has seen a fair number of disputes in the infrastructure sector and there is good reason for it. As certain governments may not be able to commit public finances for large scale infrastructure projects, PPPs are entered into, through which private financing is driven in such projects. In course of execution of these projects, invariably disputes arise out of policy decisions taken by the government, revision in concessions promised to a private party, changes in the government itself, or changes in the expected return on investment.

India being a developing nation, the GOI too has been at the receiving end of similar disputes. While most of the disputes against GOI arising out of PPPs, are resolved before an independent arbitral tribunal or domestic courts, some of these disputes have become the subject of treaty claims against the GOI, in the past as well as in recent years. Provided below are certain instances where ISDS was opted for by foreign investors in the infrastructure against GOI, which primarily germinate out of changes in government policies, revision of concessions promised or a change in government.

## Defining case studies

### Case Study: The Dabhol Power Project (2003-04)

Incorporated in 1992, the Dabhol Power Company (DPC), a company based in Maharashtra, was set up to manage and operate the Dabhol Power Plant. DPC was incorporated after Enron had approached the Government of Maharashtra with the idea of building a gas powered plant, where the LNG would have been imported from Qatar for 20 years and Government of Maharashtra would have then bought the power produced for the same number of years. The investments for setting up the power plant was drawn through Bechtel, Enron and other entities (shareholders in the DPC), and several other banks through credit facilities.

In the year 1995, when the power plant was still under construction, there was a change in the ruling government of the state. Post the new government taking over, there were widespread protests around the site of the power plant which eventually led to rioting, compelling the law enforcement agencies to use force. Human Rights Watch and Amnesty International alleged human-rights violations and blamed Enron for being complicit. Eventually, the Government of Maharashtra directed that the project be halted on account of environmental hazards, lack of transparency and exemplified costs.

The first treaty claim against the GOI was initiated in the year 2003 by Bechtel (India-Mauritius BIT), alleging expropriation of its investments as a result of reversal in the energy policy of the local government on account of political change in the Government. This was the first claim in what became a series of claims under the same issue, where several banks initiated claims against the GOI in the year 2004, for the GOI's alleged failure to protect the investor's loans in the Dabhol power plant, the default of which resulted in significant losses to the claimant's financing of the failed project. These arbitrations were invoked under BITs which the GOI had executed with Mauritius, Netherlands, France, Austria, Switzerland and the UK.

**Outcome: These arbitrations were subsequently settled in the year 2010**

### Case Study: Haldia Port (2014)

Louis Drefyus Armateurs SAS – a shareholder in a joint venture with ABG Infralogistics. The joint venture was incorporated for the modernization of berths at the Haldia port in West Bengal.

Louis Drefyus Armateurs had invoked arbitration proceedings, under the India – France BIT, for its claims arising out of a series of measures by the government that allegedly prevented the effective implementation of the joint venture. It was further alleged that the government failed to provide protection and security to the project, and to obey court orders concerning the removal of equipment from the port.

**Outcome: The matter was decided in favor of the GOI**

### Case Study: Anrak Aluminum (2016)

Anrak Aluminum Limited was a company incorporated in the State of Andhra Pradesh for setting up an alumina and aluminum refinery. Ras-Al-Khaimah Investment Authority (RAKIA) was an investor in Anrak which was promised bauxite by the Andhra Pradesh Mineral Development Corporation (APDMC) for the proposed smelting unit. On account of public agitation in the areas where mining was to be carried out, the APDMC cancelled the supply agreement by with ANRAK, based on a government order issued by Government of Andhra Pradesh.

RAKIA invoked arbitration against the GOI under the India – UAE BIT, raising claims for alleged non-fulfillment and subsequent cancellation of the bauxite concession.

**Outcome: The arbitration proceedings are currently pending**

### Case Study: Nissan (2017)

In the year 2017, Nissan initiated arbitration proceedings against the GOI under the India-Japan Economic Partnership Agreement of 2011 on account of non payment of incentives promised by the Government of Tamil Nadu. The state government in the year 2008 had promised certain tax rebates to Nissan for building a manufacturing unit in that state.

**Outcome: The arbitration proceedings are currently pending**

### Case Study: Indutech Zone (2017)

Carissa Investments LLC, which held 49% stake in InduTech Zone, invoked arbitration against the GOI, on account of the project being stalled due to allegations of corruption and money laundering. The dispute relates to the development of a special economic zone in the erstwhile state of Andhra Pradesh. The development of the project was halted because of investigations into allegations of money laundering against a senior politician involving the land intended for the new development. As per news reports, the primary allegation in the notice of arbitration is that the special economic zone failed to commence given the pending political and legal issues and that Carissa's investment had not been suitably protected.

**Outcome: The arbitration proceedings are currently pending**

### Case Study: KOWEPO (2018)

In the year 2018, South Korea's state-owned company, Korea Western Power Company (KOWEPO) initiated arbitration proceedings under the India-Korea Comprehensive Economic Partnership Agreement.

KOWEPO owns 40% in Pioneer Gas Power Limited (PGPL) which operates a gas powered power plant in the Government of Maharashtra. PGPL was promised certain gas concessions by the state government which allegedly remained unfulfilled. As the fuel supply agreement allegedly remained unfulfilled, KOWEPO claims that the same has led to losses and has thus sought compensation from the GOI under the mechanism prescribed under the India-Korea CEPA[202].

**Case Study: White Industries**

While the above mentioned arbitrations in the infrastructure sector have been the subject of much debate and deliberations, another treaty arbitration, *White Industries v. India*[203], was indeed a watershed moment for India's tryst with the ISDS.

In these arbitration proceedings, a decision was rendered against the GOI, which held that judicial delays amounted to violation of 'minimum standard of treatment'. Interestingly enough while this arbitration was invoked under the India – Australia BIT, the MFN clause in this BIT allowed the investor to invoke the 'minimum standard of treatment' from the India-Kuwait BIT.

After the White Industries issue, there has been a spate of treaty arbitrations against India which arise out of government measures undertaken in the telecom and energy sectors, retrospective changes made in tax laws and revision or non-compliance by the government of certain promised concessions.

## The Model India BIT (2016)

It was perhaps the series of treaty claims that Government of India received which led it to rethink its existing bilateral treaty obligations. Consequently, the GOI announced its decision of terminating its existing BITs and adopted the 2016 Model India BIT (**Model BIT**). The Model BIT endeavored to provide appropriate protection to foreign investors in India while also protecting Indian investors in foreign countries.

Though the GOI clearly highlighted its apprehension of the BIT arbitration regimes, it did not adopt the extreme step out of opting out of the system, something which countries like South Africa, Poland and certain other countries did.

The GOI also adopted a two-pronged approach with respect to its existing BITs. GOI served notices of termination to some countries and to the others, served notices calling upon them to issue joint interpretative statements (JIS) to clarify ambiguities in treaty texts so as to avoid expansive interpretations by arbitration tribunals.

Given the importance which the Model BIT will hold for foreign investments in the infrastructure sector, the next section details key terms of the Model BIT.

### Key terms of the Model BIT

#### Definition of investment

The definition of 'Investment' in the Model BIT has moved away from a broad asset-based definition of investment to an enterprise-based definition where an enterprise is taken together with its assets.

Article 1.4 of the Indian Model BIT provides*:*

*'Investment' means an enterprise constituted, organised and operated in good faith by an investor in accordance with the law of the party in whose territory the investment is made, taken together with the assets of the enterprise, has the characteristics of an investment such as the commitment of capital or other resources, certain duration, the expectation*

[202] The information on the disputes has been taken from https://investmentpolicy.unctad.org/investment-dispute-settlement/country/96/india and news reports

[203] https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/378/white-industries-v-india

*of gain or profit, the assumption of risk and a significance for the development of the party in whose territory the investment is made. An enterprise may possess the following assets:*

- *Shares, stocks and other forms of equity instruments of the enterprise or in another enterprise;*
- *A debt instrument or security of another enterprise;*
- *A loan to another enterprise*
  - *where the enterprise is an affiliate of the investor, or*
  - *where the original maturity of the loan is at least three years*

Therefore, only an enterprise that is legally constituted in India can bring a BIT claim. By doing away with an 'asset' based approach, the Model BIT aims to narrow the scope of protection to an investment thereby further limiting the possibility of invocation of a treaty claim against India.

However, Article 1.4 provides a non-exhaustive list of assets that an enterprise may possess. Perhaps inspired by the interpretation given to 'investment' under *Salini v. Morocco*[204], the Model BIT states that an 'investment' must have a commitment of capital and other resources, a certain duration, the expectation of gain or profit, the assumption of risk and significance for the development of the country where the investment is made. It may however be noted that the test in *Salini vs Morocco*[205] has itself been watered down in several other arbitration awards. In *LESI vs Algeria*[206], the tribunal held that it is difficult to ascertain whether an investment has contributed to the economic development of a state. To provide an ICSID perspective, the tribunal in *Quiborax v. Bolivia*[207], held that that "investment", as used in Article 25 of the ICSID Convention, has its own definition and criteria separate from a BIT definition.

Given the fact that the actual meaning of the relevant characteristics remains undefined and open for interpretation, the Model BIT may indeed lead to conflicting interpretations by future arbitral tribunals.

## The MFN clause

The Most Favored Nation (**MFN**) provision in BIT aims to create a level-playing field for all foreign investors by prohibiting the host state from discriminating against investors from different countries. In BIT arbitrations however, foreign investors have often used the MFN provision of the primary BIT (under which the dispute between investor and state arises) successfully to borrow a favorable substantive provision granted by the host state under another BIT. Investors have also relied upon the MFN provision in the primary BIT to borrow beneficial provisions from another BIT, to overcome procedural requirements, to claim treaty breaches by borrowing substantive provisions from another BIT and on certain instances, have even attempted to borrow 'umbrella' clauses to bring a commercial arbitration under the ambit of a BIT arbitration.

The exclusion of the MFN clause can be seen as a direct reaction to the ruling against the government in White Industries. The exclusion of MFN is to prevent such cases of 'treaty shopping', whereby foreign investors take advantage of provisions in other BITs by 'borrowing' them through the MFN clause.

However, the GOI could have adopted an MFN clause with certain qualifications. For instance, the EU-Canada CETA, in order to limit the scope of the MFN provision so as to obliviate the situation of beneficial treaty shopping, specifically excludes '*procedures for the resolution of investment disputes between investors and states provided for in other international investment treaties*' and further provides that '*substantive obligations in other international investment treaties and other trade agreements do not in themselves constitute 'treatment' and thus cannot give rise to a breach of this Article [MFN]*' unless a host state has adopted or maintained measures pursuant to those obligations.

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[204] *Salini Costruttori S.p.A. and Italstrade S.p.A.* v. *Kingdom of Morocco* [I], ICSID Case No. ARB/00/4 Decision on Jurisdiction

[205] Ibid

[206] *L.E.S.I. S.p.A. and ASTALDI S.p.A. v. République Algérienne Démocratique et Populaire*, ICSID Case No. ARB/05/3 Award

[207] *Quiborax S.A., Non Metallic Minerals S.A. and Allan Fosk Kaplún v. Plurinational State of Bolivia*, ICSID Case No. ARB/06/2 Decision on Jusrisdiction

The GOI could have followed the above approach (recommended by the Law Commission of India report too) and not do away with the MFN provision completely, which indeed exposes foreign investors to discriminatory treatment and substantially tilts the balance in favor of host state's regulatory power.

## Fair and Equitable Treatment

Fair and Equitable Treatment (**FET**) is one of the most important standards and has been the subject of much debate in various scholarly writings and awards. Numerous treaty claims show that FET has become a catchall provision capable of sanctioning many legislative, regulatory, and administrative actions of the host state. This interpretative outreach by tribunals, could perhaps be because of FET appearing in large number of BITs without much guidance about its normative content.

The Model BIT does not contain a FET provision. The GOI perhaps decided not to include a provision on FET because arbitral tribunals often interpret this provision too broadly. The Model BIT contains a provision entitled 'Treatment of Investments.' Article 3.1 prohibits a country from subjecting foreign investments to measures that constitute a violation of customary international law through:

- Denial of justice, which covers both judicial and administrative proceedings; or,
- Fundamental breach of due process; or,
- Targeted discrimination on manifestly unjustified grounds such as gender, race or religious belief; or,
- Manifestly abusive treatment such as coercion, duress, and harassment.

This is clearly an attempt to provide distinct standards of treatment without making any reference to the FET provision. The said Article 3.1 is further distinct from the concept of minimum standard of treatment as evolved through the 1926 Neer award (*Neer v. Mexico*[208]). The Model BIT thus attempts to restrict the applicability of a standard which has become even broader through arbitration awards in the past years.

## Taxation

Article 2.4 (ii) of the Model BIT states that the treaty shall not apply to "any law or measure regarding taxation, including measures taken to enforce taxation obligations." This article provides that if a particular regulatory measure is related to taxation in the host state (whether it made before or after the commencement of arbitral proceedings), an arbitral tribunal shall not be able to review such a decision.

Clearly, the GOI has decided to keep taxation measures outside the purview of the Model BIT in response to the Vodafone and Cairn arbitrations, challenging India's retrospective application of taxation law under different BITs.

Completely excluding taxation measures denotes that foreign investors shall not be able to challenge such measures under BITs under any circumstance. However, allowing host states to have the last word on whether a regulatory matter pertains to taxation or not might lead to regulatory abuse. As the tribunal in *EnCana v Ecuador*[209] clearly recognized that states can abuse their power to tax by designing tax laws that are 'extraordinary, punitive in amount or arbitrary' which, in turn, could trigger a claim of indirect expropriation. The tribunal in *Burlington v Ecuador*[210] recognized that taxation can be confiscatory, leading to indirect expropriation.

## Invocation of arbitral proceedings under the Model BIT

Through the Model BIT, GOI has further qualified (subject to certain conditions) its consent to arbitration by mandating that a foreign investor should first exhaust local remedies at least for a period of 5 years before commencing international arbitration. The rule related to 'exhaustion of local remedies' is a longstanding rule of customary international law. However, the time period spent before local courts in having the disputes adjudicated differs in

[208] *L.Fay H. Neer And Pauline Neer (Usa) v. United Mexican States* Mexico/USA General Claims Commission

[209] *EnCana Corporation v. Republic of Ecuador*, LCIA Case No. UN3481, UNCITRAL Award

[210] *Burlington Resources Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5* Decision on Reconsideration and Award

different BITs. Though some BITs expressly require exhaustion of local remedies, other BITs do not make any reference to it.

The 5 years under the Model BIT are to be counted from the date when the foreign investor first acquired 'knowledge of the measure in question and the resulting loss or damage to the investment' or when the investor should have first acquired such knowledge. The other critical element related to exhaustion of local remedies is that the foreign investor should submit the dispute to the local court within 1 year from the date on which the investor acquired the knowledge or should have acquired the knowledge about the measure. Pertinently, the period of limitation for filing commercial disputes before domestic courts is 3 years but the Model BIT has for reasons best known, reduced this to 1 year for a foreign investor.

The requirement to exhaust local remedies shall not be applicable 'if the investor can demonstrate that there are no available domestic legal remedies capable of reasonably providing any relief in respect of the same measure'. The burden to show that there is no reasonably available relief falls on the foreign investor.

The Model BIT has another clarification attached to Article 15.1, which precludes the investors from claiming that they have complied with the exhaustion requirement on the basis that the claim under this treaty is by a different party or in respect of different cause of action. This is an important clarification as it is often found that different companies that are controlled by the same corporate group launch multiple proceedings against the state at multiple forums.

This clarification will prohibit companies from abusing their rights. Moreover, since cause of action in domestic forum is formulated in domestic law terms, which would be different from the cause of action formulated in treaty terms, it is relatively easier to show that the requirement of exhaustion has been complied with.

## Further additional qualifications under the Model BIT

The Model BIT provides that the foreign investor, after exhausting all local remedies for five years, without reaching a satisfactory resolution, of a 'notice of dispute' to the host state. This 'notice of dispute' will be accompanied by another six months of attempts by the investor and the state to resolve the dispute through meaningful negotiation, consultation or other third party procedures.

In the event that there is no amicable settlement of the dispute, the investor can submit a claim to arbitration, subject to the following additional conditions:

- First, not more than 6 years have elapsed from the date on which the investor first acquired or should have acquired knowledge of the measure in question; and/or,
- Second, not more than 12 months have elapsed from the conclusion of domestic proceedings;
- Third, before submitting the claim to arbitration, a minimum of 90 days' notice has to be given to host state;
- Fourth, the investor must waive the 'right to initiate or continue any proceedings' under the domestic laws of the host state.

Therefore, given the above criteria, it will indeed take several years before an investor can actually bring a claim under the Model BIT, should the same be formalized with another country.

## General exceptions

The Model BIT also contains a separate chapter which provides further exceptions to bringing a treaty claim under the Model BIT. Article 32 contains general exceptions, which includes protection of public morals, maintenance of public order, protection of human, animal, or plant life or health, protection and conservation of the environment, ensuring compliance with domestic laws that are not inconsistent with the provisions of the treaty. The inclusion of these permissible objectives will provide opportunities to reconcile investment protection with the host state's right to regulate.

There is no doubt that India needs to leverage foreign capital to trigger its ambitious growth of being a USD 10 trillion-dollar economy. Likewise, Indian investors are increasingly looking overseas to diversify their business, gain access to new markets, procure intellectual property and undertake research and development. BIT's should now therefore, be increasingly a part of the India growth narrative. Assuring foreign investors of a stable business environment in which their interests will be protected is as critical as safeguarding Indian investors capital overseas.

India may have a fair share of treaty arbitrations invoked against it, and the Model BIT too may have its naysayers, however, the intention of equitable treatment on which the BIT system is rooted is not in doubt. India may have to rethink certain protectionist measures in its Model BIT going forward and must take the middle path to meet both the investor and the State interests.

# Competition Law Issues in Concession Agreements

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India’s first rocket was transported on a bicycle…

# Competition Law Issues in Concession Agreements

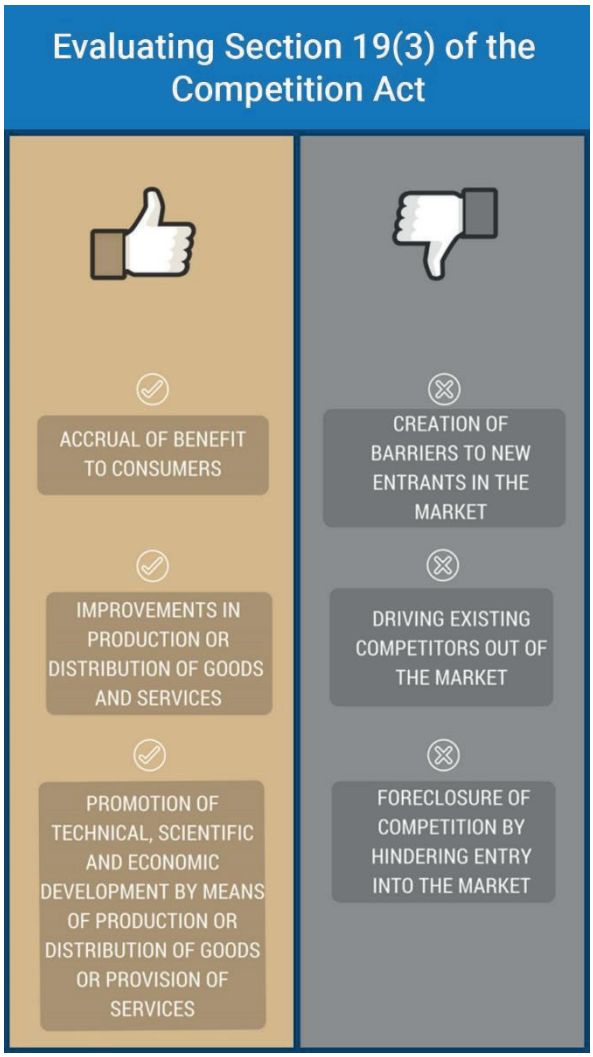
## A Brief Overview of Competition Law in India

Competition in markets in India is regulated by the provisions of the Competition Act, 2002 (**Competition Act**), which is enforced by the Competition Commission of India (**CCI**). The Competition Act seeks to ensure fair competition in the markets within India and deals with competition concerns broadly arising out of:

- Anti-competitive agreements under section 3 of the Competition Act
- Abuse of dominance under section 4 of the Competition Act
- Combinations under section 5 and section 6 of the Competition Act

***Like other agreements, Concession Agreements and conduct arising out of the process of grant of concession as well as the conduct of the parties thereafter, do have the potential to raise concerns under the provisions of the Competition Act.***

## Section 3 – Anti Competitive Agreements




Sections 3 of the Competition Act generally prohibits certain horizontal and vertical agreements which cause or are likely to cause an appreciable adverse effect on competition (**AAEC**) in India. Any such agreement is considered void under Section 3 of the Competition Act.

The Competition Act does not define the term 'AAEC' to provide definite parameters for the CCI. However, the Competition Act provides for guidelines in the form of certain identified factors under Section 19(3) of the Competition Act, that the CCI is required to consider while analyzing whether an agreement causes or is likely to cause an AAEC in India. These factors under Section 19(3) of the Competition Act can be categorized into positive and negative factors as listed in the adjoining figure.

### Categorization of Agreements

Agreements under section 3 of the Competition Act can broadly be categorized as:

**Horizontal agreements under section 3(3) of the Act**: Section 3(3) of the Competition Act deals with agreements amongst competitors i.e., agreements between two or more enterprises that are at the same stage of the production chain and in the same market. Such agreements tend to enable sharing of information which concern fixing of prices, limiting or controlling quantities, market sharing or rigging bids.

The following kinds of horizontal agreements, under the Competition Act, are *presumed* to have an AAEC in India. This

presumption however can be rebutted by the parties with evidence[211].

- Fixing Prices: directly or indirectly determining purchase or sales prices (Agreements regarding prices)
- Production: limit or control production, supply, markets, technical development, investment or the provision of services (Agreements regarding quantities)
- Market Allocation: allocating geographic markets or customers (Agreements regarding market sharing)
- Collusive Bidding: directly or indirectly result in bid-rigging or collusive bidding (collusive tendering and bid rigging)

**Vertical Agreements under Section 3(4) of the Act**:

Section 3(4) of the Act deals with vertical agreements and provides for an illustrative list of vertical agreements, which if proven to cause AAEC in India, are prohibited, i.e., any vertical agreement in respect of *inter alia* provision of services, including:

- Tie–in arrangements
- Exclusive supply agreements
- Exclusive distribution agreements
- Refusal to deal
- Resale price maintenance

## Section 4 – Abuse of Dominance

Section 4 of the Competition Act deals with and prohibits abuse of dominant position by an enterprise. It defines dominance as, a position of strength, enjoyed by an enterprise, in the relevant market in India, which allows it to – (a) operate independently of the competitive forces prevailing in the market; or (b) affect its competitors or consumers or the relevant market in its favor.

As per Section 4 of the Competition Act, there shall be an abuse of dominant position be it an enterprise or a group, if it falls within the following categories:

- Directly or indirectly imposing unfair or discriminatory:
  - Conditions in purchase of sale of goods or services
  - Price in purchase or sale of goods or service
- Limits or restricts:
  - Production of goods or provisions of services or market thereof
  - Technical or scientific development relating to goods or services to the prejudice of consumers
- Indulges in practice or practices resulting in the denial of the market access
- Makes conclusion of contracts subject to acceptance by other parties of supplementary obligations which by their nature or according to commercial usage, have no connection with the subject of such contracts
- Uses its dominant position in one relevant market to enter into or protect another relevant market

In order to determine the abuse of dominance by an enterprise or a group, it is necessary to first determine the relevant market in which the enterprise/group is operating, for the purpose of assessing the dominance. The term 'relevant

[211] FICCI Multiplex Association of India v. United Producers, 2011 CompLR 79 (CCI)

market' has been defined under Section 19(5) of the Competition Act as an amalgam of the relevant product market and the relevant geographical market.

After determination of the relevant market, the CCI takes into consideration factors listed under Section 19(4) of the Competition Act to determine dominance of the enterprise in the identified relevant market. Once dominance of an enterprise/group is established in an identified relevant market, the CCI scrutinizes whether the conduct of such an enterprise/group is abusive within the purview of Section 4 of the Competition Act. Section 4 of the Competition Act sets out a number of practices that are considered to be abusive. Such conduct could be either exclusionary, i.e. having the effect of excluding other players in the relevant market or exploitative, i.e. practices which tend to exploit the dominant entity's position by imposing unfair or discriminatory restrictions on other players and consumers in the relevant market.

## Section 5 and Section 6 of the Competition Act – Combinations

The merger control provisions of the Competition Act are enshrined under Sections 5 and 6 of the Competition Act and the procedure for the enforcement of the provisions is provided in the Competition Commission of India (procedure in regard to the transaction of business relating to combinations) Regulations, 2011. According to the provisions of the Competition Act, no person or enterprise shall enter into a combination which causes or is likely to cause an AAEC within the relevant market in India and such combinations would be treated as void.

The jurisdictional thresholds in India adopt the 'size of parties or the size of group' test and transactions, which meet any one of the following thresholds must be notified to the CCI[212]:

| Companies party to M&A or Acquisition | | | Groups (2 or more enterprises) party to M&A or Acquisition | | |
|---|---|---|---|---|---|
| ***In India*** | | | ***In India*** | | |
| **Assets** | **OR** | **Turnover** | **Assets** | **OR** | **Turnover** |
| > INR 20 Billion *(INR 2,000 Crores)* | | > INR 60 Billion *(INR 6,000 Crores)* | > INR 80 Billion *(INR 8,000 Crores)* | | > INR 240 Billion *(INR 24,000 Crores)* |
| ***In India & Outside India (aggregate)*** | | | ***In India & Outside India (aggregate)*** | | |
| **Assets (USD)** | | **Turnover (USD)** | **Assets (USD)** | | **Turnover (USD)** |
| > 1 Billion *(Including minimum INR 1,000 Crores in India)* | **OR** | > 3 Billion *(Including minimum INR 3,000 Crores in India)* | > 4 Billion *(Including minimum INR 1,000 Crores in India)* | **OR** | > 12 Billion *(Including minimum INR 3,000 Crores in India)* |

Additionally, there are certain exemptions available under the Act/Regulations and various notifications issued by the Government of India from time to time. Each combination will be required to be assessed for applicability of these exemptions on a case to case basis. Further, the CCI has recently amended the regulations pertaining to Combinations, to include Green Channel provisions or approval through automatic route.

[212] Section 20(3) of the Competition Act provides for revision of the threshold limits every two years by the Government of India, in consultation with the CCI, through notification, based on the changes in Wholesale Price Index (WPI) or fluctuations in exchange rates of rupee or foreign currencies. Accordingly, the Ministry of Corporate Affairs, Government of India, by way of a notification dated 4 March 2016, have increased the jurisdictional thresholds provided under the Act, 100% (effectively doubling the thresholds).

## Powers of CCI

It would be necessary to understand the powers of the CCI when presented with complaints and allegations under the Competition Act.

- **Initiate an inquiry**: Section 19 of the Competition Act empowers the CCI to initiate an inquiry into the agreements and conduct of dominant enterprises for alleged contravention of the Competition Act. The CCI may initiate an inquiry either on its own or on an information filed by any person or on the basis of a reference made to it by the Central Government or a State Government or a statutory authority.
- **Imposition of penalty and other powers under Section 27 of the Act**: After conducting the inquiry, if the CCI finds the conduct or the agreement in violation of the provisions of the Competition Act, it can pass the following orders:
  - That the anti-competitive agreement in question be discontinued and not be re-entered into
  - That the abuse of dominant position be discontinued
  - Impose penalty as it may deem fit, which shall not be more than 10 % of the average of the turnover of the last three preceding financial years upon each of the concerned parties to the anti-competitive agreement or abusing its dominance. Further, in case of a cartel, the CCI may impose penalty up to the higher of - three time of the profits for each year of the continuance of such agreement **or** 10 % of its turnover for each year of continuance of the agreement, on each of the parties to such agreement
  - Direct the agreements to be modified to the extent and in the manner as may be specified by the CCI
  - Pass such other orders as the CCI may deem fit or
  - Additionally, the CCI may also pass orders against the group entities, if they are found to have contributed to the violation of the provisions of the Competition Act.
- **Contravention by companies under Section 48 of the Act**: In cases where the violation by a company is established, Section 48 of the Competition Act empowers the CCI to also proceed against individuals, who at the time of the contravention of the provisions of the Act were in charge and responsible to the company for the conduct of business of the company (unless the contravention was committed without the knowledge of or the individual exercised all due diligence to prevent the contravention). Further, the CCI may also penalize directors, managers, secretary or any other officer, where the contravention took place with the consent, connivance, or is attributable to the neglect on part of such directors, managers, secretary or other officer.

## Essential Facilities Doctrine

One of the important principles that is relevant in relation to competition concerns arising out of concession agreements is the doctrine of Essential Facilities (**Doctrine**). ***The Doctrine, prevalent in jurisdictions such as the US, EU and Australia, states that a dominant firm cannot refuse to grant access to an essential facility which it controls, to other firms.***

In the US, the doctrine was conceptualized for the first time by the Seventh Circuit Court's opinion in *MCI Commc'ns Corp*. v. *AT&T*[213] The court listed conditions that held that for the Doctrine to be applied in a case, it must be shown that:

- A monopolist controls an essential facility
- The facility cannot be reasonably duplicated
- The monopolist has denied access and
- It was feasible for the monopolist to share the facility

[213] MCI Commc'ns Corp. v. AT&T, 708 F.2d 1081 (7th Cir.), cert. denied, 464 U.S. 891 (1983)

Similarly, in the case of *Verizon Communications* v *Curtis Trinko LLP*[214], the US Supreme Court stated that even if the doctrine were valid, it would be applicable only when there was no means of access and that in the case on hand, the Telecom Act already mandated access or in other words the doctrine was not applicable in a regulated industry.

*In India, the Doctrine has not been specifically recognized as such, however, the CCI in certain cases has made references to the Doctrine.*

On a similar front, the Supreme Court of India has acknowledged the Doctrine when it comes to concession agreements, however not in context of competition law – more so apropos the duty of private bodies performing public functions.

**Case Studies**

In the case of *VST Industries Limited* v. *VST Industries Workers' Union and Anr*,[215] it was held that private bodies that possess dominant position in the market, are under an implied duty to act in the public interest. The Supreme Court also observed that any private company in India that is controlling infrastructure facility through concession agreement as awarded by the government will be considered as performing a public function and thus is expected to act in public interest. If the company refuses to deal with any competitor, then it would be under judicial scrutiny for performing an arbitrary action of a body discharging public functions. This, as per the Supreme Court, would make it difficult for a concessionaire to attempt such unilateral actions.

The CCI observed in *Arshiya Rail Infrastructure*[216] that the Doctrine could only be invoked in certain circumstances, such as existence of a technical feasibility to provide access, replicating the facility in a reasonable period of time, distinct possibility of lack of effective competition if such access is denied and possibility of providing access on reasonable terms.

In another case of *Eastern India Petroleum Pvt. Ltd.*[217], the CCI was required to determine whether the terminalling infrastructure of South Asia LPG Company Pvt. Ltd. (**SALPG**) was an essential facility and that SALPG was abusing its dominant position by imposing unfair conditions on the use of its facilities by its customers. The CCI, however, did not find it necessary to identify the infrastructure of SALPG as an essential facility, it held that as SALPG was dominant, SALPG had a special responsibility to not inhibit competition and be compliant with the requirements under Section 4 of the Competition Act. The CCI, while finding SALPG to have abused its dominant position, imposed a penalty of around INR 19.21 crores.

[214] Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 410-11 (2004)

[215] VST Industries Limited v. VST Industries Workers' Union and Anr (2001) 1 SCC 298.

[216] Arshiya Rail Infrastructure Limited v. Ministry of Railways & Ors., Case No. 64/2010 & 12/2011

[217] Eastern India Petroleum Pvt. Ltd. (EIPL) vs. South Asia LPG Company Pvt. Ltd., Case No. 76 of 2011


The CCI may have an important role to play in concessions. The provisions of the Competition Act may likely stand attracted to concession agreements depending upon the nature of the agreement and stage of grant of a concession. The grant of concession agreements involves various stages depending upon the method followed by the entity involved in granting the concession. Concessions by their nature provide for certain incentives to the concessionaire such as tax holidays, exclusive supply, exclusive distribution and exclusive rights of building, operating and generating revenue in a geographical location. Depending upon the nature of the agreement and stage of the concession process, concession agreements may broadly raise the several concerns (discussed below) under the provisions of Competition Act. In this regard, it is important to note that any enterprise, including a government entity that is involved in a commercial activity will be covered within the purview of the Competition Act. The term 'enterprise' has been broadly defined under Section 2(h) of the Competition Act, to include department of the government but excludes any activity of the government relatable to the sovereign functions of the government, including all activities carried out by the departments of the central government dealing with atomic energy, currency, defense and space. As such, any conduct, that in the CCI's view is anti-competitive, can be investigated, including conduct emanating from commercial activities of government agencies or departments which are responsible for issuing tenders.

- **Exclusivity**: A concession is intended to grant exclusive rights over a certain real estate or supply/distribution channel for a long term. Although, the CCI has not particularly dealt with cases that have raised exclusivity in relation to the concession agreements, it is important to bear in mind that the grant of exclusive rights is not anti-competitive *per se*. However, if the grant of exclusive rights is done in an unfair manner and terms that have led to exclusion of others from competing on merits, it may potentially raise concerns generally under Section 3 or under Section 3(4) of the Competition Act as having an AAEC.

- **Collusive behavior:** One of the most common method of granting a concession is by way of a competitive bidding process. As discussed above, Section 3(3) of the Competition Act specifically prohibits collusive behavior in the nature of bid-rigging or collusive bidding and any arrangement/conduct/agreement of this nature is presumed to have an AAEC and is thus void. It is pertinent to note that the term 'agreement' has been broadly defined under Section 2(b) of the Competition Act and has been interpreted accordingly by the CCI.

- **Renegotiations of the Concession Agreements**: Re-negotiations may raise competition concerns where the terms of the concession agreement are restructured in a manner that they are more favorable to parties that were involved in initial phase of the bidding process. This may not offer a level playing field to other participants who are willing to compete with either the incumbent or earlier bidders. Other competitors may argue that such conditions are anti-competitive under Section 3 and/or Section 4 of the Competition Act.

  Renegotiations to refurbish/revise clauses may also have an impact on the competition in the market, depending upon the clauses being renegotiated in view of change in circumstances, cost structures, currency fluctuations, etc. For instance, extension of the term of the concession or change in the exclusivity offered under the concession agreement may potentially raise concerns under Section 3 and Section 4 of the Competition Act. However, at present, no such concerns have been presented to the CCI.

- **Abuse of dominant position***:* By their very nature, concession agreements tend to create a monopoly in favor of the concessionaire by granting it sole ownership or access to a certain market for a significantly long period of time. While mere dominance is not considered to be objectionable, any abuse of such dominance is

prohibited under Section 4 of the Competition Act. In the context of concession agreements, once granted, the concessionaire is the only player in that concerned relevant market, establishing its monopoly in that market. Competition law casts a special responsibility upon dominant enterprises to ensure that their conduct does not impede the process of competition in the market and as such, any conduct on the part of a concessionaire, being the monopolist, which dilutes or impedes the overall competitive fabric of the market in which such a concessionaire operates, may raise concerns under Section 4 of the Competition Act, if it:

- Directly or indirectly imposes unfair and discriminatory conditions on other participants in the market that are utilizing the concession project facility. These conditions could include price and non-price conditions. For instance, if the concession grant is done through the competitive bidding method, the terms of the tender documents may also be examined by the CCI. If the terms of the tender are unfair and discriminatory without any reasonable justifications, then it may be assessed under Section 4 of the Competition Act.
- Limits or restricts production of goods or provision of services or limits or restricts scientific development to the prejudice of consumers.
- Denies access to the market to market participants. For instance, where the concessionaire, being a dominant entity, does not allow to deal or imposes conditions that make it impossible for the other player to enter into the relevant market.
- Makes conclusion of contracts subject to acceptance of unfair conditions by other participants in the market.
- Uses its dominant position in one relevant market to enter into or protect another relevant market. For instance, in case a new concession is being granted and the concessionaire uses its dominant position to influence the market in order to win the concession for the new project, at the cost of exclusion of other competitors.

Further, concessions may also raise the issue of the concessionaire being in control of an essential facility. As discussed above, the Doctrine is applicable in cases where the project facility/infrastructure involved fulfils the criteria of being an essential facility and the concessionaire unjustly refuses to share access to such facility with other market participants. A case raising this issue would be covered under Section 4 of the Competition Act. However, the Doctrine has not yet been applied by the CCI as a basis in arriving at a decision under Section 4 of the Competition Act, but references to it has been made in certain cases.

- **Combinations, joint ventures and vertical integration**: An acquisition or a merger between two competing bidders or their respective parent entities may also raise concerns under the provisions of the Competition Act. Such mergers or acquisitions can potentially raise some of the following concerns:

  - Elimination/reduction of competition in the market, which is against the spirit of the Competition Act which seeks to *inter alia* promote competition in the market.
  - Chances of collusion among the newly acquired or merged entities that were originally competitors, thereby raising concerns under Section 3(3) of the Competition Act.
  - A merger or acquisition between entities that are vertically related in the supply/distribution chain, and which can be said to command dominance in their respective markets, may give rise to an entity that may control market at two levels. In such case, if the vertically integrated entity engages in a conduct that is prohibited under Section 4 of the Competition Act, the CCI may proceed against such an enterprise.
  - JVs between two competitors or entities that are vertically related may also raise similar concerns under the Section 3 and Section 4 of the Competition Act. However, JVs between competitors in appropriate cases may be defended and justified on efficiency grounds as provided in the proviso to Section 3(3) of the Competition Act.
  - Mergers and acquisitions between two entities, where the prescribed thresholds under Section 5 of the Competition Act are breached will be governed by provisions dealing with combinations. In such a case, the proposed transaction (subject to any available exemptions) will have to be notified to the CCI for its prior mandatory approval, without which the proposed transaction cannot be consummated. The CCI has the power to pass appropriate orders under Section 31 of the Competition Act.

# Income-Tax Issues: Infrastructure Contracts

“India’s solar generation capacity has expanded by 370% in three years…

# Income Tax Issues: Infrastructure Contracts

While entering into contracts pertaining to infrastructure development, examination of direct tax implications plays a vital role from the Indian party as well as the foreign investor perspective. In this section, we have broadly set out the implications under the provisions of the Income-tax Act, 1961 (**IT Act**), which the parties to infrastructure contracts should consider.

## Taxability of the Special Purpose Vehicle

The project SPV, being an Indian company is regarded as a resident in India for income-tax purposes and accordingly, its global income will be taxed in India.

Under the IT Act, the following taxes[218] are applicable to a domestic company:

- Applicable corporate tax rate is 30%
- A concessional corporate tax rate is applicable to domestic companies at 22%, provided no deductions/exemptions are availed by such a company
  - Minimum Alternate Tax (**MAT**) will not be applicable to such companies
- MAT at the rate of 15% applicable to companies, if the total income is less than 18.5% of the book profits
- Dividend distribution tax is applicable at the rate of 15%

### Incentives to domestic companies involved in the infrastructure facility

The SPV undertaking the business in the nature of developing/operating and maintaining/developing, operating and maintaining, any new infrastructure facility will be allowed a deduction in respect of the entire capital expenditure incurred for the purposes of this facility (subject to fulfillment of certain conditions). The term infrastructure facility covers:

- A road including toll road, a bridge or a rail system
- A highway project including housing or other activities being an integral part of the highway project
- A water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system
- A port, airport, inland waterway, inland port or navigational channel in the sea

## Tax considerations of a foreign party

A foreign party investing into India or when becoming party to an infrastructure contract must be cognizant of the tax implications. Listed below are three broad categories – that of investor, technology partner and execution partner.

### Foreign party: Investor

Effective tax structuring at the time of investing into India is vital, since the same determines the returns from the project in India. Following are the broad aspects, which need to be considered:

- If the investment is undertaken from an Intermediary holding company, jurisdictional analysis should take the following factors into account:
  - Taxation laws in the offshore jurisdiction
    - Double Taxation Avoidance Agreements (**DTAA**), whether any benefit is available

[218] All the above rates are subject to applicable surcharge and cess.

    - Domestic tax laws of the offshore jurisdiction (rate of tax on profits)
    - Laws relating to foreign tax credit in the offshore jurisdiction
  - Regulatory regime in the offshore jurisdiction
    - Permits investment - No stringent regulatory regime (protection of valuable rights)
    - Flexibility for incorporation of the entity
  - Administrative flexibility
    - Flexibility in terms of managing the entity,
    - Appointment of resident directors, maintenance of accounts, day to day compliance

- Type of instrument through which investment should be undertaken
- Form of the legal entity in which investment is to be made
- Tax implications arising at the time of investment, if any, including withholding tax implications on secondary purchase, on upstream of profits/interest and exit of investment (taxation of capital gains)

## Foreign party: Technology partner

A foreign party as part of the infrastructure contract may enter into a Technology Assistance Agreement/Technical Services Agreement for transferring technology, design or rendering technical services. Receipts under these contracts are liable to tax in the hands of the foreign party. Few points which need to be considered are:

- Examination of the receipts to be taxed as "royalty" or "Fees for technical services"
- Examination of the receipt from a DTAA perspective – to determine the rate of tax as well as any benefit which can be obtained
- Examination from a service Permanent Establishment (**PE**) perspective, if the services are rendered through employees deputed in India
- In case of creation of a PE, to obtain a withholding certificate to ensure taxes are deducted on a net income basis and not on a gross income basis
- Whether the receipt should be grossed-up i.e. when taxes are to be borne by the Indian counterpart
- Related compliance to be undertaken

## Foreign party: Execution partner

In this case, a foreign party as part of the infrastructure contract, is responsible for executing the contract in India in terms of supply of machinery and rendering of services. The scope of a foreign party under the contract could be as follows:

- Offshore supply of equipment
- Installation and commissioning of the equipment
- Offshore services
- Onshore services

Few tax considerations, which should be kept in mind in this case are:

- Tax implications arising on offshore supply of equipment – generally as the title and risk are transferred outside India, no tax implications should arise.
- Creation of PE on account of installation and commissioning of the machinery.
- Tax implications arising on account of composite contracts – should the offshore supply be segregated from the onshore installation and services.

# Concession Contracts: Implications of GST

“Spread over 5,000 hectares with four runways, the proposed International airport at Jewar will be ‘India’s biggest’...

# Concession Contracts: Implications of GST

With effect from July 1, 2017, the indirect tax landscape of India was completely overhauled, with multifarious indirect taxes such as Central Excise, Service tax, Value Added Tax (**VAT**), Central Sales Tax (**CST**), Countervailing Duty (**CVD**) and several cesses, being replaced and subsumed into a singular levy in the form of the Goods and Services Tax (**GST**).

India follows a dual structure of the GST, with both the Centre and the State empowered to levy GST, on equal measure, in every transaction of a 'supply'. To effectuate GST in the country, the Central Goods and Services Act, 2017 (**CGST Act**), the State Goods and Services Act, 2017 (**SGST Act**), the Union Territory Goods and Services Tax Act, 2017 (**UTGST Act**) and the Integrated Goods and Services Act, 2017 (**IGST Act**) have been enacted, and the resultant rules and notifications notified.

Some issues and aspects specific to concession contracts are listed below:

- By way of specific exemption, service by way of access to a road or a bridge on payment of toll charges as well as service by way of access to a road or a bridge on payment of annuity, are both exempt from the levy of GST.
- If roads fall in more than one State, then the toll charges will be apportioned to each State on proportionate basis i.e. on the basis of ratio of length of roads in each State.
- The service of transportation of passengers, with or without accompanied belongings, by metro continues to be exempt under GST (like it was under the Service tax regime).
- However, the issue that remains is whether the activities of construction, operation and maintenance of roads/ metro lines is carried out under BOT/DBFOT basis when carried out against toll collection rights, will be liable to GST. It remains to be seen whether such activities are seen to be are carried out for self and thus outside the purview of GST.
- Where the infrastructure is handed over back to awarding entity (e.g**.** NHAI for roads or MMRDA for metro lines) as a going concern, upon the completion of the concession period, it is noteworthy that services by way of transfer of a going concern, as a whole or an independent part thereof are exempt from the levy of GST.
- Another issue is whether GST becomes payable on grants received from the awarding entity (e.g. NHAI) to bridge the viability gap of the project. "Consideration"[219] as defined to not include any grant received from the Central Government or a State Government. However, it requires consideration whether NHAI can be understood as Central Government/State Government, especially when NHAI merely acts as a conduit to facilitate such a grant from the Central Government.
- Owing to the specific restriction of credits[220] , credit of the goods or services received for repairs of an immovable property (other than plant or machinery), to the extent of capitalization, to the said immovable property shall not be available.
- Any consideration payable by one party to a registered person on account of termination of contract would be deemed to be supply of service and attract GST, as it would amount to consideration for tolerating an act. However, if such person is supplier (in the ordinary course in respect of an arrangement with the registered person) of goods and/or services, the amount payable on the account of delay in the delivery maybe treated as price adjustment and in such case the supplier is required to issue credit note. In case, there is a dispute as to the entitlement of compensation to be paid on account of termination of the contract unless, the dispute is settled by way of acceptance of an arbitration award(s)/order(s) by both the parties, the amount payable as compensation will not enter into the realm of consideration till the dispute attains finality.

[219] under Section 2(31) of the CGST Act

[220] under Section 17(5)(d) of the CGST Act

# Corruption: The Infrastructure Sector

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1 in 2 Indians paid a bribe at least once in the past year….

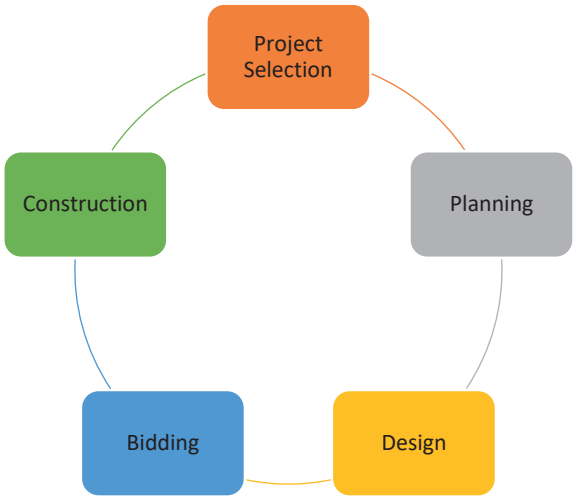
(Transparency International report)

# Corruption: The Infrastructure Sector

## The global context

The World Economic Forum's Global Competitiveness Report 2014–2015 rates corruption as the number-one impediment to conducting business in 24 out of 144 economies. Although bribery and other forms of corruption are risks in almost every industry sector, companies operating in the engineering, construction and real estate industries face unique challenges due to the nature of their business.

As per a report by the World Economic Forum[221], key corruption risks in selected phases of an industry-specific capital project include:




Based on this framework, the report also lists examples of identified corruption risks which include:

- The involvement of government in approving contracts and orders and in issuing multiple clearances creates a risk of bribery to obtain contracts and orders or to expedite clearances.
- Infrastructure and urban development is a monopolistic sector by nature, giving rise to the risk that bidders will unlawfully collude to rig bidding to favor one bidder or to exchange or fix bid prices in advance of tendering.
- The mammoth size of projects and of the subsequent contracts can create incentives for corruption and provide ample means of hiding corrupt acts. A cascading increase in the number of contractual links provides opportunities to bribe or collude.
- During the construction stage, contractors tend to hire varied groups of workers and acquire equipment so as to effectively meet the job requirements, and due to a lack of transparency in these processes, bills and invoices can be manipulated and exaggerated claims and false documentation can be submitted.

## The India context

According to a 2016 report by the World Economic Forum on corruption in the country, it has been estimated that Indian firms on an average pay 50% of the total project cost, as a bribe. World Economic Forum focused on real estate and infrastructure sectors which are perceived to be amongst the most affected by bribery around the world.

[221] https://es.weforum.org/reports/building-foundations-against-corruption-recommendations-on-anti-corruption-in-the-infrastructure-urban-development-industries

Public private partnerships or PPP projects in India's roads and power sectors are most prone to corruption, with private partners' evasion of revenue-share due to the government emerging as the biggest menace according to a survey by the United Nations[222].

The Indian Government, however, has been making sustained efforts to reduce corruption, which is evident from the fact that on World Bank's ease of doing business Index, India has jumped 53 notches in 2 years (2018 and 2019). The biggest gain was in construction permit where India climbed 129 ranks to 52nd place. While in World Bank's Ease of Doing Business Report 2020, India's rank remains at 77, it is among top 20 most improved countries. Further, in Transparency International's Corruption Perception Index, 2018, India's score has improved by 1 notch and ranking has gone up to 78 from 81 in 2017.

In light of the above, it is important to understand the legal framework on anti-corruption in India and its impact on infrastructure sector.

The Prevention of Corruption Act, 1988 (**PCA**) is the principal law[223] which criminalizes corruption in India. Further, on 26th July 2018, the Prevention of Corruption (Amendment) Act, 1988 (**Amendment Act**)[224] has been passed, which seeks to bring the Indian anti-corruption framework in conformity with United Nations Convention Against Corruption (**UNCAC**), which was ratified by India in 2011. A brief snapshot of the coverage of the Prevention of Corruption Act, 1988 is set out below:

| Under the existing law (PCA) | As per the Amendment under Amendment Act |
|---|---|
| Bribe taker who is a public servant[225] (as defined under PCA) | Bribe taker who is a public servant (as defined under PCA) |
| Bribe giver (only where he abets taking of bribe by the public servant) | Giving a bribe by any person to a public servant for improper performance of public duty or to improperly perform a public duty, has specifically been made an offence. This also covers giving bribe to a third person (intermediary) for inducing/rewarding a public servant for such purpose |
| Facilitator/inducer – a person who induces a public servant by corrupt/illegal means/by personal influence | Facilitator/inducer - a person who induces a public servant by corrupt/illegal means/by personal influence |
| | Commercial organization - where any person associated with such organization gives bribe to a public servant with an intention to obtain or retain business, or, to obtain or retain an advantage in conduct of business, for such commercial organization |
| | Director, manager, secretary or other officers of commercial organization would be liable where offence is committed with his consent/connivance |

[222] https://economictimes.indiatimes.com/news/economy/infrastructure/ppp-infrastructure-and-power-projects-most-prone-to-corruption-un-body/articleshow/20401667.cms?from=mdr

[223] Other applicable laws include Indian Penal Code, 1860, Prevention of Money Laundering Act, 2002, Benami Transactions (Prohibition) Amendment Act, 2016, Lokpal and Lokayuktas Act, 2013, Whistle Blowers Protection Act, 2011, Right to Information Act, 2005, Service Rules for Government officials, Companies Act, 2013, Foreign Contribution Regulation Act, 2010, Income Tax Act, 1961, Customs Act, 1962

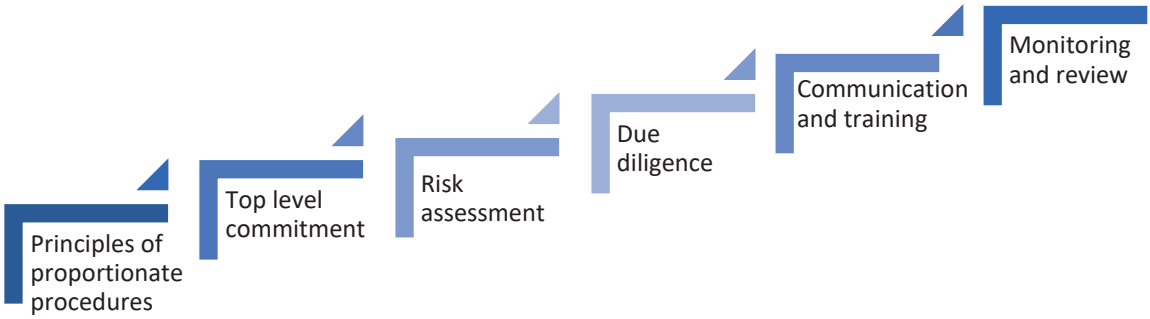
[224] Provisions are yet to be notified.

[225] The Hon'ble Supreme Court, in ***Central Bureau of Investigation* v. *Ramesh Gelli*** has held that officers of private banks are also 'public servants' under the PCA. In light of the same, question arises as to whether employees of infrastructure companies that work on government projects would be considered public servants. In an in-depth analysis carried out by ELP for a project management company, it was concluded that such employees would not qualify as public servants under the PCA.

From the above, it is evident that under the Amendment Act, where any person associated with commercial organization gives bribe to public servant with an intention to obtain or retain business, or, to obtain or retain an advantage in conduct of business, for such commercial organization, it will be an offence committed by a commercial organization.

The Amendment Act defines 'commercial organization' to include all incorporated bodies, partnerships or association of persons, whether incorporated/formed in India, or, whether incorporated/formed outside India but carrying on business or part of business in India. Having adequate procedures in place with prescribed guidelines shall be an adequate defense for commercial organizations. The onus, therefore, is on the commercial organizations to set up comprehensive anti-corruption compliance programs with requisite procedures which should be compliant with Central Government guidelines (which are yet to be prescribed).

Considering that real estate and infrastructure sectors are considered to be highly affected by corruption, it is essential that they have adequate procedures in place. Generally, compliance programs involve employing anti-corruption compliance and ethics code, training of employees, conducting third party audits, whistle-blower mechanism, monitoring mechanism etc. In this regard, reference may be made to the UK Bribery Act, 2010. The UK Government has issued guidelines based on the following six principles:




## Practical concerns

Apart from giving or offering bribes, providing gifts/other benefits and speed money (gratification for doing routine governmental action) will also be an offence under the PCA. Therefore, certain acts which may seem justifiable (as set out below) are also an offence under the PCA:

- Providing entertainment to retain business
  - Examples include paying for extravagant meals during meeting with Govt. official, paying for 'side trip' so that officials can visit tourist attractions
- Giving gifts to win and retain business
  - Examples include providing excessive gifts on festivals, weddings etc. to a Govt. official
- Giving donations to political parties to develop/retain business
- Speed money
  - Examples include paying a Govt. official to bypass inspection/overlook incorrect/incomplete paperwork, paying local fire department regulator to overlook code violations

The infrastructure and real estate sector are highly vulnerable to receiving requests for gifts/favors from Government servants, owing to their nature of business, which requires taking several permissions from Government Servants.

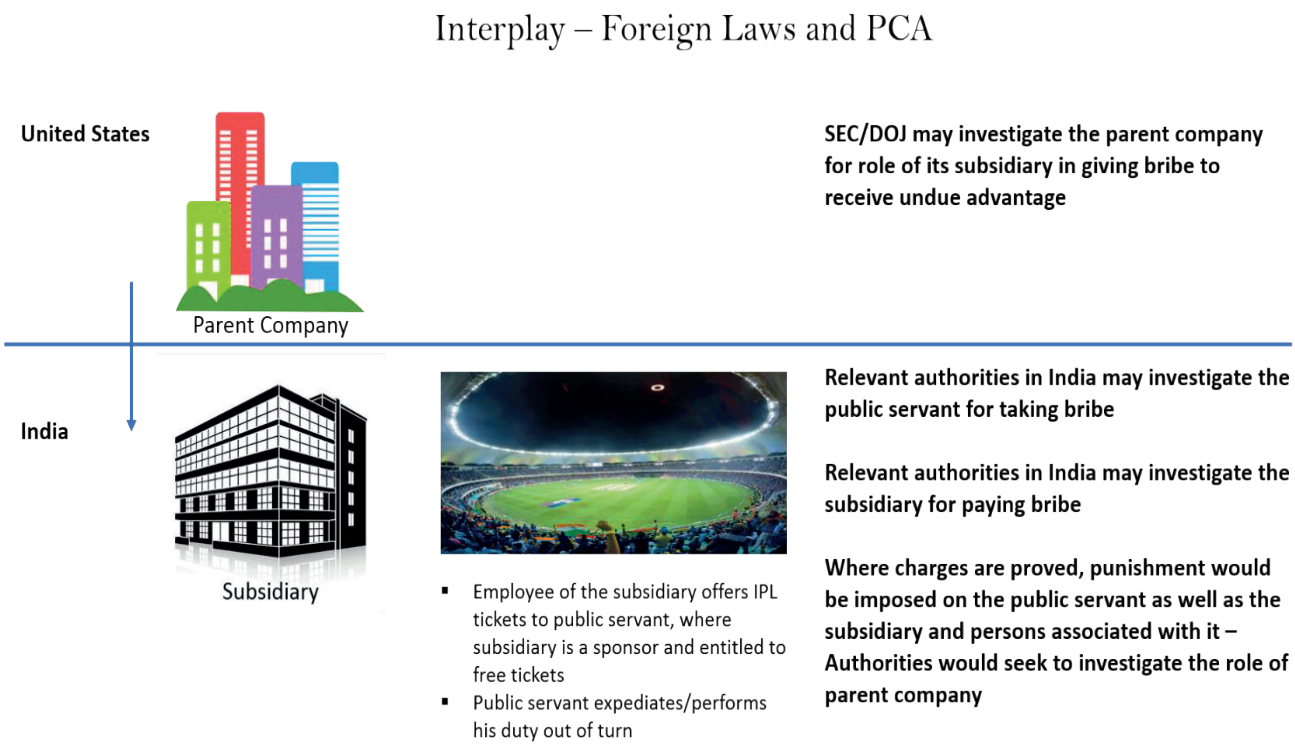
In light of the above, it is essential that stakeholders in the infrastructure sector operating in India are well-aware of the anti-corruption laws in the country. The penal consequences for committing an offence under the PCA are as under:

| Commercial organization | Director, manager, secretary or other officer of the commercial organization | Employees |
|---|---|---|
| **Fine** | ▪ Imprisonment between 3 to 7 years<br>▪ Fine | ▪ Imprisonment between 3 to 7 years<br>▪ Fine |

## Bribery of Foreign Public Officials

While there is no express provision or law in India that applies to bribery of foreign public officials, such provisions do exist under the Foreign Corrupt Practices Act, 1977 (**FCPA**), the UK Bribery Act or other anti-bribery laws of other countries. Therefore, various multi-national companies, operating in India are at risk of facing proceedings by the relevant authorities under laws of their country, for bribing public servants in India.

This interplay is explained in a snapshot below:




In light of the above, it is becoming highly crucial for commercial organizations to have stringent anti-corruption policies in place and to ensure its continuous adherence, through routine checks.

## Case Study

The Enforcement Directorate initiated investigations against London-based Rolls Royce Plc (**Rolls Royce**) in respect of allegations of corruption in India. This investigation was initiated on the basis of a First Information Report filed by the Central Bureau of Investigation against Rolls Royce on July 29, 2019. The probe was made pursuant to the preliminary inquiry against Rolls Royce upon the direction of the Government of India, Ministry of Defence in 2014.

The FIR was lodged against Rolls Royce, Rolls Royce India Private Limited (**Rolls Royce India**), Mr Ashok Patni, Director of Aashmore Private Limited (**Aashmore**), Turbotech Energy Services International Private Limited (**Turbotech**), unknown officials of Hindustan Aeronautics Limited (**HAL**), Oil & Natural Gas Corporation (**ONGC**), Gas Authority of India Limited (**GAIL**) and others. The offences registered under the FIR were criminal conspiracy, public servant taking gratification other than legal remuneration in respect of an official act, taking gratification by corrupt or illegal means to influence public servant, criminal misconduct by a public servant. The investigation covered the following aspects of dealings of Rolls Royce in India:

- **Dealings with HAL**

  An Energy Maintenance, Repair and Overhaul Center (EMROC) Agreement was executed between Rolls Royce Power Engineering Plc and HAL in June 2007 valid up to December 31, 2011. Vide the said agreement HAL provided maintenance, repair and overhaul services for the units owned by the GAIL and ONGC under above license from Rolls Royce. In order to perform these services, HAL had to purchase spare parts and engineering services from Rolls Royce. HAL issued Purchase Orders to Rolls Royce to procure spare parts, component/module or their items. The Purchase Order condition specifically mentioned that Rolls Royce is not supposed to appoint any agent in India to promote this contract and no commission is payable to such agent. It has been alleged that Rolls Royce appointed Mr Ashok Patni, as a commercial advisor in India for providing sales, logistic support, local business expertise and strategic advice in violation of terms and condition of the purchase orders (POs) and Integrity Pact with HAL. In case of supply parts, Rolls Royce paid commission to the Ashok Patni @ 10 to 11.3% of the value of the POs which were not declared earlier at the time of execution of the contract and paid commissions to Aashmore to the tune of INR 18.87 crores in 100 Purchase orders placed by HAL during the period from 2007 to 2011. It was only in December 2013, Rolls Royce declared to HAL, the name of Ashok Patni and Aashmore as commercial advisor of Rolls Royce with regard to its transactions with HAL for the period 2007-2011. It has been alleged that there is likelihood that Rolls Royce may have been engaging Aashmore on payment of commission in other Purchase Orders and part of this commission paid by may have been paid as kickback to unknown officials of HAL involved in the procurement process as the total business of HAL with Rolls Royce in recent years is in excess of INR 4700 crores.

- **Dealings with ONGC**

  It was alleged that Rolls Royce appointed Mr Ashok Patni as a Commercial Advisor in India in respect of supply of spare parts to ONGC during the year 2007 to 2011 by violating the provisions of Integrity Pact. Rolls Royce paid commissions to Aashmore in 38 transactions of supply of material/spare parts to ONGC during the period from 2007 to 2011. The value of this commission was declared in December 2013, which was at the rate of 10-11.3% of the value of order. It has been alleged that payment of above commission was not made by Rolls Royce at the time of bid/tender deliberately in order to conceal the illegal payments made to Aashmore in contravention of the provisions of the Government guidelines/request for quotation/integrity pact. Rolls Royce did not declare the name of any agent at the time of bid/tender and did not declare details of transgression in the Integrity Pact. It was only in December 2013 Rolls Royce declared to ONGC the name of Ashok Patni and his company Aashmore as a commercial advisor of Rolls Royce with regard to its transactions with ONGC for the period 2007-2011. As per the FIR, it has also been found during the enquiry that Aashmore along with Turbotech made payments of Rs. 10 lakhs as donation to a cooperative society of ONGG namely ONGC Officers Mahila Samiti which was unethically accepted by the aforesaid society.

- **Dealings with GAIL**

  It was also alleged that Rolls Royce appointed Mr Ashok Patni as a commercial advisor in India in respect of supply of spare parts to GAIL during the period 2007 to 2011 by violating the provisions of Integrity Pact. Rolls Royce paid commissions to Aashmore in 68 Purchase Orders of supply of material/spare parts to GAIL during the period from 2007 Io 2011. The value of this commission was declared in December 2013, which was at the rate of 11.13% of the value of order. As per the FIR, the declaration of appointment of Ashok Patni and Aashmore as commercial advisor and payment of above commission was not made by Rolls Royce at the time of the bid/ tender deliberately in order to conceal the illegal payments made to Aashmore.

  It is further alleged that during the 2008-2009 Rolls Royce engaged Turbotech in Vijaypur, Dadri, Bawana Pipeline Project and declared 2% commission on the bid. Further, during 2008-09 Rolls Royce also engaged the services of another company M/s. Infinity owned by Ashok Patni in the said pipeline project by violating the conditions of the Integrity Pact with GAIL and made 2% of extra payment to M/s. Infinity for project management services in connection with the above project.

As per the findings of the inquiry in relation to the matter, there was conspiracy by Rolls Royce and its subsidiary Rolls Royce India to misrepresent facts before HAL, GAIL and ONGC regarding the engagement of an agent/commercial advisor in order to win contracts with HAL, GAIL and ONGC, respectively in contravention of the terms and conditions of the bids/tenders/purchase orders issued by the aforesaid companies. It has also been observed that the facts of the matter prima facie establish that the officers of ONGC and GAIL were negligent towards protection of interest of their respective companies. Further, as per the FIR, there is a likelihood that the payment made by Rolls Royce to Ashok Patni and the entities associated with him, as commissions, may have been paid as kickback to unknown officials involved in the procurement process.

# Data Privacy - Airports

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**The average cost of data breach in India rose nearly 8% Y-O-Y to INR 12 crore…**

# Data Privacy - Airports

In today's day and age, data is ubiquitous. Personal data is collected at airports by the Government agencies as well as the airport operators.

**Nature of Personal Data Collected at Airports**

- The airport operator often collects personal data of the passengers and staff for providing security. The data collected includes camera images captured within the airport premises.
- In some situations, where airports are tasked with conducting preventive security checks, third parties are involved in collecting data.
- In airports where long term parking spaces are provided, personal data is collected for provision of these services. The operator could collect personal data in nature of name, address, arrival date/arrival time, departure date/departure time, email address, flight numbers, vehicle registration number, payment details such as a credit card number etc.
- Some airports run loyalty programs and may collect personal data to provide benefits under the programs.
- Certain airports websites use cookies and tracking pixels (web beacons).

**Facial Recognition**

In 2018, Delta was the first to introduce a biometric terminal at the Hartsfield-Jackson Atlanta International Airport where passengers could use facial recognition technology to reach the gate. This technology is now available at many other airports. Other airlines use biometric data to verify travelers during the boarding process with a photo-capture. The photograph is then matched through biometric facial recognition technology to photos that were previously taken of the passengers for their passports, visas, or other government documentation. In the process, airlines are collecting a vast amount of valuable person data.

## Data Protection: The India perspective

In India, there is no specific data privacy law in existence. The right to privacy has been recognized as a facet to the right to life under Article 21 of the Constitution. *However, unlike in other countries there is no specific legislation dealing with data privacy*. The existing legislations and policies are essentially sectoral in nature[226]. With the intent to formulate a comprehensive data protection legislature, the expert committee set-up under the chairmanship of Justice Srikrishna for formulation of data protection regime in India released in the year 2018 the Personal Data Protection Bill, 2018. After public consultations and taking on board the views of the stakeholders, the Government introduced before the Lok Sabha, on December 11, 2019, the Personal Data Protection Bill, 2019 (the **Proposed Bill**). 2019 Bill has now been referred to the joint parliamentary committee and is expected to be tabled before the Parliament in the next session. The Proposed Bill aims at regulating the processing of personal data as a recognition of an individual's right to privacy. The essence of what is considered as personal data entitled to protection under the Proposed Bill is data relating to individuals, which can lead to identification of such individual.

Where personal data is collected, processed or stored electronically, the provisions of the Information Technology Act, 2000 (the **IT Act**) and the Information Technology (Reasonable security practices and procedures and sensitive personal

[226] E.g. *Indian Telegraph Act, 1885 and National Long Distance Licence, Unified Access Service Licence and the Cellular Mobile Telephone Service Licence for Telecom Industry, Credit Information Companies (Regulation) Act, 2005, Credit Information Companies Regulations, 2006 and The Public Financial Institutions (Obligation As To Fidelity And Secrecy) Act, 1983 for Banking Sector, Mental Health Act, 1987 and he Digital Information Security in Healthcare Act for Healthcare Sector etc.*

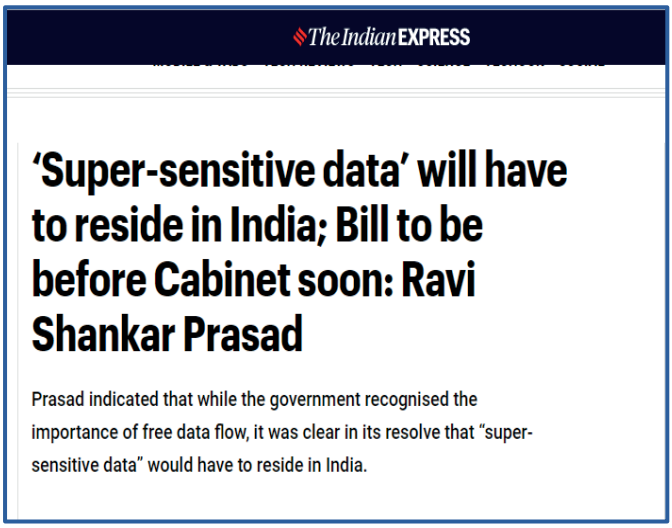
data or information) Rules, 2011 (the **IT Rules**) would need to be referred to. Most data collected at airports is in electronic form and hence would fall within the purview of IT Act and the IT Rules.

The IT Rules require that any person who on behalf of body corporate collects, receives, possesses, stores, deals with or otherwise handles information, shall provide a privacy policy setting out the manner of handling of or dealing in personal information including sensitive personal data or information and ensure that the same are readily available for review by individuals. The privacy policy is required to be published on the website of the operator. Individuals are entitled to review the information provided, to enable them to correct or amend erroneous or deficient data.

Consent is required for the collection, storage, and disclosure of sensitive personal data, e.g. financial information, medical history biometric information etc. Where operators share passenger data which is sensitive personal data with third party service providers, specific consent from the passengers for the onward sharing of data is required.

The IT Rules require safeguards in case of transfer or transmission of the information as well as adoption and implementation of policies with respect to security practices and procedures by the collection agency. The collectors of personal information are also required to establish a mechanism for redressal of grievances in compliance with the provisions of the IT Rules.

## Proposed Bill


The Indian EXPRESS

'Super-sensitive data' will have to reside in India; Bill to be before Cabinet soon: Ravi Shankar Prasad

Prasad indicated that while the government recognised the importance of free data flow, it was clear in its resolve that "super-sensitive data" would have to reside in India.

The Proposed Bill envisages stricter controls over the collection, dissemination, and processing of personal data. Under the Proposed Bill, the processing of personal data is possible only on the following grounds:

(i) On the basis of consent:

- Given prior to the commencement of processing
- Which is free, informed, specific, given through affirmative action (not implied), and being capable of withdrawal with the same ease with which it was granted
- Where provision of goods or services, their quality, enjoyment of legal rights etc. are not conditional upon such consent being provided if not necessary for that purpose

(ii) If necessary, for the function of the State

(iii) If necessary under any Indian law or required for compliance of an order of the court or tribunal in India

(iv) If necessary, for prompt action in case of medical emergency or during epidemic or disaster or public disorder

(v) For the purpose of employment

(vi) For reasonable purposes as notified by the data protection authority

Also, the Proposed Bill envisages the following rights being granted to the data providers:

(i) Right to obtain a confirmation that personal data is being processed, a brief summary of personal data processed, and the processing activities undertaken

(ii) Right to correct incorrect data, complete incomplete data and update data that is outdated

(iii) Right to transfer personal data collected to a third party

(iv) Right to restrict or prevent continuing disclosure of personal data where the purpose is served, or where consent has been withdrawn in relation to personal data processed on the basis of consent or, any disclosure was made illegally, provided such right is approved by the adjudicating officer.

Also, substantial penalties have been prescribed under the Proposed Bill. The penalties have been imposed with cascading effect depending upon the nature of contravention. The maximum penalty can extend up to INR 15 crore rupees or 4% of the total worldwide turnover of the preceding financial year of the defaulter, whichever is higher.

Additionally, the data provider who has suffered harm as a result of any violation of any provision of the data protection law would have the right to seek compensation for the loss suffered.
For certain contraventions which result in significant harm to a passenger, the Proposed Bill also prescribes imprisonment which may extend up to the maximum term of 5 years.

Given the stringent penalties and strict compliance requirements prescribed under the Proposed Bill, the operators need to be compliant while collecting, processing, transferring personal data. If a request is made for deletion of personal data, the operator would need to comply with such request. The operators also need to have processes in place to delete the personal data once the purpose for which it was collected has been served. With facial recognition being used rampantly, the threat of data breach and the consequences thereof are all the more real. Each operator needs to have sufficient security measures in place for preventing data breaches.

# Infrastructure Projects from the Lens of Employment: Guest Column by Ayesha Damania

“Cochin International Airport is the world’s first fully solar powered airport…

# Employment issues that arise in Infrastructure Projects: Guest Column by Ayesha Damania-Advocate

Infrastructure development is directly linked to generation of employment because the creation of infrastructure in the form of roads, railways, airports, ports and power generation is labor intensive. This is especially so in a developing country like India. By providing employment to thousands of workers working on infrastructure projects, these projects could kick start development even before they are operational.

This, however, presupposes that the workers engaged for construction activity, and thereafter for operational activities, are treated fairly and are not exploited. The labor force must move from the un-organized sector into the organized sector[227] and avail of all benefits available under the myriad labor laws applicable under both central and state legislation. Whether this shift from the un-organized to the organized sector occurs will depend on the type of Concession Agreement. Where the Concessionaire takes over an existing facility, modernizes the same and operates it for a fixed period of time before handing it back to the government, (OMDA model) there would be little or no shift of workers from the unorganized to the organized sector. The issues that would arise in such a scenario would be:

- Whether the transfer of the undertaking requires the prior consent of the workmen
- Whether a reduction in work force can be effected
- Whether the Concessionaire can change the terms and conditions of service of the inherited workers so as to increase productivity

On the other hand, where the Concessionaire sets up a new infrastructure project and operates it for the concession period and then hands it over to the Government, (BOT and BOOT models) there would be a shift of workers from the unorganized to the organized sector. The issues that would arise in such a scenario would be:

- Determining responsibility for compliance with employment laws relating to payment of minimum wage and other statutory benefits and the consequences of non-compliance;
- Determining responsibility for safety and security of workers;
- Concept of "Occupier" which attaches vicarious liability to Directors of a company
- Contractor's liabilities and those of the Principal Employer
- Statutory compliances under Central and State Employment laws
- Procedure for termination of employees
- International Workers and Social Security payments

This chapter seeks to address the issues mentioned herein above and highlight key statutory provisions and judicial decisions that prospective investors in infrastructure projects in India need to bear in mind.

[227] As per a survey carried out by the National Sample Survey Organisation (NSSO) in 2009–10, the total employment in the country was of 465 million comprising around 28 million in the organised and the remaining 437 million workers in the unorganised sector. Out of these workers in the unorganised sector, there are 246 million workers employed in agricultural sector, about 44 million in construction work and remaining in manufacturing and service.

## The OMDA model of Concessionaire Agreements

Operation, Management and Development Agreements (**OMDAs**) are usually entered into for operation of Airports, ports or other infrastructure projects already in operation. This section addresses the principal areas of concern, from an employment law perspective, in the OMDA model of PPP agreements.

### Consent of employees

The Supreme Court of India in the Mettur Beardsell[228] case was called upon to decide the question as to whether an employee's consent is a must under Section 25FF of the Industrial Disputes Act, 1947 (**IDA**). Section 25FF, inter alia, which sets out when the compensation would be payable to employees on transfer of undertakings. The Supreme Court held that the common law rule that an employee cannot be transferred without his consent, applies in master- servant relationships and not to statutory transfers. The Court held that there is nothing in the wording of Section 25FF even remotely to suggest that consent is a pre-requisite for transfer and that the underlying purpose of Section 25FF is to establish a continuity of service and to secure benefits otherwise not available to a workman if a break in service to another employer was accepted.

However in a more recent case where Phillips India sold one of its factories to another Company, the Supreme Court[229] held that even if all service terms and conditions are protected on transfer of an undertaking, it was settled law that without consent workmen cannot be forced to work under a different management. The Court held that employees who did not consent to the transfer were entitled to receive, from Phillips India, all the benefits and dues payable to them on a retrenchment. A conjoint reading of these two decisions would suggest that whilst employee consent is not required to transfer an undertaking, employee consent is required prior to transferring the services of the employee to the new employer and employees who do not consent to the transfer are required to be retrenched after payment of all statutory benefits.

### Reduction and improved productivity of the workforce

The size of the workforce the concessionaire would be required to take over, their skill set and productivity are a major issue in the OMDA model. Typically, there will be overstaffing and poor to average skill set and productivity. The concessionaire should, therefore, ideally negotiate down the percentage of existing work force it will be required to take over and try and negotiate for itself a right to choose which workers it inherits. For both the Delhi and Mumbai International Airports, the OMDAs required the Concessionaire to take over a minimum of 60% of the General Employees. These OMDAs also provided for a transition period of 3 years where the employees remained employees of the Airport Authority of India (AAI) and the Concessionaire was required to pay an Operation Support Cost to AAI for the Operational Support provided by these employees. At the end of the Operational Support Period the Concessionaire was required to offer employment to a minimum of 60% of the General Employees at which point the employees who accept employment with the Concessionaire were required to resign as employees of AAI and take up employment with the concessionaire on mutually agreed terms which were not less favorable than those they enjoyed as employees of AAI. The Concessionaire was given the liberty of choosing its own senior management team on terms its deemed fit.

*The above image has been sourced from the Times of India's website*

[228] *Management, Mettur Beardsell Ltd vs Workmen Of Mettur Beardsell Ltd.*

[229] *Sunil Kr. Ghosh v. K. Ram Chandran*

There may be instances when the Concessionaire is not given the aforesaid liberties to determine how many and which employees it will take over. A concessionaire taking over an undertaking as a going concern, is required to provide continuity of service to all workmen[230] and ensure that their service conditions are no less favorable than what they enjoyed prior to the transfer of the undertaking[231].

## Liability of concessionaire for past statutory dues of employees

When an undertaking is transferred to a concessionaire, the concessionaire is held responsible for any unpaid statutory dues of the employees despite the concession agreement providing that the liability will continue to be that of the transferor. The Supreme Court of India has held the successor employer liable to pay damages for any default in remitting provident fund contributions. Though the default was committed by the transferor entity prior to the date of transfer of employees, the Supreme Court has held the successor employer liable despite the agreement between the parties providing that the liability would be exclusively that of the transferor.

**Case Study**

The McLeod Russel acquired a Tea Estate which had defaulted in remitting the contributions and accumulations payable under the Employees' Provident Fund Act, 1952 (EPF Act). At the time of acquisition, the proceedings to recover dues and impose damages were ongoing. Parties had entered into an agreement which provided that any damages payable on account of failure to deposit dues under the EPF Act, would be solely that of the Transferor Company. The RPFC[232] however sought to recover Penal interest from McLeod Russel. This action was challenged, and the matter was taken up to the Supreme Court. The question before the Supreme Court[233] was whether the Transferee Company would be liable to pay damages for default committed by the Transferor Company. The Supreme Court held that the agreement between the parties would not protect McLeod Russel from the liability to pay damages imposed under the EPF Act.

## Reduction of workforce

If the concessionaire is required to take over a work force larger than its requirement, the primary question that will need to be answered will be how to reduce the work force. In India, the existing labor legislation that addresses this issue is the IDA. The IDA prohibits employers from downsizing the workforce as a result of rationalization, standardization or improvement of plant or technique, unless a Notice of Change[234] has been issued to the affected workers and their Trade Unions at least 21 days before any such restructuring and the resultant downsizing. The Notice of Change enables the workers and unions to set in motion the machinery under the IDA for a negotiated settlement or an industrial adjudication. Until either a settlement with the unions or an Award from an Industrial Tribunal is obtained, the proposed change cannot be effected. The time taken for an Award to be published, if settlement fails, could stretch from 3 to 5 years. The Concessionaire could also face industrial action in the form of strikes, go-slows and other disruptive work practices which could further bring down productivity.

The IDA also requires certain employers to seek permission from the Appropriate Government prior to effecting retrenchment or closure. The IDA Rules also specify the procedure that needs to be followed whilst effecting retrenchment and the norm that is required to be followed is that of "last come first go"[235]. If this rule is not followed

[230] Workman" has been defined under Section 2(s) of the Industrial Disputes Act to mean any person employed in any industry to do manual, unskilled, skilled, technical, operational, clerical or supervisory work for hire or reward. It however, excludes any such person who is employed mainly in a managerial or administrative capacity or employed in a supervisory capacity drawing wages exceeding Rs. 10,000 p.m.

[231] Section 25FF of the Industrial Disputes Act, 1947

[232] Regional Provident Fund Commissioner

[233] *McLeod Russel India Limited vs. Regional Provident Fund Commissioner, Jalpaiguri and others*, 2014(8)SCALE272

[234] Section 9A of the Industrial Disputes Act, 1947

[235] Section 25G of the IDA read with rule 81 of the Bombay Rules

the retrenchment would be held to be illegal and the employer could be required to reinstate all the retrenched workmen with full back wages.

**Case Study**

Mackinnon Mackenzie Ltd. was engaged in shipping business which was divided into 4 divisions. It closed down two divisions and retained two. The retrenchment notices issued to the workers who were retrenched was challenged by the Union on the grounds that the Company had (i) not sought prior permission from the appropriate government and (ii) not put up a seniority list of all its employees and that it had retained some of the junior workers whilst retrenching some senior employees and thus violated the "last come first go" rule.

The Supreme Court[236], after 23 years of litigation, decided the matter in favour of the workmen and held all the retrenchments to be illegal and ordered that the workmen be reinstated in service with full back wages.

## Measures to increase productivity

Measures to increase productivity, or any attempt to change any condition of service, may also fall within purview of the Fourth Schedule[237] of the IDA and will require a Notice of Change to be issued before implementation.

**Case Study**

A Joint Venture Company (**JVC**) between the Government of India and the Republic of Nauru is set up. The Republic of Nauru disinvested its entire equity stake to the Government of India (**GOI**) making the JVC a Public Sector Undertaking. GOI decided to increase the retirement age for all Central Public Sector Employees from 58 years to 60 years. The JVC implemented the same in 1998. GOI thereafter decided to retract its decision and changed the retirement age back from 60 years to 58 years in 2001. The JVC however, did not implement this decision. In 2002 the GOI divested the 74% of its shareholding in JVC. The JVC then withdrew the earlier order enhancing retirement age from 60 to 58 years and restored the retirement age to 58 years.

The Trade Union raised a dispute in the Industrial Tribunal on the grounds of violation of Article 9A of the IDA which requires 21 days' prior notice to be given before any privilege is withdrawn. The Industrial Tribunal held in favor of the employees by invalidating the roll back on the ground that the required notice under Article 9A of the IDA was not given. The Appeal in the High Court was rejected and the JVC challenged the decision before the Supreme Court of India. JVC contended that the Standing Order and appointment letters continued to show the retirement age at 58 years and the age was increased to 60 years only as a temporary measure.

The Supreme Court[238] whilst rejecting the appeal observed as follows:

> *"To sum up, we are of the view that at the very moment when the order of enhancement of superannuation of the employees came into force though temporary in nature, it would amount to privilege to employees since it is a special right granted to them. Hence, any unilateral withdrawal of such privilege amounts to contravention of Section 9A of the Act and such act of the employer is bad in the eyes of law."*

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[236] Mackinnon Mackenzie Ltd. v. Mackinnon Employees Union Supreme court 25th February 2015 AIR 2015 (SC) 1373

[237] CONDITIONS OF SERVICE FOR CHANGE OF WHICH NOTICE IS TO BE GIVEN

1. Wages, including the period and mode of payment ;
2. Contribution paid, or payable, by the employer to any provident fund or for the benefit of the workmen under any law for the time being in force ;
3. Compensatory and other allowances ;
4. Hours of work and rest intervals;
5. Leave with wages and holidays ;
6. Starting alteration or discontinuance of shift working otherwise than in accordance with standing orders;
7. Classification by grades ;
8. Withdrawal of any customary concession or privilege or change in usage;
9. Introduction of new rules of discipline, or alteration of existing rules except insofar as they are provided in standing orders;
10. Rationalisation , standardization or improvement of plant or technique which is likely to lead to retrenchment of workmen;
11. Any increase or reduction (other than casual ) in the number of persons employed or to be employed in any occupation or process or department of shift [ not occasioned by circumstances over which the employer has no control]

[238] *Paradeep Phosphates Ltd. v. State of Orissa & Ors*. SCC (2018) 195

### Employment issues on termination of the concession period

Whilst OMDA agreements in respect of Delhi and Mumbai International Airports have elaborate provisions for transfer of employees from the Airport Authority of India to the Concessionaire, they are silent in respect of the fate of employees at the end of the concession period or in case of premature termination of the concession agreement. Concessionaires must ensure that appointment letters issued to all employees contain clear provisions that the contract of employment is for a fixed term and terminates with the termination of the concession. Otherwise the concessionaire would be required to terminate employment by paying significant amounts of retrenchment compensation, after seeking necessary permissions which may not be forthcoming.

## The BOT and BOOT Models of Concessionaire Agreements

In the Build Operate and Transfer (**BOT**) and Build Own Operate and Transfer (**BOOT**) models of Public private partnerships (**PPP**) projects the Concessionaire is required to build infrastructure like roads, metro systems or ports, operate them for the concession period, then hand over the project over to the Government or another concessionaire. This section briefly summarizes the employment issues that would arise in BOT and BOOT projects.

### Determining responsibility for compliance

The Contract Labour Act[239] regulates the employment of contract labour. A Principal Employer is defined, in case of a factory, as the owner or occupier of the factory or the person named as the manager of the factory. In establishments other than factories, a Principal Employer, under the Contract Labour Act, would be any person responsible for the supervision and control of the establishment.

### Concepts of "factory" and "occupier"

The Supreme Court has held[240] that construction of a railway line amounts to a "manufacturing process" and the area over which the line was being laid was a "factory". The Supreme Court referred to two earlier judgments regarding power lines[241] and distinguishing these suggested that the laying of power transmission lines would amount to a "manufacturing process" even though the maintenance of those lines or the transmission of electricity in those lines would not amount to "manufacturing process". The Court held all the 54 kms. of land over which the railway line was laid to be phase-wise factories for construction of railway lines over them. The Court held that the definition of manufacturing process cannot be construed as requiring an end product which is a movable final product or a commodity. These decisions were not considering the provisions of the Factories Act but those of the Employees State Insurance Act which is applicable to all factories. However, since the definition of "manufacturing process"[242] as set out in the Factories Act has been adopted in the ESIC Act, these decisions will be applicable in determining what constitutes a Factory under the Factories Act.

In light to the foregoing, all infrastructure projects where construction activity is being carried on could potentially be considered to be a factory, not just for the purpose of coverage of its employees under various other statutes made

[239] Contract Labour (Regulation and Abolition) Act, 1970

[240] *Lal Mohammed v. India Railway Construction Co*. (1998)

[241] *Nagpur Electric Light and Power Company v. Regional Director of ESIC* (1967) and *Nagpur Electric Light and Power Company v. Regional Director of ESIC* (1967)

[242] Section 2(k) "manufacturing process" means any process for—

(i) making, altering, repairing, ornamenting, finishing, packing, oiling, washing, cleaning, breaking up, demolishing, or otherwise treating or adapting any article or substance with a view to its use, sale, transport, delivery or disposal,

(ii) pumping oil, water, sewage or any other substance; or]

(iii) generating, transforming or transmitting power; or

(iv) composing types for printing, printing by letter press, lithography, photogravure or other similar process or book binding; or

(v) constructing, reconstructing, repairing, refitting, finishing or breaking up ships or vessels; or

(vi) preserving or storing any article in cold storage;

applicable to "factories" but also for the purposes of attaching liability on Occupiers as determined under the Factories Act.

Section 2 (n) of the Factories Act, 1948 defines "occupier" in relation to factories. In case of a company, it mandates that it must be one of the directors of the company notified as such. In case no Director is notified as an Occupier, all directors will be deemed to be Occupiers. The Factories Act fixes liability on the Occupier for compliance of all provisions of the Act. In the J. K. Industries case[243] the Supreme court, upholding these amended provisions, has observed that the legislature whilst amending the Act in 1987, (post the Bhopal Gas Leak at the Union Carbide factory) wanted to bring in a sense of responsibility in the minds of those who have the ultimate control over the affairs of the factory so that they take proper care for maintenance of the factories and the safety and security measures therein. The Court held that the fear of penalty and punishment is bound to make the Board of Directors of the company more vigilant and responsive to the need to carry out various obligations and duties under the Act, particularly in regard to safety and welfare of the workers. The Court further held that for offences under the Factories Act, mens rea[244] or motive is not an ingredient. The offences are strict statutory offences for which establishment of mens rea is not an essential ingredient. The omission or commission of statutory breach is itself the offence. The Occupier is held vicariously liable along with the manager and the actual offender. Even where the Occupier establishes that the actual offender is the person named by him, he must still prove to the satisfaction of the court that he had used due diligence to enforce the execution of the Act and that the said other person committed the offence in question without his knowledge, consent or connivance. Penalties under the Factories Act include fines and imprisonment. A review of the labor laws and compliances therefore becomes imperative for all companies in the infrastructure sector. On a practical level, companies nowadays use specialized and bespoke software to keep abreast of regulations and compliances.

## Factory or building and construction site – The conundrum

The Building and Construction Workers Act 1996 (**BOCW**) would be applicable to most infrastructure projects in India[245] and aims to provide welfare measures to the construction workers. The definition of building and construction work under the BOCW however, specifically excludes building and other construction work to which the provisions of the Factories Act, 1948 apply. The BOCW along with the Cess Act[246] provides for collection of cess at the rate of 1% of the total cost of construction, which cess is paid into the Building and other Construction Workers' Welfare Fund. The monetary resources accumulated through this fund are used to secure social benefits for construction workers who are protected within the realm of this Act. Concessionaires and statutory authorities would need to decide whether the construction activities fall within the definition of "factory" as interpreted

[243] *J. K. Industries Ltd. v. Chief Inspector of Fisheries and Boilers* (1996) 6 SCC 665

[244] *Mens Rea* refers to criminal intent. The literal translation from Latin is "guilty mind." Establishing the *mens rea* of an offender is usually necessary to prove guilt in a criminal trial. Justice Oliver Wendell Holmes, Jr. (The Common Law 2 (1888) explained the concept of mens rea when he said "even a dog knows the difference between being stumbled over and being kicked."

[245] 'building or other construction work includes *'the construction, alteration, repairs, maintenance or demolition- of or, in relation to, buildings, streets, roads, railways, tramways, airfields, irrigation, drainage, embankment and navigation works, flood control works (including storm water drainage works), generation, transmission and distribution of power, water works (including channels for distribution of water), oil and gas installations, electric lines, wireless, radio; television, telephone, telegraph and overseas communication dams, canals, reservoirs, watercourses, tunnels, bridges, viaducts, aquaducts, pipelines, towers, cooling towers, transmission towers and such other work as may be specified in this behalf by the appropriate Government, by notification but does not include any building or other construction work to which the provisions of the Factories Act, 1948 (63 of 1948), or the Mines Act, 1952 (35 of 1952), apply.'*

[246] The Building and Other Construction Workers Welfare Cess Act, 1996

by the Supreme Court in the decisions mentioned above, or whether they are covered under the BOCW Act. Whilst the former may permit exemption from the payment of 1% cess, the liabilities of directors is strict and vicarious and all workers would be entitled to statutory benefits payable to factory workers.

**Case Study**

The Supreme Court in the case of *Lanco Anpara Power Ltd. V. State of Uttar Pradesh & Others*[247] was required to consider whether the appellants were covered under the Factories Act or the BOCW Act. The appellant proposed to set up a 2X600 Megawatt capacity coal-based thermal power project pursuant to being selected by a tariff-based competitive bidding initiated by the Uttar Pradesh Power Corporation Ltd. The appellant was granted registration and licence under the Factories Act to construct its plant. A letter was also received from the District Collector, calling upon the appellant to get itself/its contractors registered under the provisions of the BOCW Act and the BOCW Rules. Some more notices were issued with regard to the construction activities in respect of the construction of the township in Anpara, undertaken by the appellant. Insofar as the township is concerned, the appellant got itself registered through its principal contractors under Welfare Cess Act and started paying the cess. However, in respect of construction activity at the factory premises, the appellant reiterated its stand that by virtue of Section 2(1)(d) of the BOCW Act, it was excluded from the coverage thereof. The contention of the appellant was rejected by the respondents which led to the writ petition being filed. The Supreme Court held that the building was being constructed for carrying out the particular manufacturing process, which was generation, transmission and distribution of power. The Court held that the workers who were engaged in construction of the building did not fall within the definition of 'worker' under the Factories Act as they were not engaged in a manufacturing process. On this aspect both parties were at ad idem. The Court therefore found that these construction workers were not covered by the provisions of the Factories Act and were entitled to the welfare measures under the BOCW Act and the Cess Act.

The earlier decision of the Supreme Court in the case of Lal Mohammad (supra) has not been considered by the Court in the Lanco case. In Lanco the court proceeds on the basis that the construction workers were not engaged in any manufacturing process. Therefore, concessionaires must weigh carefully whether they should contend that their project sites are "factory" and they are exempt from the provisions of the BOCW and Cess Acts or pay the cess and contend that they are not "factory".

## Liability of Directors for non-compliance under Acts other than the Factories Act

In order to fasten personal liability onto Directors for the non – payment of statutory dues such as Provident Fund or Employee State Insurance Contributions, and for non-payment of Minimum Wages or Bonus, once it is shown that the director was in charge of and responsible for the conduct of the business of the Company, the director would be held to be personally responsible.

**Case Study**

The Supreme Court quashed criminal proceedings against the MD of Asian Hotels Ltd.[248] which runs Hyatt Regency Hotel, in a criminal negligence case in which a man had fallen from the sixth floor of the hotel and suffered serious injuries. The Supreme Court relied on the Sunil Bharti Mittal Case[249] wherein the Supreme Court had observed that "when a company is the offender, vicarious liability of the Directors cannot be imputed automatically, in the absence of any statutory provision to this effect."

Accordingly, the Supreme Court held that there was no reason or justification to proceed against the MD only on the ground that he was the Managing Director of Asian Hotels, which ran the Hotel.

[247] 2016 SCC Online SC1153

[248] Shiv Kumar Jatia v. State of NCT of Delhi

[249] *Sunil Bharti Mittal vs. Central Bureau of Investigation*, AIR 2015 SC 923

However, the Supreme Court clarified that Directors would be held liable where the statutory regime itself attracts the doctrine of vicariously liability i.e. where a statute specifies that every person who at the time of commission of the offence was responsible to the company for the conduct of the business of the company, would along with the company, be deemed to be guilty of the offence[250].

## Statutory Benefits, rights and conditions of service

Central Labor legislations such as the IDA, the Factories Act, 1948, the Code on Wages, 2019,[251] and the state-specific Shops and Establishment Acts, set out the statutory minimal obligations of the concessionaire towards employees with respect to working hours, minimum wages, bonus, termination, entitlements, health and safety standards, compensation in case of injury etc. In India, there is a separate minimum wage rate dictated by the Central Government and State Government. A concessionaire must note that under the Code on Wages, the *Appropriate Government*[252] will have the jurisdiction to determine the minimum wage rate for construction workers. Every state in India has a different minimum wage. This is largely because of socio-economic factors and variance in the cost of living. Presently, Maharashtra and Gujarat are among those States with the highest minimum wage rate for construction workers, while Jharkhand and Bihar have the lowest.

## Contractors' liabilities

In order to avoid hiring employees directly and consequently mitigate the employer's liability, concessionaires often hire large manpower on a temporary basis, engaged typically through an intermediary or contractor. Such a scenario entails the applicability of the Contract Labour (Regulation and Abolition) Act, 1970 upon the concessionaire and the contractor. The definition of contractor includes sub-contractors. A contractor is responsible, at the first instance, for payment of wages and other statutory benefits to each worker employed by him as contract labor. In case the contractor fails to make these payments within the prescribed period, or makes short payment, the principal employer is liable to make these payments and recover the amounts so paid from the Contractor. Should a sub-contractor fail to discharge his obligations, both the contractor and the principal employer will be held liable under the Act.

In order to protect the interest of the Concessionaire, firstly, the concessionaire should ensure that the contractor/sub-contractor is fully compliant under all applicable labor laws. The Contractor or sub-contractor must have a registration number under the Provident Fund Act and the Employees State Insurance Act. The Concessionaire must have procedures in place which ensure that all statutory dues are in fact deducted and paid by the contractors/sub-contractors to the statutory authorities. Secondly, there should be a watertight indemnity clause protecting the concessionaire.

One major change that will come into effect once the Code on Wages is notified, is that Contractors who are paying their workers all statutory benefits and who are registered under the statutes mentioned above, will be treated as Employers of their regular employees. Contractors will be held responsible for any breach in payment of statutory dues to these regular employees and not the concessionaire.

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[250] For instance section 14A of the Employees Provident Funds Act, 1952 which reads as follows:

**14A. Offences by companies**

(1) If the person committing offence under this Act, the Scheme , the [Pension] Scheme or the Insurance Scheme] is a company, every person, who at the time the offence was committed was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly:

**PROVIDED** that nothing contained in this sub-section shall render any such person liable to any punishment, if he proves that the offence was committed without his knowledge or that he exercised all due diligence to prevent the commission of such offence.

[251] The Code on Wages, 2019 received the assent of the President of India on August 8, 2019. The Payment of Wages Act, 1936, the Minimum Wages Act, 1948, the Payment of Bonus Act, 1965, and the Equal Remuneration Act, 1976 will stand repealed once the Code on Wages is notified.

[252] Under the Code on Wages, the term Appropriate Government is defined as "in relation to, an establishment carried on by or under the authority of the Central Government or the establishment of railways, mines, oil field, major ports, air transport service, telecommunication, banking and insurance company or a corporation or other authority established by a Central Act or a central public sector undertaking or subsidiary companies set up by central public sector undertakings or autonomous bodies owned or controlled by the Central Government, including establishment of contractors for the purposes of such establishment, corporation or other authority, central public sector undertakings, subsidiary companies or autonomous bodies, as the case may be, the Central Government; (ii) in relation to any other establishment, the State Government.

## Termination/retrenchment

Termination of employment of "workmen" can only be effected for reasonable cause or grave misconduct. One months' notice has to be provided. Upon termination, the employer is liable to pay severance payments such as gratuity, leave encashment and retrenchment unless the termination is for grave misconduct.

Judicial pronouncements have emphasized the importance of following the principles of natural justice in case of termination for misconduct. Under the IDA the termination of employment for any reason other than due to dismissal as a result of disciplinary action, retirement, termination on grounds specified in a fixed-term contract (or the non-renewal of a fixed term contract) or termination on grounds of continued ill health is retrenchment.

Persons who are not "workmen" but engaged in a managerial or supervisory capacity are not entitled to these safeguards under the IDA and their services can be terminated in accordance with the provisions of their contracts of employment.

## International workers

Most infrastructure projects will engage the services of International Workers who are mostly engaged in key positions. The Provident Fund Act defines an international worker as an employee other than an Indian employee, holding other than an Indian passport, working for an establishment in India to which the Act applies. Every International Worker of an establishment to whom the Provident Fund Scheme applies, other than an excluded employee, is required to become a member of the Fund. As a result, 12% of their salary is required to be deducted and paid into the Fund along with a matching 12% contribution from the employer. There is no upper limit to the statutory contribution. The significant accumulated contribution is payable to the employee concerned only upon the employee completing 58 years of age i.e. on reaching the age of retirement. Employees who are citizens of countries with whom India has signed Social Security Agreements (**SSAs**)[253] are excluded from making these contributions provided they are receiving social security benefits in their home country. They are also permitted to withdraw accumulations in their PF account when they cease to be employed in India and do not have to wait till the age of 58 years like other International Workers to receive the payment.

[253] As on date India has operationalized SSAs with 18 countries including Australia, Austria, Belgium, Canada, Czech Republic, France, Germany, Hungary, Japan, Luxembourg, Netherlands, Norway, Portugal, Sweden, Switzerland and South Korea.

# Concession Agreements in Highway Projects: Guest Column by Larsen & Toubro

“India’s oldest working locomotive is the Fairy Queen, manufactured in 1855. It is also the oldest functioning steam engine in the world…

# Concession Agreements in Highway Projects: Guest Column by Larsen & Toubro

## Foreword

The NHAI has played a pivotal role in significant developments in India's roads and highways infrastructure. Having one of world's largest road networks, the GOI ambitiously has undertaken the NHDP to be implemented in two phases, primarily through EPC contracts and others, by way of the BOT model. The growth of the road development sector and the need to raise funds through equity investments, necessitated the government to partner with private contractors and enter into PPP agreements and concession arrangements. Such partnership between private and state entities, not only facilitates new investments and promotes a quicker return to sustainable economic growth, but also contributes to innovation and the long-term development of infrastructure and services to the public. The European Union countries realized the need to streamline the procedures involved in such arrangements and promulgated a national directive in 2012 which was later transposed as a legislation. However, in India, although there are various rules/regulations specific to certain government agencies regulating the modalities in a concession agreement, a national legislation is yet to see the light of the day.

Ordinarily, the concessionaire undertakes the concession contract in the form and fashion of an SPV exclusively set-up for the purpose of the project contemplated. The SPV is a fictional company, created with the sole purpose of capturing all the cash flows generated by various project financing agencies. For the aforesaid reason, everything that is needed in order to design, build, manage and finance the project must be purchased by third parties. To analyze the risks associated with such concession contracts, it is quintessential to understand the network of contracts which majorly impacts the Concessionaire/SPV.

The intricacies of the contractual network are much widespread and complex than they appear. The bottlenecks of the concessionaire in such a contractual arrangement are many. This article tries to capsulate few of them.

## Contractual Structure of Project Finance[254]

### Pre-Contract

The bidders for road construction contracts are mostly local contractors. Although these contractors meet the technical requirements and are acquainted with the native issues involved in execution of such works, they are however, unaware of the complexities involved in the process of tendering and implementation of concession contracts. Due to such difficulties faced by the local contractors, the big multi-national entities race through and the works are often subcontracted to such local workers. Perhaps the employing entities are keen on entering into contracts with renowned construction contractors to ensure smooth execution in the most economic manner without any compromise on quality. However, the pre-contract stage of the concession arrangement, is not fool proof.

Further, the government agencies have their standard template of contracts with onerous and open ended clauses, mostly favoring the employer such as fitness for purpose obligations. The concessionaire has negligible scope for negotiation of such contracts and are commonly constrained to sign on the dotted lines of the contract as-is. This is often considered as a major pitfall in government contracts, as it amounts to coercion. The tender document of the NHAI, modelled upon generic FIDIC (**International Federation of Consulting Engineers**) construction contracts, envisage that since the estimation of work including the rates, prices and costs of various items of work is done on the basis of prices/costs of materials, labor and other inputs prevailing on and around the date of the submission of bid, 'Price Adjustment' (also generally known as Price Escalation/Variation) is needed so as to protect both the parties in cases of rise or fall of prices/costs of various components of work during the period when the work is being executed. In the

[254] Article on 'Private Financing and Government support to promote long-term investments in infrastructure' published by OECD, 2014

NHAI contracts, as opposed to one lump financial quote, the entire work to be executed under the contract is divided into various estimated quantities of work unit wise in the BOQ (**Bills of Quantities**) document which is part of tender document. Each bidder is required to quote rates/prices for each estimated quantities or items of work. These rates are also referred to as 'Base Unit Rates and Prices' or 'BOQ Rates/Prices'.

## Post-Contract award

Ideally, the Employer provides a 'Notice to Proceed' once the contract is executed by both parties and the conditions precedent are complied with. The NTP marks the commencement of the works under the Project and time starts ticking therefrom. The delay in the actual Date of Completion Delay by Government from the contractual date of completion may be due to various factors attributable to the employer or the concessionaire or both or for reasons beyond reasonable control of the parties.

Delays in construction of highway contracts cause tremendous financial impact on the cash flow of the concessionaire, both for present as well as in the future prospects. Therefore, the concessionaire has to bear in mind to conduct a thorough delay analysis rather than shorthand analysis of summary documents, prior to raising claims. The 'critical path' theory is mostly followed across the construction fraternity, while calculating the delay claims. The delay claims have to be typically calculated based on the Construction Schedules/the Contractor's program of work and the As-built/As-planned Schedule. The gaps found in the analysis helps to determine where, why and how the delay occurred and whether it was addressed effectively. Addressing the delay effectively means whether appropriate documentation was maintained by the contractor who encountered a delay in the project. It is also important for the contractor to effectively communicate with the employer on a regular basis, in order to document the acts of the parties which help in the process of delay analysis.

The major hiccups in the execution of the project caused to the Concessionaire are under:

### Unavailability of Land/Work front

Road contracts involve issues like village private limits, land acquisition, approvals from government authorities, phased or non-exclusive possession of the land, lands subjected to litigation, court or administrative directions restraining the execution of the works in certain areas, which are collectively referred as ROW issues. Under the concession contracts, the obligation to provide a hindrance-free work front or access to site is reposed on the employer. Delays caused as a consequence of either failure of the employer or for reasons beyond its control, have an impact on the performance of the concessionaire's reciprocal promise.

### LHS and RHS

A unique problem faced by the contractors in road/highway construction contracts is the issue of non-availability of clear work front on both sides of the site, where the roads are planned to be laid. Contractors complete a particular stretch on one side of the road/highway and are constrained to idle their resources due to non-availability of the other side of the path, thus stuck in the vicious circle without completion, incurring huge costs as a consequence.

### Non-payment of dues

The contractors often face low cash inflows, due to delay in release of payments towards certified/accepted amounts by the employer. In such an event, the contractor would be constrained to suspend the performance idling the resources at site.

### Prejudiced determination by Independent Engineers

The concession contracts provide for appoint of IEs or Engineer-in charge (**EIC**) or Employer's representative who is in charge of the day-to-day decision making. The claims of the concessionaire fall before the IE or EIC for determination and decision making. However, the IEs are seldom independent and have prejudice of mind acting as a puppet in the hands of the employer. Therefore, the concessionaire's claims often fall apart and are less appreciated by the IE/EIC. On the other hand, the concessionaires are burdened with liquidated damages and levy of penalties by the employer based on the unilateral determination of the IE/EIC.

## Wrongful encashment of Bank Guarantees

The performance bank guarantees furnished in favor of the employer acts as a tool to threaten the concessionaire in most of the occasions. The courts have also taken a back-step in restraining the employer from invocation of bank guarantees unless there is a clear establishment of fraud[255]. Therefore, the law of injunction being no longer res integra, fail to rescue innocent contractors.

## Uncertainty

There is an inherent uncertainty that plagues any long term project. The concessionaire can never be certain of the actual conditions on the ground, availability of labour and material, weather changes, changes in technology, changes in law (which itself is a contentious term) and interference from third parties and the Government. Given the inherent uncertainties and the nature of the construction work, the possibility of a change which may give rise to a claim is inevitable. Accordingly, it becomes important that due regard is paid to the provisions of the contract as regards resolution of claims. Further, for a party to succeed in a claim, it would be critical for such party to maintain adequate records so as to be able to establish the causation for the loss suffered by it.

## Variations

The prices quoted by the contractor at the time of bidding would lose its worth as time elapses. Since most of the highway construction contracts are for a substantially long period of time considering the extensions and defect of liability period, the concessionaire mostly quotes based on the variation formula under the contract. The price adjustment clause in the contracts of NHAI resulted in plenty of litigations and disputes between the parties. The arbitration awards also failed to clear the slate by giving diametrically opposite decisions in different cases.

### Case Study

The Hon'ble Supreme Court, in *M/s Progressive MVR (JV) vs. NHAI* which is considered as one of its recent landmark judgements, clarified the long pending muddle on the price escalation formula, however in favor of NHAI. The NHAI contract contains a 'price adjustment clause' which provides for a formula for adjusting prices for each month's payment on the basis of positive or negative variation from the base rates on which bids were accepted. The dispute was regarding the method of computing variable cost component 'x', 'y', 'z' for bitumen, cement and steel. According to the contractor, it has to be computed on the basis of the actual and prevailing cost of every month. It was noted by the Hon'ble Court that *"the intention in the formula was to keep in mind the base cost while arriving at the price adjustment. The clause of the agreement deals with percentages on various components that will govern the price adjustment. The three components, namely, bitumen, cement and steel variable percentage was mentioned which has to be calculated. Seventh component was 'Other Material', which was the balance percentage, after percentage of bitumen, cement and steel is arrived at, as it mentions "50 -(x+y+z)" percentage. From this, it was inferred that normally the combined percentages of x, y and z has to be less than 50%. However, when the current cost was taken into consideration while working the formula, the percentages of x, y and z far exceed 50% which would make the percentage of other materials in the negative. Such a negative aspect was to be avoided[256]."*

Therefore, the law as it stands today on NHAI or similar highway contracts, is ostensibly in favor of the employer.

Other issues arise from the long duration of the highway contracts and delays and grant of extension of time. If any contract has fixed timelines within which the contractor has to complete the works and fails to do so, the employer will have the right to repudiate the contract and the contractor shall not have any right to claim any compensation for such a repudiation, in such an event it can be concluded that 'time is the essence of contract'. Even if the contract has no express provision to that effect, when a party to a contract has caused substantial delay in performance beyond the given time, the owner can give a notice making time as essence of the contract[257] . Therefore, the contract in which time is the essence will not have any provision for extension of time.

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[255] *Dwarikesh Sugar Industries Limited vs. Prem Heavy Engineering works (P) Ltd. (A997)6 SCC 450*

[256] MANU/SC/0162/2018

[257] *Bal Saroop Daulat Ram Vs Lakhbir Singh AIR 1964 Punj 375(DB)*

If a contract includes clauses providing for extension of time in certain events, provided under the Contract and/or determined by the EIC, such clauses in a contract may render the provisions relating to time being the essence, ineffective. If the employer is accepting the progress in the execution of work beyond all deadlines without any objection and extending the deadline, then it may be inferred as time has lost its significance. Further, in *Ravindra Kumar Gupta Vs Union of India*[258] , the Hon'ble Apex Court confirmed the award passed by the arbitrator holding that the extension of time was given repeatedly by the government and hence time was not the essence of the contract moreover since the delay was attributable to the government entity, the claim of the contractor was allowed.

In the case of *Arson Enterprises Ltd vs. Union of India* it was held by the Supreme Court of India that if there is a provision

of extension of time and consequential deemed acceptance of the works, time cannot be said to be the essence of the contract. The concessionaire is often coerced to accept penalties and liquidated damages upon itself, levied by the autarchic decisions of the EIC/Employer while such extensions are granted under the contract.

Another issue is the failure of the parties to read and understand the contracts and to exercise their rights and comply with their obligations under such contracts. Given that the contracts are so complex, parties more often than not, fail to truly understand and comprehend the nature of their obligations under the contract. For instance, the FIDIC contract form has around 167 references to a notice. However, parties often overlook the obligation to provide such notices. Compliance with the provisions regarding notice and maintenance of records would accord a lot more transparency and enable effective resolution of issues. If records are maintained properly, not only would a party be fully compliant with a contract, but it would also be able to successfully initiate or defend a claim for non-performance.

## Pitfalls in recovery of Damages

Most of the contractors face difficulties in recovery of damages or cost compensation when they are made to extend their stay due to delays of the owner even while the contracts itself obligates the employer to pay damages in case of a delay on its part and grant of consequential extension of time to complete the work. In a contract which is silent on this subject, recovery of such damages, cost compensation along with the extension of time, is a hard-hitting task.

### Case Study

The Supreme Court of India addressed this issue in *Ramnath International Construction (P) Ltd., Vs Union of India*[259] the court considered the following question:

**"Whether the contractor is entitled to compensation in the light of provisions of clause 11 of the agreement?"**

Clause 11(c) in the agreement imposed a clear bar to any claim for compensation for delays in respect of which extensions have been sought and obtained. That means the above said clause was a waiver of the rights of the contractor to claim any compensation and accept the extension of time alone without compensation. But the arbitrator went ahead and granted damages on the ground that the restriction cannot apply to the arbitrator in an arbitration proceeding and the arbitrator may take the decision on the basis of the facts and circumstances of the case. Supreme Court of India while disposing of the above said matter in which the arbitral award was under challenge, held that granting damages and ignoring the contractual terms is a misconduct of the arbitrator and set aside the award. Therefore, in normal circumstances if there is a restriction with regard to damages payable by the owner to the contractor, the contractor, at a later point of time, cannot claim damages for the delay. It was held that the contract provides that if there is any delay, attributable either to contractor or employer or to both, and the contractor seeks and obtains extension of time for execution on that account, he will not be entitled to claim compensation of any nature, on ground of such delay, in addition to extension of time obtained by him. Further, the claims for compensation as a consequence of delays were barred by clause 11(C).

[258] (2010)1SCC 409

[259] (2007)2 SCC 453

However, at the same time some exceptions are[260] :

- If the contractor repudiates the contract exercising his right to do so under Section 55 of the Contract Act
- The employer gives an extension of time either by entering into supplemental agreement or by making it clear that escalation of rates or compensation for delay would be permissible
- If the contractor makes it clear that escalation of rates or compensation for delay shall have to be made by the employer and the employer accepts performance by the contractor in spite of delay and such notice by the contractor putting the employer on terms

Further, the arbitral tribunals have recognized the claims of the contractor for compensation under Section 74 of the Indian Contracts Act.

## Conclusion

Very often the contractors do not recognize the delays unless it has taken its full course. The parties involved must predict the likelihood of delays and claims at its very infancy. Perhaps establishing a project administration strategy from the outset would help mitigate such issues. The Project Reports must be studied carefully, and the concessionaires must take corrective actions to stand a better chance to win a claim in a dispute. It is difficult to avoid disputes in highway contracts owing to increasing complexity offered by the PPP model and also sophistication adopted in EPC contracts. However, given the financial stakes in the project and the consequences of a failure, it is important that parties maintain accurate records of the delay so that they can substantiate delay claims with contemporaneous documentation and serve notices wherever required.

***This article has been authored by Mr K Jagannathan & Mr Amba Prasad of Larsen & Toubro***

[260] *General Manager Northern Railways and Ors. vs. Sarvesh Chopra (01.03.2002 - SC) : AIR2002SC1272 relied by Delhi High Court in its order in the matter between Public works department vs Navayuga Engineering Co. Ltd (2014) SCC online 1343.*

# Challenges in BOT & Annuity Road Project Execution: Guest Column by Pell Frischmann

“

**CSIA’s Jaye He museum surpasses all other airport museums in scale and ambition. It houses nearly 7,000 artifacts, a 3 KM long art wall and works by over 1,500 eminent artists…**

# Challenges in BOT & Annuity Road Project Execution: Guest column by Pell Frischmann

In BOT and Annuity based highway projects, the concessionaire is responsible for the design, procurement, finance, construction, operation and maintenance of the highway project. While, the concessionaire is responsible for the quality assurance during the construction period; the IE has a defined role towards the quality assurance as per the MCA.

## Role of an IE

As per the MCA (**NHAI, 2006**), the IE has the following obligations:

- Review the Drawing and Document submitted by the concessionaire
- Review, inspect and monitor the progress of Construction Works as per the MCA
- Conducting Tests on completion of construction and issuing Completion/Provisional Certificate
- Undertaking all other duties and functions in accordance with the MCA
- The IE shall discharge its duties in a fair, impartial and efficient manner, consistent with the highest standards of professional integrity and good industry practice.

## Monitoring of Construction Works as per MCA

Relevant guidelines of MCA (**Planning Commission, 2011**) are as follows:

- During the construction period, the concessionaire shall, no later than 7 days after the close of each month, furnish to the authority and the IE a monthly report on progress of the Construction Works and shall promptly give other relevant information as may be required by the IE.
- During the construction period, the IE shall inspect the highway project at least once in a month and make the 'Inspection Report' stating in reasonable detail the defects or deficiencies, if any, with particular reference to the scope of the project and specifications and standards. The IE shall send the copy of the inspection report to the authority and the concessionaire within 7 days of such inspection and upon receipt thereof, the concessionaire shall rectify and remedy the defects or deficiencies, if any, stated in the inspection report. Such inspection or submission of inspection report by the IE shall not relieve or absolve the concessionaire of its obligations and liabilities hereunder in any manner whatsoever.
- For determining that the construction works conform to the specifications and standards, the IE shall require the concessionaire to carry out or cause to be carried out tests, at such time and frequency and in such a manner as may be specified by the IE from time to time, in accordance with good industry practices for quality assurance. The size of sample for such tests shall, to the extent possible, not exceed 10% of the quantity and/or number of tests prescribed by IRC and/or MORTH for the construction works undertaken by the authority through their contractors. The concessionaire shall, with due diligence, carry out all the tests in accordance with the instructions of the IE and furnish the results thereof to the IE. In the event that results of any tests conducted establish any defects or deficiencies in the construction works, the concessionaire shall carry out remedial measures and furnish a report to the IE in this context. The IE shall require the concessionaire to carry out or cause to be carried out tests to determine that such remedial measures have brought the construction works in compliance with the specifications and standards, and the procedure set forth in the MCA shall be repeated until such construction works conform to the specifications and standards.
- During the construction period, the concessionaire shall provide to the authority, for each calendar quarter, a video recording, which will be compiled into a 3 hour compact disc or digital video disc, as the case may be, covering the status and progress of construction works in that quarter.

With the above background, the major issues identified during such project execution on part of Independent Engineer/ Authority's Engineer are discussed in detail below.

## Sourcing of Competent Technical Manpower

As an entity overviewing the day to day works of the concessionaire, the requirement of fully competent, highly skilled and experienced manpower is of paramount importance for the IE. The manpower requirements are set forth by the authority and the personnel's' CVs are evaluated in detail (as part of technical evaluation) during the bid evaluation stage of IE's appointment contract. However, the requirement of IE engagement has increased manifold during recent years vis-à-vis the number of newly awarded/developed highway development projects creating a highly competitive scenario for technical experts. It is highly difficult to find fully competent technical manpower for designations such as the Team Leader and even after the right expert is found, the probability that he/she may continue on the project for the entire contract period is unknown and many a times the IE has to find suitable replacements more than once in the contract period which leads to a reduction in remuneration for the replaced person.

## Quality Control

The responsibility of ensuring and maintaining the quality rests with the concessionaire and the IE contracts specifies only 10/20% of tests to be witnessed.

Due to the flexibility provided to the concessionaire to use output based specifications in the technical parameters for design and execution of the highway project, and various operation issues they may undergo during the project tenure, serious challenges may arise towards the quality assurance of the project due to non-compliance by the concessionaire to its obligations as per the concession agreement.

## Cost/Time Overrun

An accomplishment of any construction projects is interconnected to its timely end within the specified financial plan, with the accurate quality and safe environment. Cost and time overruns have been another major issue in road projects. The reasons for such overruns are due to the following:

- Delay in land acquisition
- Delays in approval and clearances
- Resettlement of project affected persons
- Tree cutting
- Shifting of utilities

These delays often result in manpower idling. As it is concessionaires often quote lower prices to win the award. Any increase in costs of the concessionaire due to delays on the part of the authority ultimately leads to claims by the concessionaire and even disputes with the authority. Verification and vetting of such claims by independent engineer appointed for the project only adds up to the delay at the cost of the project.

## Settlement of Disputes/Arbitration Cases

The contract agreement between the authority and IE/AE is based on man month inputs and duration of contract is equal to the development period (about 6 months before commencement of work) and construction period. In general, the concessionaire raises the disputes/arbitration proceedings after construction since the concessionaire's agreement is for a concession period which is about 15 to 20 years. In the absence of IE/AE, the matter has to be dealt by the authority. Certain time limit for raising claims must be specified in concession agreements.

## Contradiction in conditions of contract between IE and Authority and Authority and concessionaire

Though the role and responsibility of the IE/AE is defined in concession agreement, there are few other conditions in the contract agreement between IE and authority which the concessionaire may not be aware of. This may give rise to a dispute between the authority and the concessionaire. Therefore, the required changes to remove discrepancies should be made in concession agreement.

## Traffic risk and related issues

One of the major issues related to BOT projects is the revenue realization during the concession period. While most of the concessionaires carry out their due diligence study, traffic being a derived demand, majorly depends on the movement of men and material. Several projects are hit due to the variations in projected growth rate of traffic for future years. The lower traffic on a project corridor results in reduced revenues thus impacting the fund flow of the concessionaire. If this deficit continues, the impact is felt in poor maintenance of road thus affecting the safety of road users. Often in such cases, it has become very difficult for the AE/IE and authority to take corrective measures as funds are not available with concessionaire and as such legal route is cumbersome.

Provision for quick fix solutions therefore should made in the concession agreement.

## Toll operations

As per the concession agreement, certain vehicles such as ambulances, government vehicles, military vehicles etc. are exempted from paying toll. Often, this is misused by powerful individuals and result in forced exemptions thus making day today toll operations difficult. In order to eliminate such illegal exemptions, the concessionaire has to depend on local administration/police for enforcement – these authorities are already overstretched with other duties and the concessionaire ends up losing realizable revenue.

It is suggested that the concession agreement should abolish exemptions and the government should issue coupons/card for all such exempted categories to avoid hassle free toll operations.

***This article has been authored by Mr D.M.Chame of Pell Frischmann***

# Glossary

| | |
|---|---|
| **AAI** | Airports Authority of India |
| **Amendment Act** | Prevention of Corruption (Amendment) Act, 1988 |
| **Arbitration Act** | Arbitration and Conciliation Act, 1996 |
| **BLT** | Build Lease and Transfer |
| **BOOT** | Build Own Operate and Transfer |
| **BOT** | Build Operate and Transfer |
| **BOT Annuity** | Annuity based BOTs |
| **BOT Toll** | Toll based BOTs |
| **BTL** | Build Transfer and Lease |
| **CCEA** | Cabinet Committee on Economic Affairs |
| **CCI** | Competition Commission of India |
| **CERCs and SERCs** | Central and State Electricity Regulatory Commissions |
| **Companies Act** | Companies Act, 2013 |
| **COC** | Committee of Creditors |
| **Competition Act** | Competition Act, 2002 |
| **Constitution** | Constitution of India |
| **Contract Act** | Indian Contract Act, 1872 |
| **CPC** | Code of Civil Procedure, 1908 |
| **CPP** | Captive Power Plants |
| **DBFOT** | Design Build Finance Operate Transfer |
| **DBO** | Design Build Operate |
| **DBOT** | Design Build Operate Transfer |
| **DEA** | Department of Economic Affairs, Ministry of Finance, GOI |
| **Doctrine** | Doctrine of Essential Facilities |
| **DISCOM** | Distribution companies of India |
| **EIC** | Engineer-in charge |
| **EPC** | Engineering, Procurement, Construction |
| **FDI** | Foreign direct investment |
| **FEMA** | Foreign Exchange Management Act, 1999 |
| **GMB** | Gujarat Maritime Board |
| **GOI** | Government of India |
| **GST** | Goods and Services Tax |
| **HAM** | Hybrid Annuity Model |
| **HAM MCA of 2016** | Hybrid Annuity Model released in 2016 |
| **IBC** | The Insolvency and Bankruptcy Code, 2016 |
| **IDA** | Industrial Disputes Act, 1947 |
| **IDFC** | Infrastructure Development Finance Company |
| **IE** | Independent Engineers |
| **ISDS** | Investor State Dispute Settlement Mechanism |
| **IT Act** | Income-tax Act, 1961 |
| **JV** | Joint Venture |

| | |
|---|---|
| **Kelkar Committee Report** | Report of the Committee on Revisiting and Revitalizing Public Private Partnership Model of Infrastructure headed by Mr. Vijay Kelkar |
| **MAT** | Minimum Alternate Tax |
| **MCA** | Model Concession Agreement |
| **MGC** | Minimum Guaranteed Cargo |
| **MMR** | Major maintenance reserve |
| **Model BIT** | The Model India BIT (2016) |
| **MOEFCC** | Ministry of Environment Forests and Climate Change, GOI |
| **MORTH** | Ministry of Road Transport and Highways, GOI |
| **MoS** | Ministry of Shipping |
| **MPA Bill** | Major Port Authorities Bill, 2016 |
| **MPTA** | Major Ports Trusts Act, 1963 |
| **NCLAT** | National Company Law Appellate Tribunal |
| **NH Act** | National Highways Act, 1956 |
| **NHAI** | National Highways Authority of India |
| **NHDP** | National Highway Development Programme |
| **NHIDCL** | National Highways and Infrastructure Development Corporation Limited |
| **O&M** | Operations and maintenance |
| **OECD** | The Organization for Economic Co-operation and Development |
| **OMT** | Operations, Maintenance and Tolling |
| **PCA** | Prevention of Corruption Act, 1988 |
| **PCU** | Passenger car units |
| **Planning Commission** | Planning Commission, GOI |
| **PPP** | Public Private Partnership |
| **Proposed Bill** | Personal Data Protection Bill, 2018 |
| **PSU** | Public Sector Undertaking |
| **PWD** | Public Works Department |
| **RFP** | Request for Proposal |
| **ROW** | Right of way |
| **SAROD** | Society for Affordable Redressal of Disputes |
| **SAROD-PORTS** | The Society for Affordable Redressal of Disputes Ports |
| **SCC** | Supreme Court Cases |
| **SCOD** | Scheduled Completion Date |
| **SOP** | Standard operating procedure |
| **SPV** | Special Purpose Vehicle |
| **TAMP** | Tariff Authority for Major Ports |
| **TEU** | Twenty-foot equivalent unit |
| **TOT** | Toll Operate Transfer |
| **TOT MCA of 2017** | Toll Operate Transfer MCA released in 2017 |
| **TPLF** | Third-party Litigation Funding |
| **VGF** | Viability Gap Funding |
| **WPI** | Wholesale Price Index |

# NOTES

# NOTES

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ECONOMIC LAWS PRACTICE
ADVOCATES & SOLICITORS


**MUMBAI**

109 A, 1st Floor, Dalamal Towers
Free Press Journal Road, Nariman Point
Mumbai 400 021
T: +91 22 6636 7000

**NEW DELHI**

801 A, 8th Floor, Konnectus Tower, Bhavbhuti Marg
Opp. Ajmeri Gate Railway Station, Nr. Minto Bridge
New Delhi 110 001
T: +91 11 4152 8400

**AHMEDABAD**

801, 8th Floor, Abhijeet III
Mithakali Six Road, Ellisbridge
Ahmedabad 380 006
T: +91 79 6605 4480/8

**PUNE**

202, 2nd Floor, Vascon Eco Tower
Baner Pashan Road
Pune 411 045
T: +91 20 4912 7400

**BENGALURU**

6th Floor, Rockline Centre
54, Richmond Road
Bengaluru 560 025
T: +91 80 4168 5530/1

**CHENNAI**

No 18, BBC Homes, Flat-7 Block A
South Boag Road
Chennai 600 017
T: +91 44 4210 4863

elplaw.in

insights@elp-in.com

/elplaw.in

/ELPIndia

/company/economic-law-practice