The Public-Private Partnership Law Review

Second Edition

Editors
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Chapter 9

INDIA

Sunil Seth and Vasanth Rajasekaran[1]

I OVERVIEW

Infrastructure is the fundamental branch that plays a dominant role in the overall development and economical sustainability of a developing nation. India, as a developing nation in recent years, has shown a remarkable and promising growth both in terms of viable development and economic sustainability. However, a major cause of concern for a steady economic progression throughout has been the lack of proper implementation channels and clean procurement routes. To address such shortcomings, while dealing with fiscal constraints, it was imperative for the Indian government (GOI) to attempt to induce investment through public-private partnerships (PPP). The need for private investment to bolster the economy has been persistently felt since the 1991 economic reforms, and consequently the GOI has also been taking various progressive steps to entice and induce private investment.

India enjoys a federal structure, with the Constitution of India being the *suprema lex*. The Constitution enshrines the principle of division of powers among the union government (central government) and the state legislature (state or local government).

The GOI has actively notified various guidelines, policy frameworks and an appraisal and approval committee to ensure adequate commitment towards infrastructure PPP projects:

a setting up of the PPP Appraisal Committee (PPPAC) to streamline the project appraisal process, and to eliminate administrative hurdles;

b setting up of India Infrastructure Project Development Fund (IIPDF) for extending financial assistance in infrastructure PPP projects;

c formulation of viability gap funding (VGF) scheme for making the infrastructure projects commercially viable;

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d setting up institutions such as Infrastructure Finance Company Limited for providing long-term financial support and to act as a catalyst in the stream; and

e standardising bidding and contractual documents such as request for qualification (RFQ), request for proposal (RFP), model concession agreements (MCA) for making the procurement process swift.

Presently, as per the 12th Financial Plan (2012–2017) investments worth US$1 trillion are estimated in the infrastructure sector, which is more than double the investments as projected during the Eleventh Financial Plan. The private sector is expected to contribute at least half of the over US$1 trillion investment planned in infrastructure, thereby creating an immediate need to conceptualise a robust framework to tap such resources.

The major sectors that have contributed towards the PPP mode of infrastructure development comprise the transport sector, including roads and highways, ports, airports, railways; and urban public transport under which 90 per cent of the PPP projects are envisaged. Other sectors successful in tapping private investment are the energy sector including renewable energy, electricity transmission, electricity generation; the social and commercial sector including education, healthcare and tourism; and the water supply sector including sewage treatment, water treatment plants and water pipelines.

II THE YEAR IN REVIEW

Fiscal year 2014–2015 lost considerable momentum in attracting PPP projects owing to prevalent red-tape, bureaucratic hurdles, lack of defined PPP policies and lacunas in existing PPP framework. According to the annual summary report maintained by the Department of Economic Affairs (DEA) and Ministry of Finance (MoF), there were only 31 PPP projects compared with 45 in 2013–2014.

To address the situation the GOI established a committee to revitalise and reinvent the existing PPP model. The committee headed by Dr Vijay Kelkar (the Kelkar Committee) presented its report to the Finance Minister on 19 November 2015. Its report primarily focused on issues relating to strengthening existing PPP model contracts to allow renegotiations, proper risk management and risk allocation provisions for private entities, focus on quality of service delivery rather than fiscal benefits, amendment of existing governance policies and formulation of a specific PPP law for ease of procurement.

The report of the committee is under active consideration and the GOI is expected to ramp up and streamline the PPP framework.

The GOI has also launched its innovative mission of developing 'Smart Cities' across India aimed at providing state-of-the-art infrastructure facilities. A total of 100 Smart Cities are expected to be developed through the PPP model. The project can be seen as one of the biggest infrastructure initiatives, requiring huge fiscal amount and private participation which can lead to effective and efficient PPP policies for its proper implementation.

III GENERAL FRAMEWORK

i Types of public-private partnership

There are various PPP structures and engagement models prevalent in India including Build-Operate-Transfer Model (BOT) categorised into the BOT Annuity Model and BOT Toll Model (which is most commonly used in the road and transport sector and railway sector), the power sector is more inclined towards Build-Own-Operate-Model (BOO).

Apart from the existing common mode of procurement like management contracts/performance based contract and energy procurement contracts, other known models are build-operate-lease-transfer model (BOLT), design-built-finance-operate transfer model (DBFOT) and build-operate-own-transfer model (BOOT).

ii The authorities

The GOI, along with the DEA and MoF, is involved in the structuring and support of PPP projects across India. At the central level, the PPPAC has been constituted under the services of DEA, which is responsible for approval, appraisal and streamlining the PPP process.

The DEA has also conceptualised and institutionalised a PPP Cell which is responsible for all the matters concerning PPP's including policy, schemes and other programmes. The PPP Cell exercises over all central-level PPP projects including clearances of proposals with PPPAC, proposals related to VGF funding and IIPDF, managing training programmes, developing support mechanisms for facilitating PPP, extending support to state and local governments.

Also at the state level PPP cells have been constituted that work in collaboration with the GOI to attract lucrative PPP projects and to successfully design and implement them.

Generally, the PPP projects are sponsored and identified by concerned central government ministry (e.g., Ministry of Civil Aviation, Ministry of Shipping, Ministry of Railways) or central public sector undertakings and the proposal is then submitted before the PPPAC for clearance. Subject to the approval of the PPPAC, an expression of interest (EOI) may be issued in the form of an RFQ followed by an RFP.

iii General requirements for PPP contracts

The requirements for each PPP contract fundamentally originate from their nodal PPP project and its constituting documents. For example, EOI or RFQ documents at preliminary stage of a project and RFP at latter stage. Each PPP project comes with distinct requirements, aligned in accordance with the concerned sector and proposed operating model of PPP. These documents clearly specify details about the proposed project, general and specific requirements for qualification, evaluation criteria for meeting technical and financial requirements by the proposing entity, restrictions applicable and set standards to be achieved under the project.

In case of existing 'conflict of interest', a proposing entity finds itself in a situation to materially affect fair competition or diligent performance of the procurement contract or framework agreement or is prejudicial to the interests of the procuring entity then such entity is required to be excluded by the procuring entity, to ensure transparency and competitiveness in the procurement process.

The general rule prescribed by courts as part of the administrative law of India is that any person having a conflict of interest will not be part of the bid evaluation or award process.

IV BIDDING AND AWARD PROCEDURE

The GOI has formulised various guidelines, schemes and standardised model documents for all the interested ministries, state governments and private players who are intending to venture in PPP projects. These guidelines, being broad and generic, are aimed to ensure competitiveness and provide transparency in the bidding process. The model standard document outlines essentials elements relating to the scope of bidders, eligibility and clarifications on the bidding process involved in PPP projects.

For PPPs in India a two-stage bidding process is generally followed wherein two separate bids, a technical bid and a financial bid, are invited from the bidders. The first stage incorporates a selection of eligible and prospective bidders and is the RFQ or EOI. The second stage, which involves the financial evaluation of bidders, is referred to as an RFP. The bidders are first shortlisted on the basis of the technical bid, and a financial bid of only successful technical bidders is taken into consideration for final selection.

i Expression of interest

In order to emphasise and abide by 'equal opportunity' and 'equitable treatment' for all prospective bidders, considerable significance is given to publishing the pre-qualification document, bidder registration document or bidding document, as the case may be, with a detailed description of the subject matter of procurement.

The procuring entity must elucidate the subject matter of the procurement, the method of procurement that it seeks to follow along with any criteria of pre-qualification as well as any restrictions on bidders that it intends to place before executing a framework agreement or initiating the procurement process.

The objective at EOI stage is to identify experienced bidders who have the requisite technical and financial capacity for undertaking the project.

The prospective bidders at the EOI stage are shortlisted for next stage of bidding process.

ii Request for proposal and unsolicited proposals

At the RFP stage, the pre-qualified bidders are required to submit their financial offers. Only those bidders that have been shortlisted under the EOI or at RFQ stage are required to present their financial bid.

The bidders usually engage in comprehensive scrutiny of the project, including a careful assessment of the capital and operational costs of implementing the project and also the likely revenue streams over the concession period.

Potential risks and assessment analysis in the construction and operation of the project is also conducted.

iii Evaluation and grant

The criteria for evaluation and comparison for bid proposals would be dependent on the specifications prescribed by the procuring entity in its bid documents.

For the purpose of evaluating the technical capacity of a bidder, its experience and track record in building infrastructure projects should be considered. This can be measured either from the construction work undertaken or commissioned by him or her, or from revenues of PPP projects, or from both, during a predetermined number of years preceding the date of application.

The technical capacity of a bidder can be determined on the following parameters:

a project experience on PPP projects in the specified sector;
b project experience on PPP projects in the core sector;
c construction experience in the specified sector; and
d construction experience in the core sector.

As per the standardised model RFQ, the bid may be evaluated on the criteria of 'grant' or 'premium' as per the situation. For the purpose of grant, the bidder offering the lowest financial bid based on grant may be enlisted for the next phase of bidding.

Further, in case a 'premium' is offered by the bidder, the adopted procedure would be to select the bidder offering the highest premium based on a revenue-sharing and upfront payment mechanism.

Generally, the financial proposals would be evaluated on the basis of the methods identified above, as applicable, given the nature of the bid process.

In any case, the procuring entity is not bound to accept the bid of the highest evaluated bidder and can select other bidders, subject to the procuring entity being able to demonstrate that the selection process was duly undertaken on a reasonable, fair, transparent and non-arbitrary basis.

The procuring entities may even reject bids that are extremely low or whose financial terms are extremely prejudicial to the bidder.

V THE CONTRACT

i Payment

The payment terms and type of remuneration guaranteed to the private players in a PPP contract is largely co-dependent upon the type of model contract executed between the concerned ministry and private entity (e.g., BOT, BOOT, BOLT BOT (Toll), BFOT, etc.). Sometimes the GOI may choose to pay the private entity directly for services rendered (or some part thereof). For example, in the case of road construction PPPs, instead of asking the private entity to rely solely on tolls collected, the government may directly pay the private entity a lump-sum amount on a yearly basis (also called an annuity payment). Such type of payment shall be periodic in nature and might extend through the entire concession period.

Sometimes the payment terms are performance based (i.e., the payment is made to the extent the private entity provides services to a specific performance standard).

Such type of structure in payment terms is also followed in management contracts or performance-based contracts wherein the private entity is paid a fee step by step for completion of specific responsibilities as detailed in the executed contract.

ii State guarantees

A PPP project would only be deemed successful if it receives active assistance from the both ends. Central/state government's involvement in any manner is a requisite to achieve completion of the PPP project.

The Model Concession Agreements issued by the GOI on National Highways relating to PPPs also provide certain central/state relaxations in the form of extended support and guarantees. These include comfort to the lenders, loan assistance to meet financial obligations in case of political force majeure, support in land acquisition hurdles, environmental clearances.

The enactment of a VGF scheme is also a crucial factor, since the scheme can allow the private entity to receive as much as 20 per cent of the total project cost as upfront grant assistance.

iii Distribution of risk

Various kinds of risks are involved in a PPP project, considering its vast 'initiation, operation and completion' tenure. These risks may broadly include corruption, construction or completion risk, revenue risk, operation risk, financial risk, environmental risk, land acquisition risk and force majeure risk.

In its report the Kelkar Committee has also acknowledged the risk factors involved in a PPP project and its inefficient allocation and mitigation.

Certain guidelines as set out in the report to mitigate and allocate the risk are as follows:

a an entity should bear the risk that is in its normal course of its business (for instance, acquisition of land is a normal course of business for public entities);

b an assessment needs to be carried out regarding the relative ease and efficiency of managing the risk by the entity concerned;

c the cost effectiveness of managing the risk needs to be evaluated;

d sophisticated modelling techniques are prevalent to assess probabilities of risks and the need to make provision for them; and

e need for *ex ante* provisioning of a renegotiation framework in the bid documents (concession agreement).

iv Adjustment and revision

Given their long-term nature, PPP contracts differ from the contracts entered between two parties in the normal course of a transaction in various ways. Such a long-term commitment makes it impossible for a PPP contract to incorporate all such solutions and outcomes from unforeseen circumstances that may happen during the life span of the project. These unforeseen circumstances may result in unfavourable conditions leading to impossibility of performing or executing the obligations under the contract. This develops a need among the interested parties to renegotiate or amend the provisions of the contract in accordance with the time allotted and to avoid any risk or massive losses.

Presently, the standard MCAs do not consist of any clauses or reference of adjustment or revision of contract terms and conditions, although the Kelkar Committee report has also acknowledged the need for renegotiations and has given recommendations to the DEA as follows:

The benchmarks to be applied to each proposed renegotiation trigger may include:

a evidence that the project distress is material and likely to result in default under the concession agreement at some future point should it continue;

b evidence that it is not caused by the private party and likely to cause adverse outcomes for the government or users of the concession assets or both;

c evidence that a renegotiated concession agreement is likely to have direct cost implications for the government that are less than the financial outcomes of doing nothing;

d the fact it is likely to have social benefits or avoided costs that provide better long-term outcomes; and

e it is not materially different in terms of risk allocation to the GOI.

Presently, the DEA has established that model clauses on renegotiations are in the draft stage, and it will also include a scenario for triggering rebidding in the PPP contract.

v Ownership and underlying assets

The ownership of the underlying assets depends upon the type of PPP model chosen for completing the PPP project. Depending on the characteristic of the PPP model, the ownership would shift from private entity to public entity during the tenure of the PPP agreement.

vi Early termination

Early terminations of contract in a PPP project are majorly arise owing to force majeure, political force majeure, consistent defaults from public entity, termination as a result of default in services of private entity.

Certain model MCAs (for example, the MCA on national highways) issued by the GOI contain provisions to protects the private entities by ways of compensatory payments from arbitrary and discriminatory termination by the government in exceptional situations such as political force majeure and continuing default from a public entity.

VI FINANCE

Large infrastructure projects supplemented through a PPP initiative are bound to face budget constraints during their long-term tenure. Strong financial support with quick and easy access is a must to ensure the smooth functioning of the project. The capital requirements in such projects can be available through various sources, such as raising funds through equity investors and securing financing by way of loans from national and international financial institutions (debt financing).

A special purpose vehicle (SPV) born under a PPP project can opt for recourse and non-recourse financing structures. In the case of a non-recourse financing structure (prevalent in BOT models), the collateral will be sought in the form of securing cash flows that will be generated from the project and project assets which are created.

The GOI has also taken initiatives to provide financial support to implement and fund PPP projects in India, mainly:

a setting up of India Infrastructure Finance Company Ltd, an SPV, to meet the long-term financing requirements of potential investors. It will provide financial assistance through long-term debt, lending up to 20 per cent of the capital cost of the project;

b provision of VGF to provide upfront capital grant extending up to 20 per cent of the project cost; and

c the Infrastructure Development Finance Company to develop and provide an environment for long-term debt financing.

The Kelkar Committee has also provided recommendations to ensure efficient streamlining of capital funds such as:

a MoF to allow banks and financial institutions to issue zero coupon bonds that will also help to achieve soft landing for user charges in infrastructure sector;

b RBI to issue guidelines to lenders on encashment of bank guarantees in line with ICC norms;

c a review of tax and duties and relaxations for PPP projects; and

d identification of viable revenue-generating projects.

The international financing of infrastructure could be in the form of greenfield FDI, ADRs, GDRs, asset securitisation, finance through SPV, etc. Infrastructure financing through the FDI route is another viable prospect. The GOI has relaxed the FDI norms to provide 100 per cent FDI through the automatic route, in sectors such as mining, power, airports, construction and development projects and in certain sectors such as civil aviation, existing airports and telecommunications.

VII RECENT DECISIONS

The framework of PPP is still in a developmental and constant ramification's phase in India. There being no particular law related to PPP in India, no recent decision or judgments concerning PPP have seen the light.

However, there are various court rulings concerning breach of contractual obligations in various management contracts and in relation to causing prejudice in the tender process.

VIII OUTLOOK

Keeping in mind the growing economy of India and robust trend in infrastructure development, PPP projects in India will be in great demand. The need for implementation of projects at a rapid pace and providing quality services to the general public will act as catalyst in bringing innovative PPP models and efficient policy decisions from the government.

Appendix 1

ABOUT THE AUTHORS

SUNIL SETH

Seth Dua & Associates

Sunil Seth is a co-founder and senior partner at Seth Dua & Associates with professional experience that spans over 25 years of advising multinational and Indian corporations in setting up business operations in India as joint ventures or wholly owned subsidiaries, either as greenfield projects or through the M&A route. He has advised clients in sectors as diverse as aerospace, defence, automotive, industrial, engineering, consumer goods, infrastructure, construction, real estate, hospitality, healthcare, power, oil and gas, water, roads and transport. He has rich and extensive experience in advising clients on procurement laws, policies and regulations across various sectors. He has delivered papers at various international conferences and has contributed articles to leading international publications and journals.

VASANTH RAJASEKARAN

Seth Dua & Associates

Vasanth Rajasekaran is a partner at Seth Dua & Associates. He has considerable expertise in relation to international arbitration, infrastructure projects (roads, power, airports, ports, railways, water and sanitation), defence, aerospace and aviation, PPP projects, procurement law and general litigation. He has advised many foreign companies on Indian procurement law and policies in several key infrastructure PPP projects across various sectors. He recently advised the Indian government's Ministry of Finance on the procurement process, and has also drafted the procurement manual for their *sui generis* socio-economic PPP.

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