

Overview of the framework

India has witnessed significant interest from both domestic as well as foreign investors following the policy initiatives taken by the Government of India to promote Public Private Partnership (PPP) on Design, Build, Finance, Operate and Transfer (DBFOT) basis. As a result, over a thousand PPP projects, which were structured on DBFOT basis and sustained by user charges, have either been completed or are under implementation. In the recent past, however, there have been suggestions from various quarters to provide an alternative to the user charge based DBFOT model, particularly for projects where user charges cannot sustain the required private investment.

This Model Concession Agreement (MCA) contained in this volume responds to the need for a revenue model that is sustained by annuity or unitary payments to be made by the project authority, especially where user charges alone cannot sustain the required private investment. A precise policy and regulatory framework for an alternative model in the form of design, build, operate and transfer (DBOT) has been spelt out in the MCA. Under this model, the project is partly financed by the private investor and its investment and costs are recovered through Annuity payments to be made by the project authority (the “**Authority**”).

Framework for DBOT model is a pre-requisite

Multi-sector template

The framework contained in the MCA can be used across sectors, such as highways, railway lines, hospitals, jails, schools and accommodation, by making sector-specific substitution of the relevant provisions since the MCA has been formulated mainly by way of a template. It addresses the issues which are important for infrastructure projects across sectors. These include mitigation and unbundling of risks; allocation of risks and rewards; symmetry of obligations between the principal parties; precision and predictability of costs and obligations; reduction of transaction costs; force majeure; and termination. It also addresses other important concerns such as user protection, independent monitoring, dispute resolution and financial support from the Government.

Template for use across sectors

Project Cost

The project cost, inclusive of cost of construction, interest during construction, working capital, physical contingencies and all other costs connected with construction of the project shall be determined through competitive bidding. The project cost so established shall be adjusted on a monthly basis to reflect the variation in Price Index.

Project cost to be determined through competitive bidding

Sharing of Project Cost

Fifty per cent of the adjusted project cost shall be paid by the Authority to the Concessionaire in five equal instalments during the construction period and shall be released after the Concessionaire has expended a pre-determined proportion of the project cost. Since the Government can raise comparatively cheaper funds, such sharing would reduce the financing costs that would ultimately reduce the burden on the exchequer. This arrangement would also provide greater comfort and support to the Concessionaires and thus encourage lower bids.

50 per cent of project cost to be paid by Authority

If the Government is required to pay 50 per cent of the project cost during the construction period, it would reduce the deferred annuity liability and thereby minimise pre-emption of future budgetary resources. Commitment to pay 50 per cent during the construction period would also ensure that the Government does not commit itself to excessive future liabilities merely because it does not have to provide much funding during the construction period. Such an arrangement is, therefore, expected to ensure greater fiscal prudence in making future commitments.

Payment of 50 per cent by the Authority during the construction period may be reduced to 40 per cent where the Concessionaire is entitled to collect user charges or undertake real estate development. It may be increased to 60 per cent where the potential bidders are likely to have difficulty in raising debt.

Annuity Payments

The remaining 50 per cent of the project cost along with interest thereon shall be disbursed as Annuity Payments in 20 biannual instalments spread over a period of ten years commencing from the 180th day of COD. Each of the biannual payments to be made in the first three years, next four years and the last three years following the COD will be 1.5, 2.5 and 3.5 per cent respectively of the project cost, along with interest on reducing balance of project cost at an interest rate equal to the Bank Rate plus two per cent.

Annuity payment over 10 years

Mobilisation Advance

The MCA also provides for mobilisation advance of upto 10 per cent of the project cost upon submission of a bank guarantee by the Concessionaire. The mobilisation advance shall carry interest equal to the Bank Rate.

O & M Support

All the expenses relating to operation and maintenance of the project will be borne by the Concessionaire and the Authority shall provide financial support in the form of biannual payments for this purpose. The biannual payments in lieu of O&M expenses shall be specified as a percentage of the project cost.

Financial support for O&M expenses

User Charges

The MCA provides an option to the Authority to include the levy and collection of user charges by the Concessionaire. In such a case, a pre-determined user fee would be specified for the entire concession period since this would be of importance in estimating the revenue streams of the project. Such an arrangement would help in reducing the annuity outgo of the Authority.

Collection of user charges

Technical parameters

Unlike the normal practice of focussing on construction specifications, the technical parameters proposed in the MCA are based mainly on output specifications, as these have a direct bearing on the level of service for users. Only the core requirements of design, construction, operation and maintenance of the project are to be specified, and enough room would be left for the Concessionaire to innovate and add value.

Technical parameters will focus on the level of service for the users

In sum, the framework focuses on the ‘what’ rather than the ‘how’ in relation to the delivery of services by the Concessionaire. This would provide the requisite flexibility to the Concessionaire in evolving and adopting cost-effective designs without compromising on the quality of service for users. Cost efficiencies would occur because the shift to output-based specifications would provide the private sector with a greater opportunity to innovate and optimise designs and processes in a way normally denied to it under conventional input-based procurement specifications.

Concession period

The MCA provides for a pre-determined concession period of 10 years commencing from commercial operation date of the project.

Pre-determined concession period

Selection of Concessionaire

Selection of the Concessionaire will be based on open competitive bidding. All project parameters such as the concession period, user charges, price indexation and technical parameters are to be clearly stated upfront, and short-listed bidders will be required to specify only the project cost. The bidder who bids the lowest project cost would win the contract.

Competitive bidding on single parameter will be the norm

Risk allocation

As an underlying principle, risks have been allocated to the parties that are best suited to manage them. Project risks have, therefore, been assigned to the private sector to the extent it is capable of managing them. The transfer of such risks and responsibilities to the private sector would increase the scope of innovation leading to efficiencies in costs and services.

Risk allocation and mitigation are critical

The commercial and technical risks relating to construction, operation and maintenance are being allocated to the Concessionaire, as it is best suited to manage them. On the other hand, all direct and indirect political risks are being assigned to the Authority.

Other commercial risks, such as the rate of growth of traffic in a highway project, have been allocated to the Concessionaire. It is generally recognised that economic growth will have a direct influence on the growth of traffic and that the Concessionaire cannot in any manner manage or control this element. By way of risk mitigation, the MCA provides for extension of the concession period in the event of a lower than expected growth in traffic. Conversely, the concession period is proposed to be reduced if the traffic growth exceeds the expected level. The MCA provides for a target traffic growth and stipulates an increase of upto 25 per cent in the concession period if the growth rate is lower than projected and reduction of upto 10 per cent if the growth rate is higher than projected. Any such reduction or increase in the concession period shall not alter the liability of the Authority to make Annuity payments.

Financial close

Unlike other agreements for infrastructure projects which neither define a time-frame for achieving financial close, nor specify the penal consequences for failure to do so, the MCA stipulates a time limit of 180 days (extendable up to another 185 days on payment of a penalty), failing which the bid security shall be forfeited. By prevalent standards, this is a tight schedule, which is achievable only if all the parameters are well defined and the requisite preparatory work has been undertaken.

Project implementation must commence as per agreed timeframe

The MCA represents a comprehensive framework necessary for enabling financial close within the stipulated period. Adherence to such time schedules will bring in a significant reduction in costs besides ensuring timely provision of the much needed infrastructure. This approach would also address the typical problem of infrastructure projects not achieving financial close for long periods.

Construction

Handing over possession and obtaining of environmental clearances of at least 90 per cent of the project land are being proposed as conditions precedent to be satisfied by the Authority before financial close.

Safety and quality of service must be ensured

The MCA defines the scope of the project with precision and predictability in order to enable the Concessionaire to determine its costs and obligations. Additional works may be undertaken within a specified limit, only if the entire cost thereof is borne by the Authority.

The MCA provides for damages which the Concessionaire shall pay to the Authority for not achieving the milestones prescribed for project completion. A provision has also been made for payment of bonus by the Authority to the

Concessionaire for completion of the project before the scheduled completion date.

Before commercial operation of the project, the Concessionaire will be required to subject the project to specified tests for ensuring compliance with the specifications relating to safety and quality of service for the users.

Operation and maintenance

Operation and maintenance of the project is proposed to be governed by strict standards with a view to ensuring a high level of service for the users, and any violations thereof would attract stiff penalties. In sum, operational performance would be the most important test of service delivery.

Maintenance standards will be enforced strictly

The MCA provides for an elaborate and dynamic mechanism to evaluate and upgrade safety requirements on a continuing basis. The MCA also provides for regulation, police assistance, emergency medical services and rescue operations.

Right of substitution

In the infrastructure sectors, project assets may not constitute adequate security for lenders. It is project revenue streams that constitute the mainstay of their security. Lenders would, therefore, require assignment and substitution rights so that the concession can be transferred to another company in the event of failure of the Concessionaire to operate the project successfully. The MCA accordingly provides for such substitution rights.

Lenders will have the right of substitution

Force majeure

The MCA contains the requisite provisions for dealing with force majeure events. In particular, it affords protection to the Concessionaire against political actions that may have a material adverse effect on the project.

Concessionaire will be protected against political actions

Termination

In the event of termination, the MCA provides for a compulsory buy-out by the Authority, as neither the Concessionaire nor the lenders can use the project assets in any other manner for recovering their investments.

Termination payments have been quantified precisely as compared to the complex formulations in most agreements relating to private infrastructure projects. Political force majeure and defaults by the Authority are proposed to qualify for adequate compensatory payments to the Concessionaire and thus guard against any discriminatory or arbitrary action by the Government or the Authority. Such termination payment shall not be less than the sum of Annuity Payments remaining unpaid for and in respect of the Concession Period, including interest thereon upto the Transfer Date. Further, the project debt would be fully protected by the Authority in the event of termination,

Pre-determined termination payments should provide predictability

except for three situations, namely, (a) when termination occurs as a result of default by the Concessionaire, 90 per cent of the debt will be protected, (b) in the event of non-political force majeure such as Act of God (normally covered by insurance), 90 per cent of the debt not covered by insurance will be protected, and (c) when termination occurs on account of Concessionaire Default during Construction Period, the initial expenditure equal to 40 per cent of the Total Project Cost will be set apart, and for the expenditure in excess of such 40 per cent, an amount equal to 90 per cent of the debt expended will be protected.

Monitoring and supervision

Day-to-day interaction between the Authority and the Concessionaire has been kept to the bare minimum by following a ‘hands-off’ approach, and the Authority shall be entitled to intervene only in the event of a material default. Checks and balances have, however, been provided for ensuring full accountability of the Concessionaire.

Independent supervision is essential

Monitoring and supervision of construction, operation and maintenance is proposed to be undertaken through an Independent Engineer (a qualified firm) that will be selected by the Authority through a transparent process. Its independence would provide added comfort to all stakeholders, besides improving the efficiency of project operations. If required, a public sector consulting firm may discharge the functions of the Independent Engineer.

The MCA provides for a transparent procedure to ensure selection of well-reputed statutory auditors, as they would play a critical role in ensuring financial discipline. As a safeguard, the MCA also provides for appointment of additional or concurrent auditors.

To provide enhanced security to the lenders and greater stability to the project operations, all financial inflows and outflows of the project are proposed to be routed through an escrow account.

Specifications & Standards

The Concessionaire shall comply with the Specifications and Standards set forth in the Manual to be provided by the Government. The Manual for Specifications and Standards, by reference, form an integral part of the concession agreement for a specific project and shall be binding on the Concessionaire. The MCA stipulates that only the basic requirements of design and construction shall be laid down in the MCA, and greater emphasis shall be placed on specifying the output specifications that have a direct bearing on the reliability and quality of the project.

Output specifications to be emphasised

Miscellaneous

The MCA addresses issues relating to dispute resolution, suspension of rights, change in law, insurance, defects liability, indemnity, redressal of public grievances and disclosure of project documents.

**An effective
dispute resolution
mechanism is
critical**

Conclusion

Together with the Schedules, the proposed contractual framework addresses the issues that are likely to arise in financing of projects on DBOT basis. The proposed regulatory and policy framework contained in the MCA is a prerequisite for attracting private participation with improved efficiencies and reduced costs, necessary for accelerating growth.

**Private
participation
should improve
efficiencies and
reduce costs**