

# Overview of the framework

## Need for a framework

Traditional warehouses for shortage of foodgrains have been built in the public sector mainly by Central Warehouse Corporation (CWC), Food Corporation of India (FCI) and the State Warehousing Corporations (SWCs). A large number of warehouses built in the private sector have also been hired by the public sector for storage of foodgrains procured for the public distribution system. However, the total storage capacity continues to be short of the requirement of FCI which has been procuring ever increasing supplies of foodgrains under its price support operations. Besides shortage of warehousing capacity, there is virtually a complete absence of modern storage facilities like silos, which can store foodgrains for longer periods while preserving their quality. Government of India has, therefore, decided to create modern storage facilities with a capacity of 2 (two) million tonnes in the first phase.

**Need for modern storage**

Significant investment would be required for building modern storage capacity and much of it would have to be mobilised from the private sector. Experience over the past decade suggests that infrastructure projects across sectors have witnessed a significant interest from both domestic as well as foreign investors following the policy initiatives taken by the Government of India to promote Public Private Partnerships (PPP) in building and operating such projects. However, a pre-requisite for private participation of this nature and scale is the adoption of a comprehensive policy and regulatory framework which is necessary for addressing the complexities of PPP and for balancing the interests of users and investors. In particular transformation of rules will need to be accompanied by a change in the institutional mind set.

**Need for private investment**

For building and operating storage projects through PPP, a precise policy and regulatory framework is being spelt out in this Model Concession Agreement for storage of foodgrains (MCA). This framework addresses the issues which are typically important for limited recourse financing of infrastructure projects, such as 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 independent monitoring, dispute resolution and financial support from the Government.

**A comprehensive framework is a pre-requisite for PPP**

The MCA provides the basis for optimal utilisation of resources on the one hand and adoption of international best practices on the other. The objective is to secure value for public money in the form of efficient and cost-effective services.

## Elements of financial viability

The three critical elements that determine the financial viability of storage projects are the concession period, storage charges and capital costs. The concession period

for a storage project may normally be fixed at thirty years in line with the life of a typical steel silo. A provision has been kept for extension of the concession period for upto 10 years. This timeframe should enable a robust project structure with cost-effective storage charges. The MCA also provides for determining the storage charges broadly in line with the prevailing storage charges paid by FCI to CWC.

Since two of the three parameters stated above would be virtually pre-determined, capital cost is the variable that will determine the financial viability of a storage project. Adoption of cost-effective specifications would, therefore, be essential for reducing capital costs in order to improve viability. Yet the project may not attain the financial viability necessary for servicing the capital and operational costs. As a result, bidders may require a capital grant/subsidy from the project authority (the “Authority”) in order to reduce their capital investment for arriving at an acceptable rate of return. Where bidders do not seek any grant and are instead willing to make a financial offer to the Authority, they will be free to quote a premium to be paid to the Authority.

### **Storage Charges**

The MCA provides for storage of foodgrains against payment of storage charges which are divided into two parts, viz., Fixed Charge and Variable Charge. Fixed Charge is to be paid for the storage capacity made available by the Concessionaire. Variable Charge is payable for the actual quantity of foodgrains stored in the facility. The MCA also provides for charges to be paid for other services such as unloading, bagging, stacking and loading of foodgrains.

**Storage charges should be determined with care and precision**

The MCA provides for an annual reduction in the Fixed Charge to account for the depreciated value of the project assets. It has been stipulated that the storage charges subsequent to the first year of operation may be determined by reducing the same to the extent of a pre-determined percentage in the band of 1 to 2 per cent per annum. The Concession Agreement also provides for variation in the storage charges to the extent of variations in Price Index.

**Indexation to WPI**

### **Third party usage of unutilised capacity**

To avoid idling of capacity, the Concessionaire has been permitted to hire out the vacant storage space to third parties in the event that the available capacity is not utilised by the Authority. In such cases, 40 per cent of the revenues earned by the Concessionaire from such third parties shall be shared with the Authority.

### **Capacity Augmentation**

The MCA allows for capacity augmentation. In the event such augmented capacity is used by the Authority, the Fixed Charge payable in respect thereof shall be 90 (ninety) per cent of the Fixed Charge payable for the existing storage facility. All other provisions related to third party use shall be applicable to such augmented capacity.

**Augmentation of capacity**

## **Agro estate development**

Capital subsidies alone may not suffice in meeting the likely gap in the viability of a storage project. One of the options to bridge this gap can be to provide development rights over real estate for generating additional revenue streams in order to make the project viable. Provision for agro estate development by the Concessionaire has, therefore, been kept in the MCA with restrictions on the nature and extent of such use. This would enable the Concessionaire to use the real estate with a view to ensuring optimal utilisation of project assets.

**Agro estate  
can cross-  
subsidise**

## **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 preserving the quality of foodgrains stored in the facility. Only the core requirements of design, construction, operation and maintenance of the storage facility have been specified, leaving enough room for the Concessionaire to innovate and add value.

**Technical parameters  
for  
level of service**

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 storage of foodgrains. Cost efficiencies would occur because the shift to output-based specifications would provide the private sector with a greater opportunity to innovate and optimise on designs in a way normally denied to it under conventional input-based procurement specifications.

## **Performance standards**

The Concessionaire would not only procure the construction of the storage facility, it would also provide a service in the form of storage of foodgrains. The efficiency of the Concessionaire would normally reflect in the quality of service provided to the Authority. The MCA, therefore, identifies the key performance indicators relating to operation and maintenance of the storage facility and stipulates penalties for failure to achieve the requisite levels of performance.

**Performance  
standards to be  
enforced**

In particular, the Concessionaire is required to ensure the availability of storage capacity at the pre-determined normative levels. The number of forced closures in a quarter year has been capped in order to ensure system reliability. Losses of foodgrains must also remain within the specified normative levels.

The MCA requires the Concessionaire to declare the availability of the storage facility. Normally, the storage facility will be deemed as available to the extent of the specified storage capacity. In the event of any defect or deficiency, the Concessionaire must declare the actual availability so that its storage charges are computed accordingly. The MCA stipulates stiff penalties in case of mis-declaration by the Concessionaire.

For monitoring the key performance indicators, monthly status reports and inspections of the Independent Expert have been prescribed. The Concessionaire is also required to maintain the requisite ISO certifications for the storage facility.

### **Selection of Concessionaire**

Selection of the Concessionaire will be based on open competitive bidding. All project parameters such as the concession period, storage charges, technical parameters and performance standards are to be clearly stated upfront. Based on these terms, the short-listed bidders will be required to specify their financial offer without any conditions. The bidder who seeks the lowest grant or offers the highest premium, as the case may be, should 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 these 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 would be best suited to manage them. On the other hand, all direct and indirect political risks are being assigned to the Authority.

The MCA provides for extension of the concession period in order to compensate the Concessionaire for specified events. In case the stipulated extension of concession period cannot be granted, the MCA provides for a pre-determined monetary compensation to be paid to the Concessionaire.

**Extension of concession period**

### **Financial close**

Unlike other agreements for private 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 120 days for achieving financial close (extendable for another 90 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 the comprehensive framework necessary for enabling financial close within the stipulated period. Adherence to such time schedules will usher in a significant reduction in costs besides ensuring timely provision of the needed infrastructure. This approach would also address the typical problem of infrastructure projects not achieving financial close for long periods.

## **Construction of the storage facility**

Handing over possession of the land required for construction of the storage facility and obtaining of environmental clearances are being proposed as conditions precedent to be satisfied by the Authority before financial close. Procurement of applicable permits has been proposed as a condition precedent to be satisfied by the Concessionaire. In order to facilitate the process, the Authority would provide reasonable support and assistance to the Concessionaire in procuring the aforesaid licence and permits.

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

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

**Service quality and safety must be ensured**

## **Operation and maintenance**

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

**Maintenance standards will be enforced strictly**

## **Right of substitution**

The project assets may not constitute adequate security for lenders. It is the 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 and mortgage**

As security for recovery of debt due in the event of termination, creation of a mortgage on the storage facility has been stipulated in the MCA. This is expected to provide added comfort to the lenders.

## **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. The MCA also provides for relief to the Concessionaire upon occurrence of an unforeseen event.

**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 the site, including the storage facility, is owned by the Authority. Termination payments have been quantified precisely as compared to the complex formulations in most concession agreements relating to infrastructure projects. Political force majeure and defaults by the Authority would qualify for adequate compensatory payments to the Concessionaire and will thus guard against any discriminatory or arbitrary action by the Authority. Such termination payments shall not be less than the product of forty and the fixed charge due and payable for and in respect of the last month of the Concession Period when such fixed charge was paid. Further, the project debt would be fully protected by the Authority in the event of termination, 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 Concessionaire shall bear the initial expenditure equal to 40 per cent of the Total Project Cost and for the expenditure in excess of such 40 per cent, an amount equal to 90 per cent of the debt attributable to such expenditure will be protected.

**Pre-determined termination payments should provide predictability**

Upon expiry of the specified concession period, the Concessionaire would be entitled to a termination payment equal to 20 times the fixed charge payable in the last month of the Concession Period when such fixed charge was paid. However, the Concessionaire would have the right to seek an extension of 10 years in the concession period and in such an event, no termination payment shall be due and payable after expiry of the extended period.

## **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 Expert (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 implementation. 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.

## **Specifications & Standards**

The accountability for providing a safe and reliable storage facility for preservation of foodgrains ultimately rests with the Authority and the MCA, therefore, refers to the Specifications and Standards that the Concessionaire must conform to. The Specifications and Standards are, therefore, included in the MCA and shall be binding on the Concessionaire. The MCA stipulates only the basic requirements of design and construction while greater emphasis has been placed on specifying the output specifications that have a direct bearing on the level and quality of storage.

## **Payment Security**

With a view to providing payment security to the Concessionaire, the MCA stipulates a Default Escrow Account and a Letter of Credit to be provided by the Authority. The Letter of Credit is to be provided for an amount equivalent to 125 per cent of the Fixed Charge payable for the storage facility for one month. This Letter of Credit can be invoked by the Concessionaire in the event that the payment against the monthly invoice is not made within the specified time. The funds in the Default Escrow Account can be used for payments due to the Concessionaire on account of Storage Charges as well as for termination payments. Further, if the Concessionaire is unable to recover his dues from the Default Escrow Account and the Letter of Credit, he may do so by hiring out the storage facility to third parties. In the event the Authority does not set up the Default Escrow Account or the Letter of Credit and the Concessionaire is unable to recover his dues by hiring storage capacity to third parties, he may recover his dues by sale of the foodgrains in his custody.

**Support and guarantees by the Government are essential**

## **Miscellaneous**

The MCA addresses other important issues such as dispute resolution, suspension of rights, change in law, insurance, defects liability, indemnity, redressal of public grievances and disclosure of project documents. It incorporates the best practices that would enable a fair and transparent framework for private participation.

**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 storage projects on DBFOT basis. The proposed regulatory and policy framework contained in the MCA is critical for attracting private participation with the concomitant efficiencies and lower costs, necessary for accelerating growth.

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