DND FLYWAY – CONCESSIONS, CONTRACTS & CONSEQUENCES

Vignesh M, Analyst, Punj Lloyd Institute of Infrastructure Management Infrastructure

DND Flyway Verdict – Concessions, Contracts and Consequences

- Projects around the world have gone through trials and tribulations in the form of many hurdles, risks and challenges in every phase of its development cycle (Conception – Execution and Operations). PPP projects face more challenges/ risks than projects based on traditional government procurement as it involves devolution of project financing and development to the private sector while still dependent on the public (authority) to provide necessary support systems and good regulatory practices to be successful. Typical characteristics of infrastructure projects like Natural Monopoly, High sunk/ retrospective costs, Non-tradability of output, Non- rivalry (up to congestion limits) and Possibility of price exclusion (enjoyment of benefits is contingent on payment of user charges) make it a hotspot for tensions, contention, and politics.

- Infrastructure projects implemented through the PPP route in developed and developing countries have undergone much iteration and their management subject to a lot of experimentation before landing on established models and processes agreeable to developers, regulators and governments. India has been no exception to this as ever since it removed barriers for private investments in infrastructure the country has had a mixed success in PPP projects usually due of the lack of: a. clear understanding of proposed asset, b. thorough preparation and evaluation of bidding/ contractual documents, c. prudent sharing of risks and rewards associated with the asset and d. adequate plans for mitigation measures. A great example of such a project which had a smooth ride till completion and was for a while celebrated as a successful model of a PPP initiative, The Delhi-Noida-Direct Flyway – India's first PPP Toll bridge project, soon turned sour as deep-rooted problems in its contracts, finances and a general lack of a process in its development led to criticisms from various quarters including an overzealous media, ill-informed civil society groups, opportunist political outfits, unresponsive/ indifferent government which finally led to the turn of the populist-tending judiciary to turn the heat on the project.

- The project was conceived by the NOIDA and Delhi Government in joint venture with IL&FS as a transformational project for Noida residents who had to depend on more cumbersome bridges with poor infrastructure to access Delhi metropolitan area. While the 8-lane 9.5km long flyway was instrumental in the development of Noida into the booming town as we know today, with this development and integration into NCR came its problems. PPP toll roads was never envisaged as a solution for urban settings, rather was designed as a popular model for highways.

- A typical PPP BOT project involved the private company creating, operating and maintaining the project assets for a concession period as specified in a concession contract with the Government before transferring the built assets. The DND Flyway, executed through Noida Toll Bridge Company

Ltd (NTBCL), a Special Purpose Vehicle dedicated to the project, was built at the cost of Rupees 408 million in the year 2001. December 27, 2017 Mohali, Punjab VOL-1-NO.5 7 The concession period allowed for a period till 2031 to help NTBCL recover the costs. However, with the project seeing the Operations & Maintenance stage, the inherent deficiencies in the processes of development, terms of contracting and absent regulation came to the fore through Planning Commission's report by Sheoli Pargal. This report noted that the

- concession contract had structural flaws with its vagueness in defining the 'guaranteed returns' and a possible 'conflict of interest' with the fact that the developer played multiple roles in project development and financing where it could have designed procurement terms and conditions to favor its interests. It went on calculate that under the said terms of an assured extension of concession period till recovery of 20% returns on project IRR with shortfalls added back and undefined inordinate expenditures would result in the developer never claiming profits enough to warrant handover as it had no incentive to reduce costs.

- This prospect of a perpetual contract fueled public dissent and agitations against toll collection while an exorbitant termination payment made the Government a mute spectator which eventually culminated in a PIL (Public Interest Litigation) in 2012. By October 2016, a decisive verdict was spelt by the Allahabad High Court which was held binding at the Supreme Court early this year axing the collection of user fee by the concessionaire while still tasked of maintaining the asset till handover in 2031. The verdict, regulatory in nature, touched upon key areas of project development that were blatantly violated through this project including Article 14 of the Constitution of India where the contract was awarded through direct negotiations rather than a transparent open bidding/ selection process and the case of 'Excessive Delegation' where the project authority – NOIDA went out of the way to ask the private developer (NTBCL) to collect user fee when its powers were limited at the time of contract award.

- An amendment in law bestowing NOIDA with legal rights before signing the concession agreement could have spared the criticism in this regard but it merely served its case to the lack of process and institutional capability. While the project had its own financial troubles with initial traffic projections going haywire resulting in loss of revenue before undergoing Corporate Debt Restructuring (CDR) program in 2006 to revive profits, with this verdict 80% of project revenue of NTBCL coming from toll collection would be cutoff while its O&M obligations are intact till 2031. This invited some cautious criticism from developers and project backers who claim that the verdict would serve no good to either the developer or the public with undesirable low-quality maintenance and asset deterioration being a ripe possibility as a result. The timing of the verdict is noteworthy when nationalist expressions and economic downturns due to lack of interest among private players to risk investing in infrastructure projects have threatened to play spoilsport with the Government's plan to rope in the private sector with about 50% the planned investments in the infrastructure space in the coming years. Despite being rated as a 'mature player in Operational PPPs' by the Economists Intelligence Unit among countries invested in PPP for infrastructure development as recent as 2015, this project is a vindication of the fact that the sheer of lack of experience in handling and renegotiating skewed

contract terms without avoiding media glare and public/ legal scrutiny is something Indian regulators and contractors need to learn quickly to avoid embarrassment and loss of investment opportunities with the private sector.

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- DND Flyway was the first toll bridge project developed and operated through the PPP model which was at its infancy in India. Considerable interest was generated when the celebrated project landed in trouble years after it began operations. The issues of contention went beyond tolls and included processes of planning and development. This was the motivation behind the institute's interest in a detailed case study.

- While the part 1 of the coverage on this case (Newsletter - December 2017) gave a synopsis, the part 2 will focus on the legal aspects and what science of thought, reasoning and deduction culminated in the verdict. The Public Interest Litigation (PIL) expressed FONRWA's (plaintiff) pain points which primarily had to do with NOIDA Toll Bridge Company Ltd.'s (NTBCL) power to impose, realize and even increase the user fee from time to time. This power was vested through the concession agreement which was a negotiated Build-Operate-Transfer deal with NOIDA (Authority) than a more conventional & transparent bidding process.

- The plaintiff raised objections at the method of calculation of 'Total Project Cost and Returns' which formed the basis of the transfer of project assets to NOIDA and a hefty compensation on forced termination of contract. They contended that it was a clandestine deal done to benefit a private company at the cost of public finances and interests. The PIL wanted the court to examine if the award of the contract, collection of 'user fee' and the computation of 'Total Project Cost (TPC) and Returns' as per contract are fair, legally sustainable and in accordance with public policy requirements. The court was aware that it can only strike down unfair and unreasonable public contracts that forbids equal bargaining power. It had to think through the scope of interference addressing conflict of interest, compromised terms, means of restoring the contract and decide if the PIL is maintainable by law.

- The court assimilated the facts of the case. IL & FS was entitled as per the concession agreement to recover its capital outlays together with interest @ 20% per annum from the date of disbursement of funds till the date of recovery by collection of toll. 'Returns' were formulated by deducting O & M expenses and taxes from the Gross revenues from user fees. As per Section 14.1 of the Concession Agreement, shortfalls in the recovery of returns in a specific financial year as per the formula in Section 14.2 were added to Total Project Cost. The concession also featured term extension 2 years at a time if 'Returns' were not recovered as per agreement.

- The court decided to exercise its powers of judicial review using the Article 226 of Constitution of India – Power of High Courts to issue certain writs to examine the case. The court's motivation was to examine the terms relating to potential loss of public finances in case of forced termination of

contract and rights of 5 Vignesh M, Analyst Punj Lloyd Institute of Infrastructure Management JUNE 6, 2018 MOHALI, PUNJAB VOL-1-NO.6 commuters/ users. Under the grounds of 'Public Interest', the power of judicial review was permissible even in contractual matters. Thus, the court reviewed the concession terms of the contracting parties (IL & FS, NOIDA Authority on behalf of Govt.) through Article 226 without needing a special application or intention to proceed against the parties on those terms by the plaintiff to bring to light the vagaries of the contract.

- The verdict was delivered answering the key questions as follows: 1. Whether, in the facts of the case, the selection of Concessionaire is violative of Article 14 of the Constitution of India? The court examined the Planning Commission's report where the author Sheoli Pargal had highlighted the contractual design deficiencies and serious conflict of interest highlighting multiple roles performed by the concessionaire. IL & FS transformed from government owned company during the project's conception and planning stage to an independent entity enabling execution. It also warned of the potential perpetual nature of contract given its enforced conditions.

- The court concluded that the selection of Concessionaire in the facts of the case was violative of Article 14 of the Constitution of India and was found to be unfair and unjust. No supporting documents were provided by NOIDA to justify the need for a negotiated contract deal rather than selection through transparent open bidding process as per law. As per the 'Doctrine of Equality' based on Article 14, The Government or an instrumentality of the State while awarding the contract must select the recipient after due advertisement/notice inviting tenders.

- The doctrine extends to even the distribution of largesse like allotment of land, grant of quota, permit license, etc. by the State and its agencies. This is done to ensure fair and equitable treatment and avoid favoritism or nepotism. Since no efforts were taken to call for bidders it amounted to violation with denial of fundamental rights and equality. It is only in exceptional cases that the recipient of the contract can be selected without advertisement or notice inviting tender.

- The parties to the agreement contended that at the time of making of the Concession Agreement, they could neither anticipate nor comprehend the impact of Section 14 of the Concession Agreement with regards to the method of calculating the Total Project Cost. NOIDA claimed that the initial cost had been recovered by the Concessionaire from the tolls collected since 2001. Moreover, if the Project had to be taken back by NOIDA as on March 2012, the NOIDA Authority would have had to pay a whopping Rupees 2339.07 Crores to the Concessionaire as termination/ compensation fee which was a far cry from the project cost calculated at 407.64 crores from February 2001. The court took refuge on the 'Wednesbury Principles of Unreasonableness/ Doctrine of Irrationality' to be able to judge governmental action (NOIDA) and find inadequacies in contract structure leading to unreasonable public expenditure or inconvenience or losses. The grounds of judicial review of unreasonableness as per the doctrine is "When the decision is as such so unreasonable that no reasonable person on proper application of mind could take or if it is established that there is illegality, irrationality and procedural impropriety". The court made use of the 'Doctrine of Unconscionable Contract' in contract law that describes terms which would be un-enforceable by law. Terms that are so extremely unjust, or overwhelmingly one-sided in favor of the party with superior bargaining power that it is

unconscionable in the light of current business 7 JUNE 6, 2018 MOHALI, PUNJAB VOL-1-NO.6 practices. Accordingly, it was clear that the provisions under Section 18.1 of the Concession Agreement – Termination clause and concept of 'Guaranteed Returns' would be unconscionable with significant monetary obligation to NOIDA and result in loss of government revenue. Court observed that "Certain clauses of the concession agreement are affecting the public at large i.e. commuters who pay toll for the use of a public road in perpetuity due to wrongful arbitrary terms and conditions of the contract". Since the project asset has been functional for considerable amount of time, they decided to use the 'Doctrine of Severability' sighting Section 25.4 of Concession Agreement – Severance of Terms to see that only the offending clauses of the Agreement are severed from the contract leaving the contracting parties to perform their other obligations.

- The court said that "The method of calculation of project cost, appropriation of the user fee, and the selection of concessionaire was held as arbitrary, unfair and unjust and hence opposed to Public Policy. The Concession Agreement which guarantees an annual return of 20% of the Project cost and addition of the shortfall in the return of the previous year in the next year, is against public interest at the time of making of the Concession agreement." On that account, it recommended that Article 14 (Clause) of the Concession Agreement be severed. 5. Is it fair to retain maintenance obligations with the concessionaire without providing for the right to collect user fee to sustain operations? It was evident that the NTBCL which was a listed company at BSE was paying its dividends to shareholders from 2011. Exorbitant expenditure has been made by the Concessionaire on payment of remuneration to key managerial personnel to which the courts did not take a light view.

- The judges were convinced that the Concessionaire had been recovered not only the cost of construction i.e. the Project Cost but also reasonable profits which were shared with the shareholders in the form of dividends since 2011 and hence they decided to hand over the bridge to NOIDA as per the clauses of the agreement with immediate effect before the transfer date. Despite the violations, it recommended that the contract still be legally valid. The Doctrine of Frustration shall not apply as it is a case of default of NOIDA itself.

- The doctrine was developed as a means of dealing with subsequent, unforeseen events which render performance of a contract impossible, or illegal, or which fundamentally change the nature of the contractual obligations undertaken by the parties. It quoted "A contracting party cannot be relieved from the performance of his part of the contract if the frustration of the contract is self-generated or the disability is self-induced." Therefore, as per the contract, the court justified that the O&M obligations rests with the concessionaire