Advanced Contracts, Tendering and Public Procurement
Prof. (Dr.) Sairam Bhatt
Professor of Law
National Law School of India University
Public Private Partnerships: Law and Policy in India - Part 04

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PPP Contractual Clauses

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- Waiver of sovereign immunity clause
- Exclusive territorial and business operation Area: 150 kms
- Renewal clause

So, coming to the last leg of understanding public-private partnership contracts, we will try and take three kinds of clauses, which are critical to such kinds of contracts. Of course, the discussion of all clauses is impossible. But, as an example, we can take three clauses which are normally there in a public- private partnership contract. One of the first and most interesting clauses that do exist in a PPP contract is that the government declares and agrees that it will not claim sovereign immunity in this contract.

Sovereign immunity, is a great kind of defense, it is an immunity that is generally provided to sovereign governments. Only governments are sovereign, and under sovereign immunity, governments cannot be sued and they do not have tortious or civil liability. And hence, very often than not in India, on the ground of whether the government is liable and responsible, like any other civil contracting party, there have been lots of issues and challenges in this country.

And we have decisions like the Kasturilal case, and several others, which have debated whether the government can be sued and can the government be liable and responsible equally as any other private contracting party can be. We note that in India through the legal system, the Constitution developments, though article 300 says that a suit can be filed against

the government, the question is not about the suit being filed. But the question is about the extent and the content of liability of the government when it is sued, because, unfortunately, in the past, the government has taken a lot of defenses and a lot of arguments have been put across against imposition of government liability.

And very often than not, the government has escaped contractual performance and contractual obligation, on the grounds that the sovereign public interest and public policy concerns forced the government not to complete the contract or the contractual obligation. So, the larger public interest defense is something that the governments have often taken as sovereign powers and sovereign powers have no limits; sovereign power is a completely absolute power.

And for anything interested in terms of public policy and public interest, the sovereign has every right and every decision can be made in that kind of sovereign power, or what we call the ultimate absolute power of the state to override any private civilian contractual obligation. Considering India's history, the legal system, the legislative framework, it is a very well-negotiated clause, where the government waives the right to claim sovereign immunity in such contracts because it is no longer a sovereign asset, it is no longer a sovereign contract, it is a PPP contract in which the private party rights and interests are involved and hence, unless the private parties' rights and interests are being discharged, the government cannot override and take over this project, under the plea of sovereign immunity. It is important and critical that you consider these infrastructure projects as commercial projects because the government can definitely enter into commercial contracts.

They are not defence related projects and hence, this claim of sovereign immunity should not be there. They are not something that the private parties cannot do, like running of highways, airports and so on and so forth. So, it is not a sovereign function in any way. Sovereign functions are legislative functions, the taxation functions, they can be defence, but running of infrastructure, running of any of these commercial ports is not a sovereign function and hence sovereign immunity does not exist to the government in this context. So, that is the background, that is the purpose, that is how the clause is actually operationalized and viewed and that makes this clause a very interesting one.

Second clause is the exclusive territorial and business operation clause or promise. Interestingly, in Hyderabad and Bangalore, the PPP concession agreements are given exclusive operational area of nearly 150 kilometers in diameter to the concessionaire which

means that no other civilian airport will be allowed to operate within that 150 kilometers of radius.

And the private player will have an assurance that the government will not establish another competitor and will not enter into a contract to establish another airport. 150-kilometer radius is quite a huge radius for your operation, it ensures your revenue, your profit maximization and it also ensures that you will not have a competitor. But interestingly and controversially, you will not have this competition for the next 30 years, that is a kind of challenging atmosphere there.

Now, we have seen that very modern cities like New York or London have more than one airport and these are definitely within 100 kilometers and 150 kilometer radius. It is necessary because the traffic in one airport becomes unmanageable; we need to distribute the traffic of the city as well because we cannot have everything concentrated in one area.

And 30 years is pretty huge a time, you will already notice that in cities like Bangalore and Hyderabad, this kind of a clause is already a challenging one for many reasons, citizens want at least some flights to take away from a closer airport, not from the airport which is around 50 kilometers away from the major city.

Also, you want competition in even the airport sector so that it can be competitive with rates and services. And airlines can also distribute the traffic between the two airports that exist in the city. Apart from this, the exclusive territorial clause becomes problematic to those kinds of cities that are on the border of other states.

For example, Hyderabad, now, the 150 kilometers promise that is given to Hyderabad airport also means that say Bidar, it is a city, small city, on the borders of Telangana and Karnataka and it falls within that 150 kilometers radius and range of Hyderabad airport.

Now, you cannot probably have a civilian PPP kind of an airport. Right now, the Bidar airport is an Air Force base strip that is used by commercial airlines. It is a small city, so there are not many flights. But, just on a jurisprudential point, such clauses before we make such a promise of exclusivity, one we have to revisit, one we have to think about.

In the Delhi airport, no such promises were made because it is an operation maintenance and development airport and hence Delhi may get its second international airport very soon near Noida, that is in Uttar Pradesh because Delhi has been surrounded by different other states.

You will notice that there is Rajasthan, there is Haryana, there is UP and these states will probably want to have an airport very close to Delhi as the second airport.

Anyway, that is not the complete discretion of the state government. It is a discretion that is there with the central government and the central government will also have to divert traffic in Delhi, Bombay, and some of these metropolitan cities as they are very crowded there right now. The last interesting clause that we would just want to consider for our discussion in this course, is the Renewal Clause.

Interestingly, the renewal clause or clauses are very clearly put in this contract because there is a possibility of renewing the PPP for another 30 years. So if you want to renew it for another 30 years, it is a possibility. And in case you are planning to do it as a PPP again, the Right of First Refusal (ROFR) is the right of saying, 'if I am not interested to continue or renew, then you can give to someone else. If you intend to renew it at any point in time at the 30-year mark, then I should be given the first preference to continue as your preferred partner'. That is how the renewal clauses are put in these contracts and, to some extent, they are justified, because there is already an existing relationship, an existing contract, it is better to continue with their existing partners rather than search for any new ones.

Plus, it also gives a kind of assurance to the private players that it is not a short-term business relationship, it is a long-term business relationship; you are looking at long-term profits, and it can go beyond 30 years and that is kind of one generation to another generation kind of transformation of the infrastructure project. So, that renewal clause does exist and hence, though the initial period of concession is mentioned, it can definitely be extended on mutually convenient terms and conditions, however, the existing partners do get the first right to run the airport. And interestingly, in the Bangalore case, you already have a private limited company that is incorporated and hence continuation of the same makes sense. You do not want a new incorporation and a new business partner and hence that is how the continuity may go forward with. So these three clauses are just giving you some insight into the concession agreement and the clauses that exist in a concession agreement.

They are unique in a PPP contract. They are generally not used in other forms of government contracts. And hence, understanding them gives you a broader perspective of how the negotiation processes in PPP take place, and how the contract is customized for such PPP contracts.

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ROFR in Government Contracts

ROFR in Government Contracts

- National Highways Authority of India vs M/S Gwalior Jhansi Expressway ... on 13 July, 2018 SC
- Concessionaire could complete only 62% of the work and could not deploy man, machine to resources to complete the remaining work. Concessionaire was liable for cost and risk clause.
- Concessionaire before the court states that he will float a tender and award the work to L1. NHAI wanted to float its own tender and did so. In this tender the concessionaire did not participate but insisted on ROFR.
- Held: unless participated in the tender, for the remaining work based on a contractual clause in the agreement of ROFR cannot be granted to the concessionaire.

In the right to first refusal in government contracts, there is a very interesting case called the Gwalior Jhansi expressway case. It is a 2018 Supreme Court judgment. This is with respect to the Gwalior Jhansi Expressway, where the concessionaire was able to complete only 62 per cent of the work and he could not deploy machine and man to complete the remaining amount of work. Interestingly, you will notice that most of these contracts have what we call as the cost and risk clause, or the cost purchase clause.

The importance of the cost and risk clause is demonstrated here; which means now, if the existing concessionary is unable to complete the work, then you go into what we call a substituted performance, which means you get the performance done for somebody else. Now, please note, substituted performance today is by the rule of law, it is under Section 20 of the Specific Relief Act, whether the clause exists or not, today, in these infrastructure sectors, the government can actually get the work substituted by someone else.

That is a very settled position as we speak forward with. The constant risk project clause, or what we call, the risk and cost purchase clause sometimes, it does give the government the leverage to get this remaining part of the work completed from someone else and the difference in the cost can be probably taken from the first concessionaire or the first contractor.

Now, why this clause exists? It exists so that you do not have to issue a notice of termination, then consider breach, then sue for damages and then, later on, find someone else to complete

the work. Right now, because the concessionaire is not showing any intention of completing the work, under this clause. You can give it to someone else, you do not need his permission or guideline to do it.

And the difference that you have to pay to the second party or substituted performer to come and complete the work, you can recover as damages from the first party. So, the contract itself has a plan B in place, because plan A is for the concessionaire to complete. Many times, there are risks. The contractor may not be in a position to complete, he may probably do it intentionally or may not do it intentionally; it all depends upon who the contractor is.

Hence, a breach is something that you can always anticipate, and these are critical infrastructure projects. So, they affect the citizen approach, they affect the political scenario. So, you have to go to plan B and plan B is to have such a clause called the cost and risk clause, and the risk of non-completion and the cost of getting it completed by another person has to be borne by the first party. That is how that clause operates.

Now, in the Gwalior Jhansi Expressway case, the concessionaire went to the court and he said that the work has to be given to a tender, so that plan B will come into place. And he had the right of first refusal clause in his contract. So, now right to first refusal clause usually operates only after completion of the work and in terms of extension. How does the right of first refusal clause apply to a person who has just completed 62 per cent of the work?

Can he take part in the second tender in which you are going to give it to Plan B or the substituted performer? Generally, unless you are blacklisted or debarred, then he should be allowed to participate. But suppose the National Highways Authority decides to float a tender, then the first party of the L1 or the person who had left with 62 per cent work, that is Gwalior Jhansi Expressway company, have to take part in the tender.

And in that tender if they do not take part, how can the right to first refusal clause come into existence? So, this was a technicality that was involved in this contract. So, the court held that unless the party had participated in the tender for the remaining work based on the contractual clause in the agreement, the right of first refusal cannot be granted to the concessionaire. So, if you want to exercise the right of first refusal, you must take part in the second tender in the second call and then try and invoke the right of first refusal.

However, in this case, more than the fact that the concessionaire could take part in the tender and invoke the right of first refusal clause, the point here is, if you are seeking equity from

the court of law, the principle rule I have always said is that you must do equally. If you have not completed the project or the work and you have just completed 62 per cent of the work and you do not have the man and machine resources to complete the work, how can you take part in the second render to come and establish yourself and say, I will complete the remaining part of the work? That is not possible.

So, to some extent, the courts should here very clearly say that in case you want to invoke any right of first refusal clause, you must take part in the second process of finding a substitute performer, you must complete the tender requirements and only then, if you wish to match to the price of the substituted performer and you want to take part in it, you could possibly try and do the same.

So, the right of first refusal clause is not an automatic clause in a government contract. You have to fulfill the process that is established for invoking the right of first refusal, which means taking part in the tender or call for request for proposal or negotiation, and then wherever that bid or the winning match is announced, you will then get the rights to match it. If you cannot match it, then it will be given to the new substituted performer.

Otherwise, under the ROFR clause, you can be given the right to match to that winning bid, and you will probably be given the contract. That is how the Court has held on the right of first refusal in a PPP government contract. This is quite substantial in terms of the discussion that we have taken so far under the Public Private Partnership process.

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PPP/EPC

PPP v/s EPC

- Advantages of EPC model
  - 1. The capital is raised by issuance of government bonds and by securing road toll post-construction. The government has to pay all the expenses incurred from the beginning of development of the project.
  - 2.Government also takes the responsibility of acquiring clearances, permissions, preventing and mitigating other problems that may arise in course of the project.
  - 3. Private party to plan, design the project, procurement of raw materials and the construction work which reduces time required in the completion remarkably.
  - 4. **Hybrid annuity model** (**HAM**) was introduced by the National Highway Authority of India in 2016.

And finally, we will conclude by looking at PPP vs EPC. EPC is the Engineering Procurement and Construction Contract. This is kind of a contract now that has become very popular in the highway sector because there are PPPs that have not been profitable. And EPC is something that has been insisted by the contractors.

So, why EPC and not PPP? Because EPC has certain distinct advantages as compared to PPP. The first thing that you will notice is that for the private contractor, EPC mode is the most preferred mode. The reason is, in EPC mode, the government secures the funding for the construction of the project. In the PPP mode, the entire investment has to be borne by the government.

So, the government can do it by floating government bonds or by starting toll collection even prior to the construction or post-construction. But that is what the government will have to do, so the government funds the project and the government pays the upfront money to the project proponent. And with that money, the project proponent can easily complete the work on time that is expected.

So, he will have to design, he will have to procure the material and he will have to construct. And he will have to also take the responsibility of getting all the clearances, and permissions; he will have to look at environmental, social and other problems in the project, including litigation. So that is also something that he loves to take care of, he will have to complete the

work in time and with that kind of money that he is paid by the government, he will obviously be able to complete it.

However, once this project is completed, the project may be given to the government entirely. But, the toll is something that he would help the government to actually collect. So that is how, probably in the EPC mode the government gets a contractor to complete the entire work right from design to build, to operate, and collect toll or whatever it is. And to that extent, the government has to just shell out the initial money. But the government will be helped by the private party in the collection of tolls, in getting that revenue.

And the private party will continue to even maintain the contractual obligations during that stage as well. Of course, we have the Hybrid Annuity Model that was introduced in 2006. The annuity model is an annual payment model. It is kind of a combination of PPP and EPC. So, these are structural, basic foundational changes that have been introduced so that private contractors are compensated very immediately at the completion of the project at one time, so he gets his money, he can put that money into other projects as well.

And then the government which can actually cushion out that kind of thousands of crores of rupees, they can probably get that recovery through the toll money. And then for all the expenses, the deductions can be given to the contractor. Again, there will be a maintenance cost of the roads and those expenses also can be given to the contractor. So, this is like very interesting combination of PPP, but on a different style, where the initial capital or initial project cost is paid by the government and the entire revenue is something that the government will have to take back through the total expenses.

So, that is EPC model for you. And EPC model is very advantageous to the contractor and hence, that is something that is preferred in the highway sector because, unfortunately in the last two decades, the hybrid sector has seen contractors suffer huge amount of losses for the kind of money and investment and expenses they have incurred in building those highway projects.

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Project Performance

Project Performance

- Following ten factors were identified to measure the project performance.
  1) Preconstruction time
- 2) Construction time
- 3) Total Time
- 4) Speed of construction
- 5) Unit cost of Building
- 6) Time overrun
- 7) Cost overrun & client satisfaction
- 8) Time
- 9) Cost
- 10) Quality

So, let us conclude the discussion on public private partnership mode and you will notice finally that there are 10 factors that are identified for project performance in a PPP structure. There is preconstruction time, and there is construction and total time is taken into consideration, the speed of construction is always very important, unique cost of the building, time overruns and risks has to be always factored in and cost overruns, client satisfaction, and then quality. So, these are some of the factors that are measured to check project performance by a private contractor. And there are parameters and criteria that is fixed on each of these 10 factors to test whether project performance has been satisfactory or not.