Chapter 6

Analysis and Finding

Indian Railways in one of the largest Railway network in the world in terms of route kilometers. Against the total route length of 64640 Km. only 21034 Km. is electrified. Considering the requirement of economy and size of country the expression of railway network has been inadequate. Indian Railways here added 11864 km. of new lines since independence. It has not been able to cover major areas in country. Gauge conversion has been instrumental in adding capacity in the system despite low addition of new line. The network needs extensive modernization of infrastructure to meet the needs of rapidly growing economy.

It is estimated that during the 12^{th} plan period Rs. 519221 Crore investment is required to achieve the plan objective visualized for this period. This include Rs. 194221 Crore of general budgetary support (GBS), Rs.225000 from internal and extra budgetary resource (IEBR) and reaming Rs. 1,00,000 Crore is expected from private sector.

It should be clearly realized that modernization of Indian railway cannot be achieved simply relying on additional GBS. Requirement of funds cannot be met from IEBR also. Hence for modernization investment from private sector essential. The expansion and modernization of Indian Railway was slow in past due to paucity of resources. A superior mode of investment in infrastructure is through PPP approach where construction operation and commercial risk are borne by private sector.

Private sector participations in infrastructure development is not however a simple matter. It requires a framework that can enable the private investor to secure a reasonable return at manageable levels of risk, assure the user of adequate service quality at an affordable cost, and facilitate the Government in procuring value for public money. These preconditions are more difficult to fulfill that is commonly realized. Because of the multiple stakeholders pursuing conflicting interest, risk mitigation arrangements are usually complex. They involve detailed legal and contractual agreements that specify the obligations of different participants, set forth clear penalties for non performance, and offer protection to investors against actions beyond their control. Even the best of solutions involve managing competing objectives. It is, therefore, important to address the problems associated with risk allocation, standard setting and transparency. Inadequate preparatory work in these areas will only lead to excessive transaction costs, years of delay in project implementation, inadequate quality, and large contingent liabilities for the Government.

The concession agreement unbundles risks and costs and allocates them to the party best suited to manage them. Throughout, it seeks to achieve a reasonable balance between risks and rewards for all participants. The predictability of cost and obligations will be a key factor in improving efficiencies and reducing costs.

Various provisions incorporated in PRCL concessionaire agreement are examined below to evaluate their suitability for balancing the risk among the various stake holder and also operation of the agreement during the period of concession. A compression of these provisions is also made with the corresponding relevant clauses in the newly issued model concession agreement for joint venture project through PPP mode by Indian Railway.

Linking traffic variation with the Concession Period

From the scrutiny of PRCL Concessionaire Contract it is found that no provisions are available in regard to linking of traffic variation with period of concession. Important clauses linking the traffic variation with the period of concession are reproduced below from latest MCA issued by Indian Railways.

"24.1.1 The Parties acknowledge that the total NTKM during the Concession Period as [on October 1, 20__] is estimated to be ***** (the "**Target Traffic**")[13].

24.1.2 In the event that, as on expiry of 25th (twenty fifth) year after Appointed Date the actual NTKM shall have fallen short of the Target Traffic by more than [4% (four per cent) thereof or exceeded the Target Traffic by more than [4% (four per cent) thereof, the Concession Period shall be deemed to be modified in accordance with Clause 24.2. For the avoidance of doubt, in the event of any Dispute relating to actual NTKM, the Dispute Resolution Procedure shall apply.

24.2.1 Subject to the provisions of this Clause, in the event actual NKTM shall have fallen short of the Target Traffic, then for every 2% (two per cent) shortfall or part thereof as compared to the Target Traffic, the Concession Period shall be increased by 6(six) months or part thereof; provided that such increase in Concession Period shall not in any case exceed 5 (five) years.

24.2.2 Subject to the provisions of Sub-clause 24.1.1 above, in the event actual NKTM shall have exceeded the Target Traffic, then for every 2% (two per cent) excess or part thereof as compared to the Target Traffic, the Concession Period shall be reduced by 6(six) months or part thereof; provided that such reduction in Concession Period shall not in any case exceed 5 (five) years."

The Target Traffic shall normally be a number based on five percent Cumulative Average Growth Rate over the base traffic assumed for the Rail System. The target traffic shall be for the entire Rail System and not for individual lines or sections of the Rail System."

During the initial period of concession actual traffic and targeted traffic as stipulated in traffic guarantee agreement, is compared below:

Table: Comparison of actual traffic with target traffic:

Year	Actual Traffic (MT)	Target Traffic guarantee (MT)	Shortfall (MT)
2003-04	0.39	1.0	0.61
2004-05	0.88	2.0	1.12
2005-06	1.57	3.0	1.43
2006-07	2.28	3.0	1.72
2007-08	2.18	3.0	1.82

PRCL entered into a Traffic Guarantee Agreement (TGA) with GPPL and MOR. As per the terms of this agreement, GPPL has to provide one million tons (MT) of cargo in the first year of operation (2003-04), two MT in the second year of operation and three MT from the third year onwards. So, from 2005-06 GPPL would be required to provide at least 3 MT cargo for the project line and MOR/WR as part of this agreement has to provide sufficient rolling stock for evacuation of minimum guaranteed traffic (MGT). In case there is any shortfall in the traffic, PRCL will be compensated for any shortfall by GPPL. While Railways also at times defaulted in 100 percent evacuation, the port traffic was continuously low over the years.

In the latest MCA Provision of variation of traffic at the rate of 5 percent growth from base year is kept and concession period if to be modified on the basis of available actual traffic in comparison to estimated traffic used for deciding the concession. To address the issue of windfall gains the Agreement providers a review of concession in terms of traffic materialization after a period of 25 years from signing of concession agreement. The concession period of 30 years will be reduced or extended symmetrically depending upon traffic exceeding/going below a Projected NTKM threshold. For this purpose the traffic will be measured after a period of 25 years from signing of concession agreement. However, the concession period shall not be less than 25 years or extend beyond 35 years.

However review of concessionaire period is to be done only after 25 years from the appointed date which may not likely to satisfy private concessionaire. Due to this private concessionaire may not get adequate confidence in regard to availability of projected traffic and corresponding projected revenue.

Selection of Concessionaire

On scrutiny of various provision of concession agreement and details available in the literature it is observed that offers for expression of interest were not invited in PRCL project and partner for JV was selected on the basis of proposal from GPPL for port connectivity. Accordingly MOU was signed between MOR and GPPL in 2000.

In the latest overview of frame work issued by planning commission, for selection of Concessionaire will be through an open competitive bidding. All project parameters such as the concession period, toll rates, price indexation and technical parameters are to be clearly stated upfront, and short-listed bidders will be required to specify only the amount of grant sought by them. The bidder who seeks the lowest grant should win the contract. In exceptional cases, instead of seeking a grant, a bidder may offer to share the project revenues with the Authority.

Ministry of Railway Document of participative models for rail-connectivity and capacity augmentation projects issued vide letter no. 2011/infra/12/32 dated 10.12.2012. Brief details of this policy are surmised below.

Selection of equity partners, Funding, Revenue Model

- It envisages participation of the stakeholders and beneficiaries besides national level infrastructure funding institutions in the development and creation of rail infrastructure through appropriate concession.
- Financial participation will be through equity participation in the JV. The JV will be a joint venture with Railways as a partner with IR or its PSU holding a minimum of 26 percent equity share. Other partners will be selected from the stakeholders such as users of the line like ports, mines etc. Selection of partners will be done through a transparent Expression of Interest process, with clearly laid down technical qualifications based on parameters like networth, minimum threshold of equity participation etc. However participation by state governments and PSU's and other government entities will be through nomination basis.
- Project will be assigned to the JV by Ministry of Railways on nomination basis.

- Debt will be raised through Project Finance route without any guarantee by the Government of India.
- Revenue from the operation on the project line will be collected by IR through its commercial staff. Revenue stream of the JV shall be established through revenue apportionment from freight operation for the project line as per Inter-Railway Financial Adjustment as stipulated in IR Finance Code Vol-I. No apportionment of passenger revenues will be made. JV will provide free access to IR passenger trains. Normal IR tariff/ freight rates shall be applicable. Inflated tariff to improve bankability could be approved by Railway Board in specific cases. Commercial utilisation of railway land, commercial publicity rights as permissible under the law and public policy.

In a recent documents under the title "Overview of Framework for Participative Models of Rail-connectivity and Domestic and Foreign Direct Investment", Ministry of Railways further confirmed the policy of creating JV for constructing the Railway project. As per policy, for JV project, it is envisaged that concessionaire in future for JV model projects will be selected through open bidding process mentioning all the project parameter.

Although now as per the new policy document Railway Ministry has agreed for calling of EOI but only for selection of partner for JV and not for selection of concessionaire. System of selecting private partner in the form of JV as per latest Railway Policy is not likely to be very efficient system to utilize the potential and creativity of private sector, instead this arrangement is likely to dampen the innovativeness and creativity of private partner.

In the above policy document private concessionaire who is a equal partner in the project has not been allowed to collect the revenue. Further rate the revenue is to be decided by railway administrator and JV partner has not been given any role on the matter. In this manner involvement of the private concessionaire is quite limited.

In the PRCL project Indian Railway is playing both the roles simultaneously one as regulator and operator in the form of partner. This is against the sound business norms due to the conflicting interest under these two roles and private partner does not get proper level field in the project.

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.

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. Other commercial risks, such as the rate of growth of traffic, are also being allocated to the Concessionaire. On the other hand, all direct and indirect political risks are being assigned to the Ministry of Railway.

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 growth rate. 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. It would be seen that there was a considerable time lag from the conceptualization of the project to the execution of various contractual agreements specifying the roles and responsibilities of the concerned stakeholders.

In the PRCL project construction of gauge conversion/new construction line from Surendranagar to Pipavav Port was finally undertake in by Western Railway hence there was no scope to utilize the creativity and innovation of private partner. The only purpose private partner GPPL has served was to provide additional fund for the project construction.

Right of substitution

Substitution rights are quite important from lenders point of view for securing their interests through substitution clauses . However PRCL concession agreement does not permit any substitution. In this regard relevant clauses from PRCL concessionaire agreement are given below.

"4.3 (c) without the prior approval of MOR, not to assign or crate any lien or encumbrance on the Concession hereby granted except as permitted in this Agreement

(d) without the prior approval of the MOR, not to assign the whole or any part of the Project nor transfer, lease or part possession therewith except as permitted in this Agreement."

In the latest MCA issued by the Ministry of Railways proper substitution clause alongwith the draft substitution agreement is incorporated. Relevant clauses from MCA pertaining to substitution rights is given below.

"33.3 Substitution Agreement

33.3.1 The Lenders" Representative, on behalf of Senior Lenders, may exercise the right to substitute the Concessionaire pursuant to the agreement for substitution of the Concessionaire (the "**Substitution Agreement**") to be entered into amongst the Concessionaire, MOR and the Lenders" Representative, on behalf of Senior Lenders, substantially in the form set forth in Schedule-L.

33.3.2 Upon substitution of the Concessionaire under and in accordance with the Substitution Agreement, the Nominated Company substituting the Concessionaire shall be deemed to be the Concessionaire under this Agreement and shall enjoy all rights and be responsible for all obligations of the Concessionaire under this Agreement as if it were the Concessionaire; provided that where the Concessionaire is in breach of this Agreement on the date of such substitution, MOR shall by notice grant a Cure Period of 120 (one hundred and twenty) days to the Concessionaire for curing such breach.

33.4 Assignment by MOR

Notwithstanding anything to the contrary contained in this Agreement, MOR may, after giving 60 (sixty) days" notice to the Concessionaire, assign and/ or transfer any of its rights and benefits and/or obligations under this Agreement to an assignee who is, in the reasonable opinion of MOR, capable of fulfilling all of MOR"s then outstanding obligations under this Agreement."

From private partners point of view, 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.

Termination Payment:

In the PRCL concessionaire agreement provision of the compensatory payment to concessionaire is available. These provisions are given below

"8.2 Transfer Payment on termination on account of MOR's Event of Default.

PRCL may require the MOR to purchase all the movable and immovable assets existing in the Project Area for a consideration equivalent to

- The Depreciated Replacement Value ("DRV") of such Assets plus 30% of DRV if the default occurs within 15 years of COD.
- The Depreciated Replacement Value ("DRV") of such Assets plus 20% of DRV if the default occurs after 15 years but within 25 years of COD.

- The Depreciated Replacement Value ("DRV") of such Assets if the default occurs after 25 years of COD.

8.2.1 The assets will be taken over by MOR unencumbered

8.2.2 "DRV" is defined as (Cost of replacing the asset on Termination Date) minus (Depreciation on straight line method)

Depreciation on straight line method is defined as (number of years the asset has been in use divide by the codal life of the asset) multiplied by (the cost of Replacement of asset on Termination Date).

The asset life will be as per the provisions in the codes and manuals of the Ministry of Railways. Wherever life of an asset is not mentioned in Railway codes/or manuals, if will be decided mutually between the Railway and the Company.

Cost of Replacement will be determined by the then prevailing accepted rate for the relevant assets of the Indian Railway.

8.3 Transfer Payment on Termination of PRCL's Event of Default.

Ministry of Railways shall acquire all the movable and immovable assets of PRCL existing in the Project Area at 50% of the book value of such assets. The book value of the assets shall be computed by depreciating the historical cost of the assets on a straight line method, on the basis of the codal life of the assets as per Railway's codes and manuals.

9.0 Transfer fees and charges.

Transfer fees and charges, if applicable and other incidental expenses incurred at the time of Termination or Normal Transfer shall be borne by the MOR and PRCL in the following proportion.

Sl.No.	Head of Charge	Onus
1.	Transfer fees or stamp duties, recording costs, notarial fees	Party in default or On expiry of this agreement by MOR
2.	Fees to third party experts for any required inspections or certifications, if applicable	Shared by both
3.	Fees to Appraising Team, if applicable	Shared by both
4.	Internal costs and expenses of each party (management time, cost of surveys, inventories, inspections, etc.	To be borne by each Party respectively"

In the PRCL agreement it is quite difficult to calculate the actual DRV value hence it is likely that these clauses may not withstand the test of the time under conditions leading to termination.Further utility of these clauses in such a complex contract having so many stakeholder it quite limited.

In the latest MCA, issued by the Ministry of Railways rational method of calculating the termination payment is incorporated out of which relevant portion is given below.

"30.3.1 Upon Termination on account of a Concessionaire Default during the Operation Period, MOR shall pay to the Concessionaire, by way of Termination Payment, an amount equal to:

(a) 90% (ninety per cent) of the Debt Due less Insurance Cover; and

(b) 70% (seventy per cent) of the amount representing the Additional Termination Payment:

Provided that if any insurance claims forming part of the Insurance Cover are not admitted and paid, then 80% (eighty per cent) of such unpaid claims shall be included in the computation of Debt Due.

For the avoidance of doubt, the Concessionaire hereby acknowledges that no Termination Payment shall be due or payable on account of a Concessionaire Default occurring prior to COD.

30.3.2 Upon Termination on account of a MOR Default, MOR shall pay to the Concessionaire, by way of Termination Payment, an amount equal to:

(a) Debt Due;

(b) 150% (one hundred and fifty per cent) of the Adjusted Equity; and

(c) 115% (one hundred and fifteen per cent) of the amount representing the Additional Termination Payment."

*COD-- Commercial Operating Date

Ministry of Railways (MoR) shall terminate the agreement in case specified defaults are not cured within 60 days period. Similarly, JV can terminate the agreement if MoR fails to cure its default within 90 days. Ministry of Railway in case of JV's default during the operation period shall pay to the JV an amount equal to 90 percent of the debt due less insurance cove and 70 percent of the amount representing Additional Termination Payment. In case termination is on account of MoR's default, JV will be paid an amount equal to full debt due plus 150 percent of the Adjusted Equity and 115 percent of the amount representing Additional Termination Payment.

In the event of termination, the MCA provides for a compulsory buy-out by the Government, as neither the Concessionaire nor the lenders can use the rail system 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 Government are proposed to qualify for adequate compensatory payments to the Concessionaire and will thus guard against any discriminatory or arbitrary action by the Government.