advocates & solicitors

Law of Contracts - Auctions

A practitioner's perspective

Amit Kapur

April 4, 2021: NALSAR Online

PG Diploma in Alternate Dispute Resolution 2021

OUTLINE

- Auctions : Constitutional, economic & jurisprudential underpinnings
- Designing & Implementing auctions
- Case Studies
  - Robust & transparent selection
    - Sanctity of bid process and discount offers/L-1 bid renegotiation
    - Statutory bids vs normal bids
    - Role & Risk allocation for unforeseen change
    - Impact of statutory & policy framework
- Practitioners' Insights

Auctions

A constitutional mandate or a policy choice

Economic & Jurisprudential Underpinnings of Auctions

- **Article 39 (b) & (c)** of Constitution requires State to direct its policy to secure
  - Ownership & control of material resources are distributed to subserve common good
  - Operation of economic system does not result in concentration of wealth and means of production to common detriment
- **Auction Theory (Nobel 2020** Paul Milgrom & Robert Wilson**)**
  - Auctions are one of the modes for allocation of resources
  - Aim to maximize social value/welfare : seller raise higher revenue; Buyer procures at lower costs
  - 3 factors define bidders' strategic behaviour & auction outcome
    - **Format/Rules** : Open / Closed; How many bidders; what price to pay (highest or 2nd highest)
    - **Value** of the Object in the eyes of bidders
    - **Uncertainty/Information asymmetry**

Presidential Reference 💣

Concerned about national and international (BIT claims) implications of the 2G judgement quashing all 122 telecom licenses and directing for allocation of all 2G and 3G spectrum by auctions, President of India referred some questions to Supreme Court on 12.04.2012 (summarized below)

- Whether conducting auctions is the only permissible method for disposal of natural resources in all circumstances? If so, does that not run contrary to several judgements of the Supreme Court?
- Whether a decision holding auctions as the sole method amounts to policy making unsettling past policy decisions for valid considerations like
  - Lack of public resources;
  - Need for innovative and different approaches for development of various sectors of the economy?
- Scope for court interference with policy-making by Govt re methods for disposal of natural resources?
- Whether in deciding that a policy is flawed, courts are not obliged to take into account investments made under the said policy including by foreign investors under multilateral / bilateral agreements?
- Implications for future spectrum auctions which were not pressed by Attorney General?

💣 **(2012) 3 SCC 1 dated 02.02.2012**

Auctions … Supreme Court's Opinion-1

- **Auctions may be the best way of maximising revenue but revenue maximization may not always be the best way to subserve public good.** **@ 116**
  - Where revenue maximization is the object of a policy, being considered qua that resource at that point of time to be the best way to subserve the common good, auction would be one of the preferable methods though not the only method. **@ 119**
  - Where revenue maximization is not the object of a policy of distribution, the question of auction would not arise. Revenue considerations may assume secondary consideration to developmental considerations. **@ 119**

Auctions … Supreme Court's Opinion-2

- **Allocation of natural resources to the highest bidder may not necessarily be the only way to subserve the common good and at times may run counter to public good. @ 120**
- **Auction**
  - Economic policy choice of disposal of natural resources.
  - Though a more preferable method of allotment of natural resources auction - not a constitutional mandate.
- **If auction is held to be a constitutional mandate**
  - That would distort Article 39(b) which mandates that ownership and control of natural resources should be so distributed to best subserve common good. **@ 113**
  - That would render void every action that deviates from it, including social endeavours, welfare scheme and promotional policies. **@ 112**

Auctions … Supreme Court’s Opinion-3

- **Policy decision to not resort to auctions/enter into direct negotiations pass muster if challenged where**
  - Taken in public interest like promoting domestic industry (bundling of exploration and exploitation contracts) or research and development (patents)
  - Decision is found bonafide and reasonable – not tainted by whim, caprice, malafide, corruption or compromise.
  - Higher burden to justify decision on anvil of transparency. **@ 121-131**
- **One set of citizens cannot prosper at the cost of another set of citizens. No natural resource can be allocated for private exploitation without justifiable consideration**
  - Earning revenue, and/or
  - Best subserve common good. **@ 200**

Implemented in Telecom (AGR) & Coal mine allocation

- **Manoharlal Sharma v. Principal Secretary: (2014) 9 SCC 516 @ paras 110, 160 to 167**
  - It is not the domain of the court to evaluate the advantages of competitive bidding vis-à-vis other mthods of distribution of natural resources.
  - If allocation is found to be violative of article 14 of the constitution – unfair, unreasonable, discriminatory, non-transparent, capricious or tainted by nepotism/favouritism
  - The allocation of coal mines/linkages by the Standing Linkage Committee were found to be violative of Section 3(3) of the Coal Mines (Nationalization) Act, 1973 and arbitrary
- **Union of India v. AUSPI: (2020) 3 SCC 525 @ para 86**
  - State is a trustee of the natural resources and
    - Is obliged to hold it for the benefit of the citizens and ensure equal distribution to subserve common good
    - Has exclusive power to determine license conditions for allocation of natural resources
    - Must make an effort to get the bets price for its valuable rights and not throw them away

Public Procurement

Key Governing Principles

1. Freedom to contract within limits of law (CVC, Fin Rules, Sec 63 EA)

2. Value, Risk and Reward

3. Allocation of responsibility and risks

Governing principles of contracts

Essentials of a valid contract in terms of Section 2(1)(h) of the Indian Contract Act, 1872 are:

- A set of mutually agreed reciprocal promises,
- Agreed upon for lawful consideration,
- With lawful objective,
- Amongst parties competent to contract,
- With free consent agreeing on the same thing.
- Contracts define the inter-se responsibilities and risk allocation between the parties, including how to handle differences/disputes and unforeseen developments

Commercial Contracts

We must be conscious of certain core aspects in all commercial arrangements that impact success

- The '**value proposition**' for both parties
- The '**risk**'. The moment anyone agrees to perform certain commitments in future, it entails commitments like paying an advance for future supply; creating a facility investing resources to supply goods / services.
- The other side of 'risk' is '**reward**' even change of enhanced value.

Public Procurement

- Cover a wide range
  - FROM one-off purchase of goods or services
  - TO long term supply contracts, concessions and PPP
- With varying Complexities linked to
  - Duration of contract ~ quality, reliability, demand & credit risks
  - Challenges of interlinked supply chains

Two age-old lessons are vital

- **As you sow, so shall you reap**: PROJECT IDENTIFICATION+ BID + RISK ALLOCATION/CONTRACT DESIGN
- **A stitch in time saves nine**: TIME VALUE FOR MONEY

Kautilya # 1.19.35-36 Arthashastra

… "The root of wealth is (economic) activity and the lack of it (brings) mental distress … In the absence of activity, both current prosperity and future growth will get destroyed"

Project Preparation

Project Identification/Selection

- Mode of implementation: state owned, PPP or private
- Public elements like concessions/grants, vgf, subsidy et al
- Keep focus on outcomes for which procurement is being done

Project Preparation

- Techno-economic feasibility
- Land/RoW
- Environmental and other initial consents/ clearances
- SPV

Request for Qualification:

Invitation to interested parties to demonstrate their credentials to participate

Abraham Lincoln … "Give me six hours to chop down a tree, and I will spend the first four sharpening the axe".

Bid Process

- RFP is an **invitation to offer/bid** issued to qualified candidates with
  - Proposed contract with party rights & responsibilities
  - Give clear risk-allocation and mitigation mechanism
  - Ensure that expected outcome (like reliable "public goods / services" at affordable price) is an enforceable commitment
  - The project "vfm" is captured
  - Contract documents must imbibe the spirit of partnership – not set the stage for a running conflict : fairness
  - Provide balanced 'mechanism' to meet uncertainty and share burden of unforeseen change: force majeure, change in law, material adverse effect, exit payments, dispute resolution
- Pre-bid conferences: remove information asymmetry + give certainty to get best competitive bids

Offer and Acceptance - Offer/Bid

- A well-defined transparent method is adopted identifying the bid parameters : L-1 or H-1, et al.
- Interested parties intending to submit their proposal must participate in the bidding process.
- Norm is not to allow any conditional bids
- Rules governing bidding (RFP) are strictly enforced
  - Date of submission
  - Time (if any) for filing clarifications or withdrawal
  - Keeping performance guarantees alive till award
  - Rules of rounds of bids, matching bids, price-negotiation
  - Conditional bids, counter-offers and unascertainable bids normally get rejected
  - Evaluation and award criteria

Offer and Acceptance - Acceptance

- Bids are opened and shared with all bidders
- Bid process manager often declares successful bidder in public, while reserving the same for approval of the Government or Regulator
- Government/Regulator accept the [lowest bid or highest price] as long as it is aligned to the prevailing market price.
- Letter of Intent/Declaration of successful bidder
- Once accepted, the Government or Regulatory Authority cannot reject the bid or enter into negotiations with a third party offering a lower bid.
- Contract/Concession is then executed per agreed terms

Case Study #1

NOIDA Toll Bridge Co Ltd vs Federation of NOIDA Residents Welfare Association : 2016 SC

- Transparent and robust selection process
- Reasonable returns
- Excessive delegation

The Procurement Process

- 07.04.1992: MOU to develop DND Flyway on BOT basis
  - Between New Okhla Industrial Development Authority (NOIDA), Delhi Administration (DA) and IL&FS
    - IL&FS, the Promoter to recover investment with returns @20% per annum from date of disbursement of funds till date of recovery by levying of toll from users
    - IL&FS with UP Govt to decide the toll rate
    - All costs incurred for development of project to be treated as Project Cost
    - "Steering Committee" constituted to monitor progress of the Project ~ **UP Govt, NOIDA and IL&FS representatives**
    - Steering Committee decided that Project be implemented by a corporate entity promoted by IL&FS.
- 08.04.1996: IL&FS incorporated a wholly owned subsidiary Noida Toll Bridge Company (Concessionaire)

The Contract - Risk and Value/Reward

- 12.11.1997 : Concession [NOIDA, IL&FS & SPV]
  - NOIDA to formulate Rules for collection of fee from Users
  - Total Project cost = Project cost + maintenance expenses + shortfall in the recovery of Returns in a financial year
  - Concession for 30 years from Effective Date
    - If Concessionaire unable to recover total project cost with return on investment within 30 years, Concession Period may be extended for 2 years at a time till total cost +returns recovered.
    - If total cost +returns recovered prior to 30 years, Project would be transferred to NOIDA
- Fee to be revised by the Review Committee
- If fee is not recoverable due to change in law or restriction through any process of law, Concessionaire will receive compensation from NOIDA
- In case of termination on account of Concessionaire Event of default, NOIDA will pay the outstanding debt

The Challenge

- February 06, 2001: Project was commissioned
- 2012: PIL filed before Allahabad High Court challenging levy of toll by Concessionaire
  - Project was awarded to a private company, without any competitive bid.
  - Definition of total project cost (restatement) per Concession Agreement ensures that the concession will go on in perpetuity - arbitrary.
  - Concessionaire had recovered its costs and more than 20% returns for the period upto 31.02.2014 and has a free run till 2031 to keep making untrammelled profits

Allahabad High Court's finding

- Award of concession to a wholly owned subsidiary of a member of steering committee without competitive bidding is unfair.
- Concession not quashed since the project is complete and being used by public for 15 years
- Applying doctrine of severability, offending clauses harming public interest was severed from the rest.
- Govt must dispose of state-owned property and resources by auction.
- Levy (determination, revision) of user fee cannot be delegated to Concessionaire - excessive delegation.
- NOIDA could delegate power to collect toll. Recovery of toll stopped.
- Private company cannot earn profit from public property at the cost of public at large.

Supreme Court's finding

- On 11.11.2016, Supreme Court considered the SLP challenging Allahabad High Court verdict to
  - Refuse stay of the Allahabad High Court judgement due to balance of convenience stating that if the Concessionaire succeeds it could be compensated suitably by extension of time
  - Ordering for CAG to audit all relevant records of the Concessionaire (examine all benefits that flowed to Concessionaire) to ascertain whether the total cost of the project has been recovered or not.
- Matter is pending in Supreme Court as on date

Key lessons

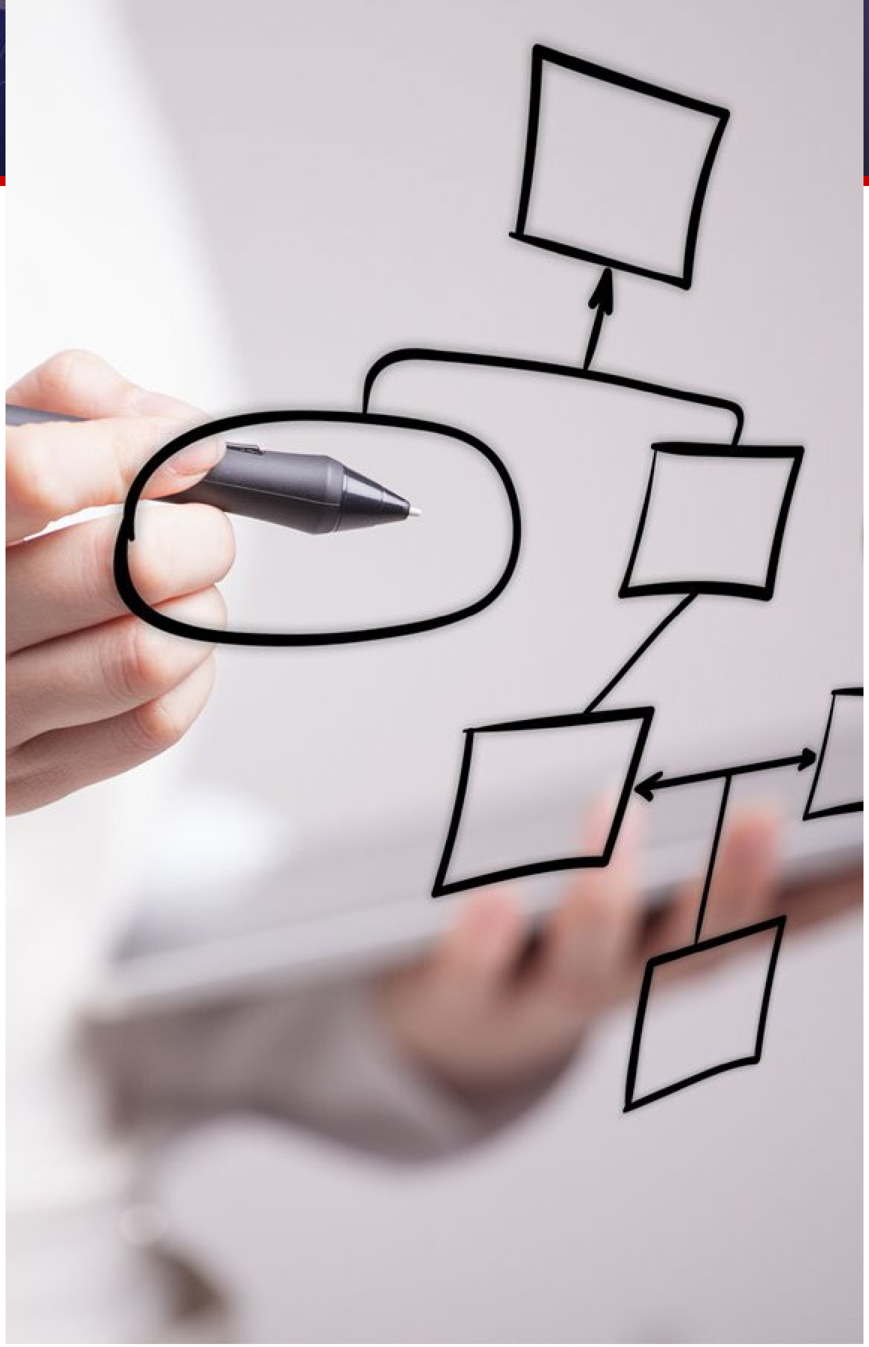
- Courts view infrastructure projects as ‘**public goods**’ involving ‘**public interest**’
  - Transparent competitive bidding is the norm
  - Awarding contract to a member of steering committee without bidding is bad
  - Directed audit of accounts of a private company
  - Considered excessive earnings of the project to quash the provision for toll recovery
- Concession Agreements should be fairly designed:
  - Providing for a cap on the returns of investment
  - With transparent financial model
  - With balanced terms of contract
- Accountability of Transaction Advisors
  - Negligence of transaction advisors to involve Concessionaire in determining / revising toll rates

Case Study #2

2.1 NHAI vs Gwalior-Jhansi Expressway Ltd : (2018) 8 SCC 243
2.2 Essar Power vs UPERC : 2012 ELR (APTEL) 182

- Sanctity of Bid process and rights of parties
- Discount offer in L-1 bids
- Right to match lowest bid for an existing Concessionaire
- Statutory bids vs normal bids

NHAI: The Project Progress



- 17.12.2006: Concessions Agreement for 4-laning of 2-lane NH-75 in UP and MP signed.
- March 2012: Concessionaire achieved only 62% progress and abandoned the project site.
- 19.10.2013: NHAI issued Cure period notice to Concessionaire. This was disputed in reply by Concessionaire.
- 27.02.2014 & 07.03.2014: NHAI issued termination notice to Concessionaire.
- 25.05.2016: Termination was disputed by the existing Concessionaire in arbitration during which proceedings an order was passed permitting the Concessionaire to complete the balance work if all conditions imposed by NHAI were agreed to.

NHAI: Bid Evaluation and Award

- **28.11.2016**: The existing Concessionaire acquiesced. As per agreed terms, NHAI issued tender for balance works on the lines of normal NHAI tenders.
- Both Invitation for Bids and RFP had a condition that required the existing Concessionaire to participate in the bid and be a responsive bidder to be entitled to exercise a right of first refusal/match the lowest bidder as per notified procedure (pay 2% of bid amount to NHAI).
- **05.01.2017**: Technical envelopes were opened.
- **29.03.2017**: Financial envelopes were opened.
- Existing Concessionaire did not participate in the bid process.
- **25.04.2017**: Concessionaire claimed right to complete balance work claiming that it was entitled to match lowest bid in terms of the order dated 23.07.2016 of the arbitral tribunal.
- **24.05.2017**: Arbitral tribunal allowed the application of the existing Concessionaire noting that it had invested substantial money and labour to direct NHAI to allow the ROFR.
- **21.08.2017**: Delhi High Court upheld the order of the Arbitral tribunal when challenged by NHAI based on the arbitral tribunal order dated 23.07.2016 holding that there was no condition for existing Concessionaire to participate in bid.

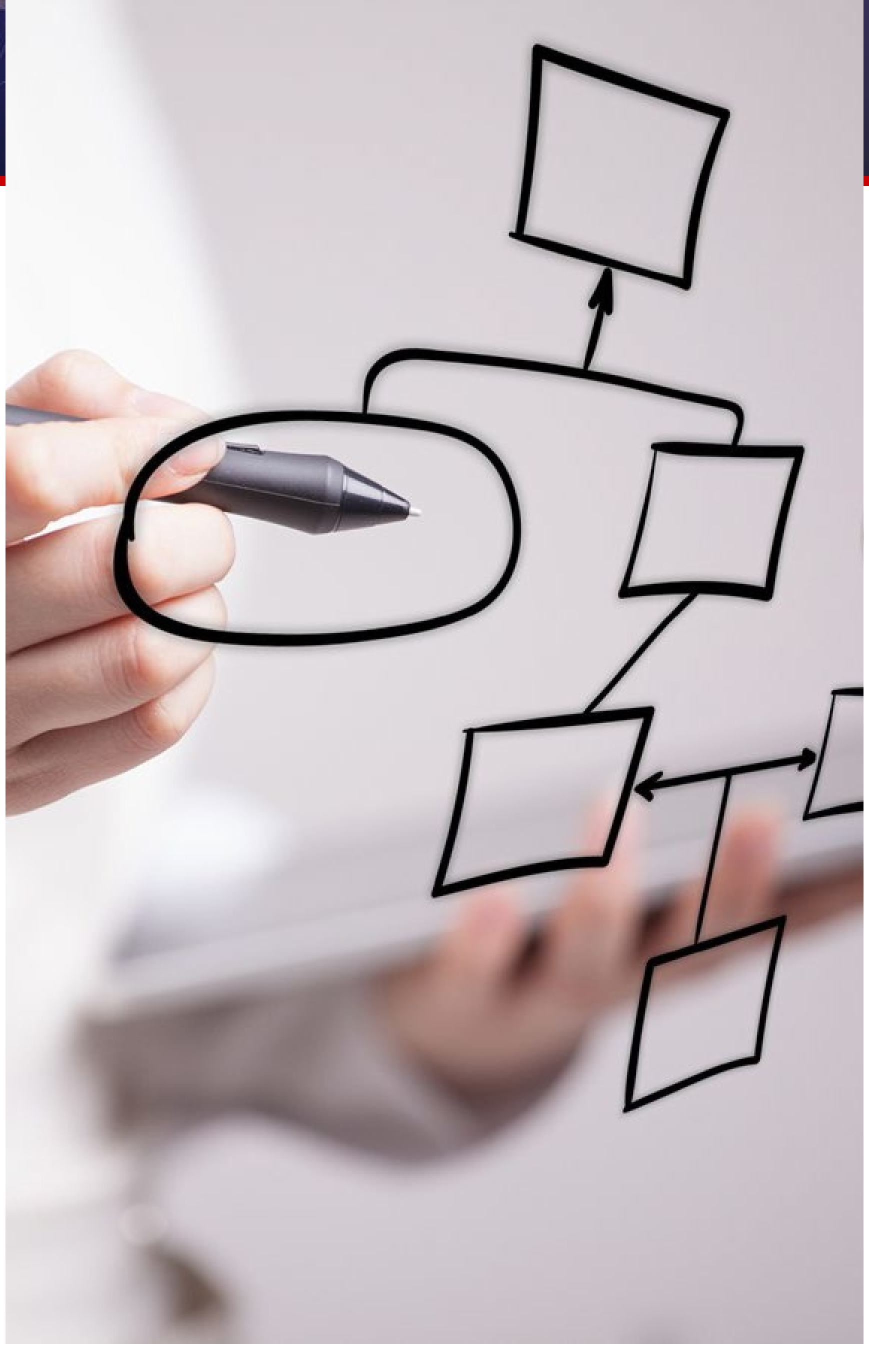
NHAI: Findings of Supreme Court

Supreme Court held that

- The option to participate in the bid process was not availed of by the existing Concessionaire for no justifiable reason.
- By its own conduct the existing Concessionaire had ruled itself out and lost its right to match the lowest bid.
- If now, the existing Concessionaire is allowed to match the lowest bid or to exercise right of first refusal without participating in the qualifying bid process despite express stipulation in the tender documents, the participating bidders shall be prejudiced.
- The fact that the existing Concessionaire had invested a substantial amount in the project and had completed substantial work can be no basis to overlook the fundamental policy of Indian law regarding the tender process and the rights and obligations of the parties involved.

Essar: The Procurement Process

- 08.10.2009: UP State Commission approved bidding process and documents including the RFP for procurement of 500 MW power through competitive bidding process u/s 63 of the Electricity Act, 2003, directing them to approach the Commission in case of any deviation.
- 11.10.2010: NOIDA Power initiated the process of procurement of 200 MW of power, issuing standard RFP approved by the State Commission.
- Essar Power was amongst the 6 bidders who participated in the bidding process.



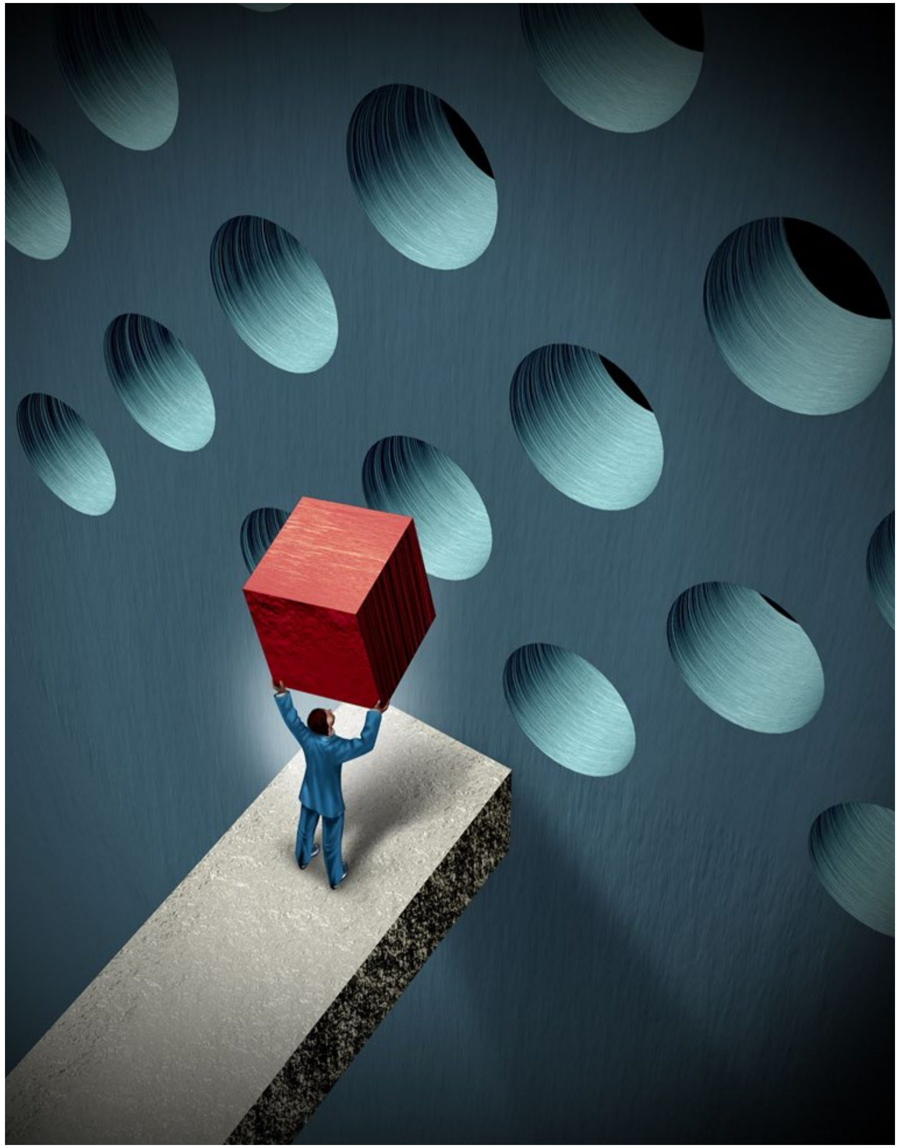
Essar: Bid Evaluation and Award

- Essar emerged as the lowest bidder.
- Essar's bid was approved by the Evaluation Committee set up by NOIDA Power in accordance with the Central Government's guidelines.
- 07.04.2011: NOIDA Power filed a petition before State Regulator with the evaluation committee recommendation that Essar was lowest bidder and the PPA be signed adopting Essar's bid
- While the petition was pending before UPERC
  - NOIDA Power received an offer from Athena Energy, a 3rd party to bid process offering a 10% discount on Essar's bid price.
  - Athena Energy had not participated in RFQ, RFP or bidding
- 27.04.2011: NOIDA Power filed an IA seeking appropriate orders from UPERC taking note of the fresh developments averring that the 10% is in public interest.
- 20.05.2011 : Essar intervened at UPERC demanding a right of hearing on NOIDA Power's IA.
- 30.05.2011: Without hearing Essar, UPERC permitted NOIDA Power to take necessary steps per Request for Proposal.
- 09.06.2011: NOIDA Power asked all bidders to match or offer a lower Tariff than the third party.

Essar: Challenge in appeal

Essar challenged the legality of UPERC Order dated 30.05.2011 and NOIDA Power's letter dated 09.06.2011 on the following grounds:-

- Having elected to go for competitive bidding, once it accepted the Evaluation Committee recommendation of Essar bid being L-1 and consistent with market conditions, NOIDA Power was obliged to sign the PPA with the declared lowest bidder.
- The stage of rejecting the bids was prior to accepting L-1 and declaring lowest bidder.
- Once the Petition declaring Essar as the lowest bidder was filed the Commission could only either adopt the bid or reject it. It could not have introduced an extraneous party.
- UPERC violated principles of natural justice and transparency by passing an order to the detriment of Essar without granting it an opportunity to be heard.



Essar: Findings in appeal

6.12.2011: Appellate Tribunal quashed UPERC's Order and UPPCL's letter to uphold sanctity of bid

- Athena Energy had ruled itself out from consideration (having neither qualified nor participated in bidding). Its proposal cannot be considered at this belated stage.
- NOIDA Power could have rejected the bid prior to accepting Evaluation Committee recommendations and filing the petition for adoption of tariff at UPERC, if
  - Bidding was not conducted as per the statutory bidding framework
  - Quoted Tariff did not align with the prevailing market price.
- Once the Evaluation Committee and NOIDA Power had declared a bid to be successful and the procurer filed the petition, UPERC was obliged to exercise its power according to the statute - to adopt or reject the bid. No new proposal can be considered at this late stage.
- With declaration of L-1 consistent with market conditions and filing of initialled PPA, signing of the PPA was a mere ministerial act
- State Commission violated principles of natural law by not hearing Essar before passing an order detrimental to it.

Key lessons

- **Bid manager/procurer/bidders cannot act contrary to the bid conditions – that nullifies the sanctity of the entire bidding process.**
  - In Essar case, Discom was not permitted negotiate with an unqualified third party after the declaration of a successful bidder and filing for approval.
  - In NHAI case, the existing Concessionaire lost his right to match lowest bid / ROFR by own conduct of failing to qualify as a bidder.
- **Statutory frameworks can have an overarching impact on bids and contracts**
  - Competitive bidding process under section 63 must be consistent with the Government's guidelines
  - Deviation from standard RFP and model PPA by the Government has to be approved by the State Commission before the bid process.
  - State Commission has specific powers under section 63 of the Electricity Act 2003.
  - Principles of Section 61 of the Electricity Act require a balanced approach.

Case Study #3

Energy Watchdog vs CERC : (2017) 14 SCC 80 @ Paras 19,20,47,56-58 and its implementation

- Risk allocation in bid documents
- Risk assumption by bidders in bid process
- Impact of statutory and policy framework on bids and contracts

Procurement Process re Adani

- 01.02.2006: Gujarat issued public notice inviting proposals for supply of power on a long term basis.
- 25.05.2006: Haryana Utilities initiated bidding process for purchase of 2000 MW power.
- Both Gujarat and Haryana State Regulatory Commissions had approved the procurement processes.
- Adani Enterprises Consortium submitted its bid for generation and supply of 1000 MW to GUVNL : selected as the successful bid on 11.01.2007.
- Adani Power submitted its bid for supply of 1425 MW of power to Haryana Utilities and was selected as the successful bid.

Procurement Process: Mundra UMPP

- January 2006: Govt of India issued the ultra mega power project policy to induce investment in coal fired generating stations at pit-head and ports using super-critical technology
- 01.02.2006: Competitive bid process (RFQ, RFP) was initiated on behalf of states of Gujarat, Maharashtra, Rajasthan, Punjab and Haryana for developing a 4000 mw imported coal fired plant near Mundra port to supply power for 25 years.
- 28.12.2006: Letter of Intent issued to Tata Power as the successful bidder to develop and operate the Mundra UMPP.
- 22.04.2007: PPA signed between project SPV and 5 procuring states

Intervening Events

- Two developments impacted the availability and price of coal (fuel) at these and similar power plants
  - Since 2009 domestic coal shortages crisis causing default on promise of the then coal distribution policy assuring full coal supply to completed projects
  - In 2010 Indonesia changed its laws over-riding all existing contracts for coal supply to align export price of coal to international market prices to more than double
- Tatas and Adani filed petitions before the Central Regulatory Commission seeking restitutive relief
  - Claiming adverse impact of change in law
  - Claiming force majeure
  - In exercise of statutory powers under sections 61, 63, 79 of the Electricity Act read with Bidding Guidelines
- Domestic coal crisis led to statutory decisions to grant relief : Cabinet Committee of Economic Affairs decision + revised Tariff Policy + directives of MoP/MoC

Findings of Regulator & Appellate court

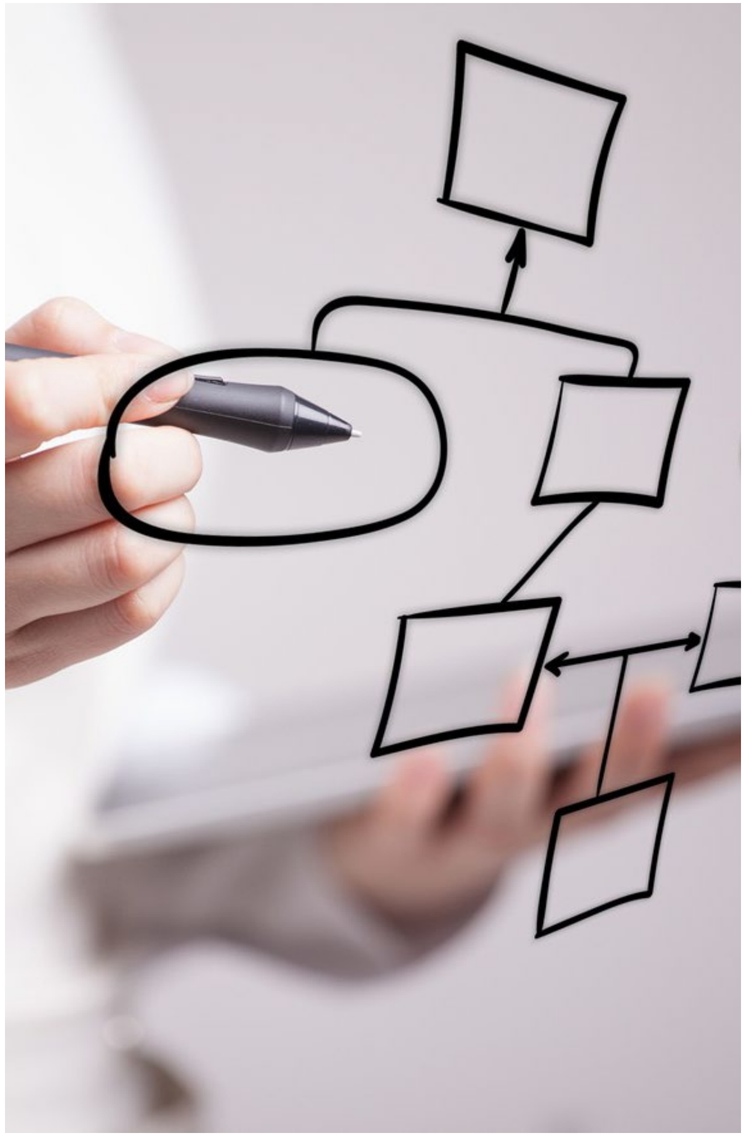
- The main issue at hand was the moral hazard of giving relief to bidders who took the risk at the cost of consumers.
- 02.04.2013: Central Regulatory Commission
  - Rejected the claim for relief on account of force majeure and change in law.
  - Granted relief in exercise of regulatory powers under Sections 61, 63 and 79 to restore its economic position.
- 07.04.2016: On appeal by states, Appellate Tribunal for Electricity
  - Rejected the generators' claims on account of change in law and exercise of regulatory powers.
  - Granted restitutive relief on account of force majeure.

Supreme Court verdict

- Relief must be considered in context of the contract and statutory bidding guidelines read with the Electricity Act.
- Regulatory powers u/s 79(1)(b) may be exercised only when a situation that arises is not provided for in the contract and the statutory guidelines.
- Claims under force majeure/frustration were rejected since there was no prevention of performance:
  - Fundamental basis of the PPA remained unchanged.
  - Bidders had no constraints on where to procure coal from Indonesia.
  - Risk of fuel price fluctuation was a known.
- Generators were granted relief for Change in Law for domestic coal – not for imported coal.

Follow through in recent judgements

- **UHBVN & Anr v. Adani Power : (2019) 5 SCC 325 @ Paras 7, 10 & 16**
  - The in-built restitutionary principle in the contract compensates the party affected by change in law which must restore the affected party to the same economic position as if such change in law has not occurred ……covers carrying cost (basically cost to service unpaid dues till they are paid)
- **Adani Mundra v. GUVNL : (2019) 19 SCC 9 @ Paras 48, 53**
  - The bid of the appellant was on the basis of commitment by GMDC to supply indigenous coal.
  - The appellant (bidder) was entitled in law and on facts to invoke Article 3.4.2 of the PPA to terminate the agreement, and it stood terminated with effect from 04.01.2010.
  - To do economic justice, on the principle of business efficacy, the appellant would be entitled for additional capex with interest + opex with interest.



Some Practitioners' Insights for designing the bids and contractual arrangements

Some principles to guide discretion…1

Law makers, policy makers, statutory agencies, courts and PPP partners must internalize some fundamentals

- Absolute disclaimers and skewed risk-allocation hurts the project and its capital outlay **[Nathpa Jhakri HEP]**
- Time-value-for-money is crucial in decision-making and mplementation **[UMPP, Dabhol v. NTP Migration & NHAI Renegs and Revival : 2018 Amendment to Specific Relief Act, 1963]**
- Capital is a primary factor of production : not evil **[Go-No Go, iron ore ban, spectrum & coal mine allocation cancellations]**
- Capital is distinct from the capitalist: punish the wrongdoer
- Resets and adjustments must be based on objective criteria and implemented through robust process **[DND Total Project Cost & Toll; Sasan UMPP COD]**

Some principles to guide discretion…2

- Address incomplete nature of long-term contracts with decision framework and guidelines **[NHAI; NTP Migration; UMPP]**
  - Resets / Adjustments / Renegotiation
  - Takeover
  - Re-bid
- Credible project preparation and implementation
  - "Partner" the project proponent in the true sense **[Nathpa Jhakri HEP]**
  - Recognize provision of public goods / services remains eventually a state obligation
  - Accountability of decision-makers re impact on economic development and impede growth: Skin in the Game **[Go– NoGo]**

Some principles to guide discretion…3

- Getting to the sweet spot balance between sustainable growth / viability and welfare/ redistribution
  - Capital is a factor of production for the economy once invested in fixed assets - distinct from who invests : public vs private
  - Time value for money qua infrastructure [**telecom migration policy (1994 to 1999) vs. Dabhol and stranded assets]**
  - Enforceability of contracts in time bound manner
    - Lenders and insolvency enforcement
    - What about "public interest" in the hands of SOEs and PSUs [**Arbitration; Go - No go]**
  - Limit short-term populist directives to absorbable fiscal limits of economy (loan waiver/melas, subsidies, uncovered debt)
  - Inertia is now spelt with a "C": 5 Cs … Courts, CVC, CAG, CBI, CIC (Central Information Commission)

Some principles to guide discretion…4

We need a robust regime for

- Designing and implementing PPP projects with a reasonable policy choice in public interest **[Article 39(b); In re Allocation of Natural Resources]**
- Allocating natural resources **[2G spectrum & Coal allocation]**
- Selecting concessionaires **[Airports & DND]**
- Implementing the project when faced with unforeseen and uncontrollable changes to ensure its underlying objectives **[Energy Watchdog; Shiv Shakti Sugar]**
- Expeditious adjudicatory processes **[Regulatory Mechanism, Special Courts, Arbitration et al]**

Public Goods & Statutory Contracts

Projects involve grant of privilege/concessions: freedom to contract is constrained by statute / policy

- **Promissory Estoppel** vis-à-vis change in law and policy.
- **Legitimate Expectation** of stakeholders; right to property.
- **Public Trust doctrine** where the facility/services in question are "responsibilities of State" and/or entail vesting of certain rights or privileges of "State" in hands of the operator.
- **Public Interest** in bid-process and award; regulating market power re pricing, access and safety (maximizing welfare).
- Securing **inter-generational equities**: balance between
  - Economic development and investment climate
  - Sustainability of human race and earth

Public Procurement - Contract Design

Socio-economic-political environment influences nature of contracts + how they get administered / implemented

- **Nature of the commodity or services**: Capital v. Consumer goods v. Nationalized products/services v. Public goods v. significance of supply re national security/interest.
- **Tenure of contract**: one-off sale of a consumable v. long term supply arrangements (say 30 years).
- **Ownership structure** and governance issues: public v. private v. public-private-partnership.
- Open market/competitively available goods or services v. monopoly/oligopoly supplier.
- Whether the construction, maintenance and operation of the facility entails grant of largesse/concessions by the sovereign?
- Who is the procurer of the goods/services – the State or Citizens in open market?

Contract Design - Risk and Value…1

- Award of supply contracts
  - Sale by description / SOPs : merchantable quality
  - Performance guarantees : latent and patent defects
- Award of contract + financial closure constitute the beginning of a partnership: not an end in itself
  - Actual project implementation begins
  - Parties must perform their respective roles to ensure effective project implementation
  - To deliver efficient and affordable infrastructure services with the project "vfm" in a viable and sustainable manner

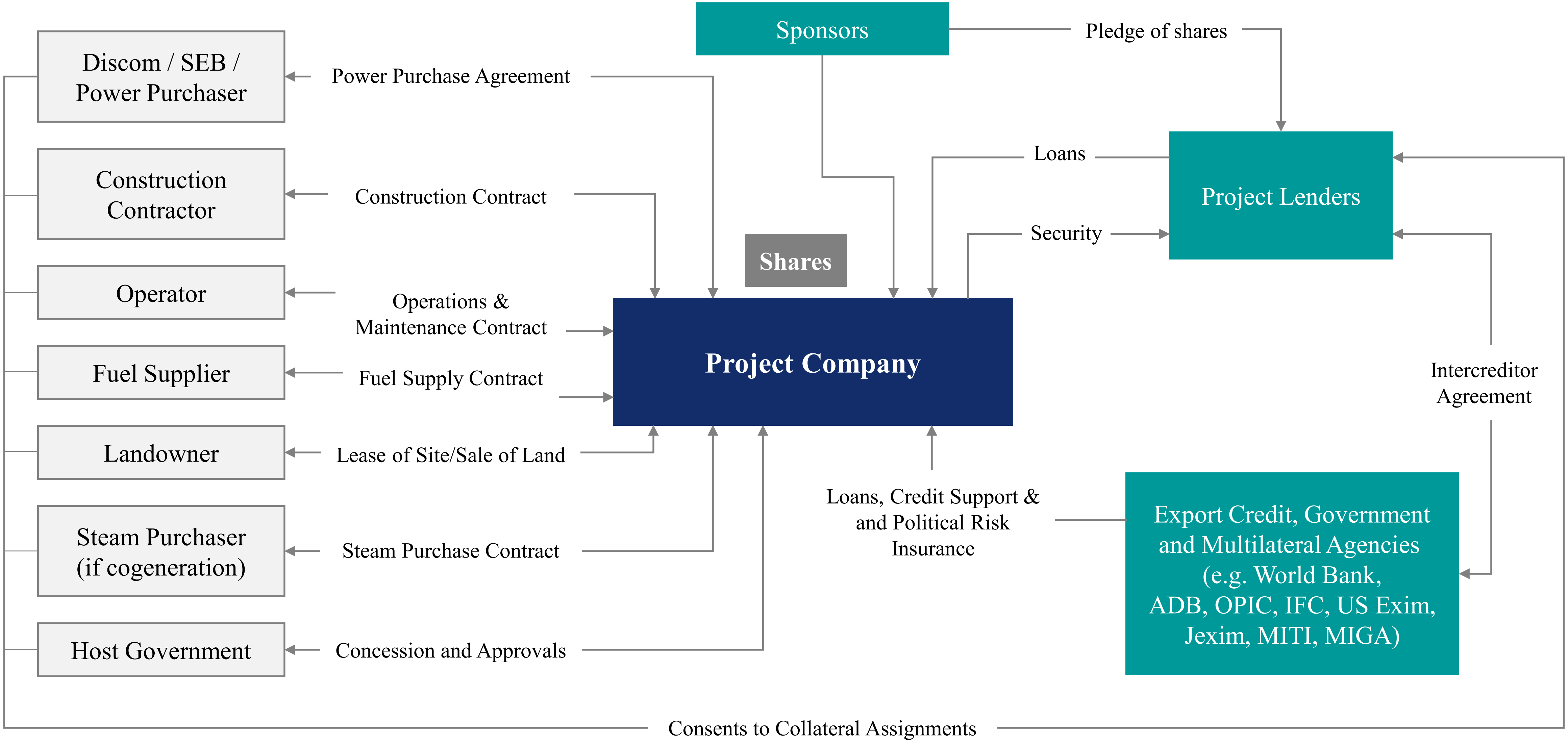
As you sow, so shall you reap!

Contract Design - Risk and Value...2

Each phase of the project must have specific roles, responsibilities, rights, duties and risks (including adjustments/resets)

- **Construction phase** involving design, engineering and construction, leading to completion, testing and commencement of commercial operation
- **Commercial operation phase** commencing with capacity testing through operations and service delivery : O&M
- **Exit & Hand over phase** related to exit or termination of the contract/ concession
  - Upon completion of the term without renewal (incl rebid)
  - For default, including step-in rights
  - Due to prolonged force majeure events
  - Other reasons

Complex Contracts - Power project



Contract Law…1

- Indian jurisprudence premised on common law on various aspects, including the following:-
  - Courts enforce contract based on valid offer & acceptance made of freewill of parties : ‘consensus-ad-idem’.
  - Contract must have been entered into for lawful object and lawful consideration.
  - Enforcement based on privity of contract & consideration.
- For breach of contract or repudiation
  - Preferred remedy was compensation, subject to any specific negative covenants.
  - Specific performance of contract was an exception.
  - This position has changed on 01.10.2018 by amendment to the Specific Relief Act, 1963.

Contract Law…2

Conventional wisdom is undergoing a sea-change re. enforcement of contracts in light of: -

- Commercial Courts Act and amendments thereto
- 2016 and 2018 amendments to the Arbitration and Conciliation Act 1996
- Insolvency and Bankruptcy Code, 2016 and amendments thereto
- 2018 amendments to the Specific Relief Act, 1963
- Recent judgements …movement to do complete justice and mould relief
  - Shiv Shakti Sugar case [(2017) 7 SCC 729]
  - Energy Watchdog case [(2017) 14 SCC 80] and its implementation + follow on judgements
  - Hindustan Construction vs NHAI [(2019) SCC Online SC 1520]

Challenge posed by long-term contracts

Inherently "incomplete" nature of arrangement

- The unforeseen developments.
- **Law** proceeds on the basis of "caveat emptor" (let the buyer beware) while **business reality** is premised on "information asymmetry" (producer/ supplier has best information about its pricing and quality)... information arbitrage.
- Such long-term contracts must have a set of risk-allocation and mitigation clauses to:
  - Handle unforeseen developments beyond "controllable" or "absorbable" impact on economic substratum of the bargain
  - Mitigate and protect the investment/supply from destruction/frustration.
- State enterprise find it tough to implement the reset mechanism causing risk premium being built into bids.

Renegotiation of a PPP Contract - Necessity

- PPP Contracts in ports & highways involve high upfront investment with long gestation periods.
- Unforeseen changes like the global financial crisis can pose fundamental challenges to viability of project, resulting in:
  - Need to balance between stable relationship amongst parties and need to deal with unforeseen changes.
- Certain contractual mechanism may provide flexibility:
  - Price variations
  - Change in law clauses
  - Change in scope clauses
  - Force majeure provisions
- However, these might not always be enough: contracts cannot foresee and specify for all possible contingencies. ***Incomplete Contract Theory (2016 Nobel for Economics : Oliver Hart & Bengt Holstrom)***
- Some circumstances that may affect the contract terms are not predictable ex ante. That is why they are called unforeseen events

Renegotiation of a PPP Contract - Aspects

- Contract renegotiation is a change in the original contract terms that is agreed upon by both parties.
- Wherever changes are unavoidable, the financial and other effects involved should be examined and recorded.
- Specific approval of the authority competent to approve the revised financial and other commitments should be obtained, before varying the conditions.
- All such changes should be in the form of an amendment to the contract duly signed by all parties to the contract.
- Undesirable outcomes typical to renegotiation:
  - Caused by imperfect enforcement and opportunistic behavior by the contracting parties
  - Examples are rent-shifting activities, politically-motivated investments and corruption.

Amit Kapur

Comments and queries are welcome: amit@jsalaw.com
+91-9899381000/+91-11-49370630

"As you go through life brother, whatever be your goal.
Focus on the donut and not the hole!"

Thank You

jsa

advocates & solicitors

Ahmedabad | Bengaluru | Chennai | Gurugram | Hyderabad | Mumbai | New Delhi