Airport projects in India: cleared for take-off

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Air traffic in India has witnessed a 35 per cent average growth, year upon year, for the past six years. This far outpaces the global growth of only about nine per cent per annum. Privatisation of airports has become necessary. In the recent past, India has signed four concession agreements relating to two greenfield and two brownfield airports. But this is only the tip of the iceberg. There are 35 more airports in the pipeline. By all accounts it is a booming sector. This article explores the contours of the concession agreements entered into so far, and the critical issues at stake.

India is at the threshold of emerging as an economic power. It is recognised, however, that infrastructure holds the key to this transformation. The infrastructure gap in India is obvious to all. Of late, the government has dedicated itself to addressing this gap on a war footing. The task is huge. It involves not only harnessing financial resources, but also technology and know-how.

Around the world, more and more airports are moving towards privatisation. This is the trend in Asia, Europe and Latin America. In India, too, private participation is felt necessary and, therefore, the government has opened up this sector to the public private partnerships (PPP) route.

At first blush, it may seem that the government's efforts are too little too late, but it may be worthwhile to bear in mind that air traffic in India has witnessed a 35 per cent average growth, year-on-year, for about the past six years, as against the global growth of only nine per cent per annum.

In this article we explore the path adopted by the Indian Government so far in airport privatisation. Essentially we look at three segments:

- first, we examine the basic approach in the concession agreements comparing both the greenfield and brownfield sectors;
- secondly, we draw attention to the need to have an independent regulator in place; and
- thirdly, we examine the dispute resolution mechanism put in place in the concession agreements.

Basic approach in the concession agreements

So far, the government has signed off four airport concession agreements – two in the greenfield sector (Bangalore and Hyderabad airports) and two in the brownfield sector (Delhi and Mumbai airports).

For the purposes of this article, we take up the concession agreements for Bangalore and New Delhi as our model (ie one in the greenfield and the other in the brownfield sector).

Notwithstanding the privatisation route, the government has retained a 26 per cent shareholding in these airports (either through the Airport Authority of India (AAI) or through the state government). This crucial 26 per cent shareholding ensures that the government is able to veto certain 'fundamental resolutions', which, as per the Companies Act, require a minimum vote of 75 per cent of shareholders (for instance, issuance of new shares, change of directors, change of auditors, etc). Hence, the government does continue to retain some level of control over the private entity.

The commercial backbone of the project is the large chunk of land the private entity is 'gifted', ie allowed to develop along with the airport for any commercial purpose it may choose (subject to local laws). Here it may set up not only hotels or malls – it can even go for Special Economic Zones, manufacturing factories, country clubs, golf courses, power plants etc. At Bangalore, the concessionaire got about 300 acres of land, and at New Delhi 250 acres for free commercial development.

Nature of the concession

Basically, the concession agreement is for construction, development, operation and maintenance of the airport over a period of 30 years (concession period) extendable

at the sole option of the concessionaire by another 30 years (ie total 60 years). The land is leased out to the concessionaire by the state government at a nominal rent.

The Government of India has extended its full commitment and support for the project; for instance, the Bangalore Concession Agreement states, 'GOI acknowledges and supports the implementation of project'. It further states that the government will not take any steps or action in contradiction with the Concession Agreement which results in or would result in its shareholders or the lenders being deprived or substantially deprived of their investment or economic interest in the project. Further, all statutory and non-statutory bodies under the control of the central government are required to act in compliance with the Concession Agreement as if they are a party thereto and the government is to ensure that all statutory compliances as may be required are granted promptly.

The state governments have similarly entered into state support agreements. This is a unique feature in airport privatisation agreements. The port and road sectors do not place similar obligations on the government.

Types of construction

Here we find a departure between the approach taken in the greenfield sector and the brownfield sector. Whilst the greenfield projects essentially leave it to the concessionaire to plan the construction, as per the approved master plan, the brownfield concession agreements are far more specific. The Concession Agreement for New Delhi for instance stipulates development of a master plan within six months of the Concession Agreement. This is to be updated and reviewed every ten years. Any delay in submission of the Master Plan would result in liquidated damages at the rate of US$65,000 per day.

The Concession Agreement sets out certain type of works called 'Mandatory Capital Projects' (which are set forth in a schedule). For instance, for New Delhi Airport, a parallel runway is listed as one such work, and it is required to be completed within 24 months of the signing of the Concession Agreement. If it is not, liquidated damages would follow. Then, there is a category of works which fall under the heading of 'Major Development Plan'. These comprise projects expected to have a capital cost in excess of US$25 million.

All the above are subject to review and approval by the government. While strict timelines are stipulated for submissions of the plans for approval, the AAI or the government concerned is not obliged to revert with their approval/suggestions within any stipulated time period. This can lead to a situation where work is commenced (as it has to in order to meet the time deadline) and belatedly the same is not approved, or some modification is required by the government.

Adherence to standards

Here, again, we find that the approach of the government in the greenfield sector versus the brownfield sector is not consistent. In the brownfield sector (Delhi and Mumbai), the concessionaire is required to adhere to:

- good industry practices;
- development standards and requirements – these are specified in a schedule. For instance, it is stated that the airport must conform to the ICAO Aerodrome Design Manual (DOC 9157), the Airport Services Manual (DOC 9137), the National Building Code of India, etc; and
- operations and maintenance standards and requirements. These again are set forth in a schedule. For instance, it is stated that the relevant standards prescribed by the ICAO (Chicago Convention) are to be followed.

In the greenfield sector, however, the approach is far more hands off. The specifications are very broad and vague.

Monitoring of the project

The inconsistent approach of the government between the greenfield and brownfield sectors comes out most dramatically when it comes to monitoring of the project and imposition of damages for default. In the brownfield sector the concession agreement has in place an aggressive manifold monitoring mechanism. To begin with, 'objective' and 'subjective' service quality requirements are set forth in separate schedules.

To illustrate, one 'objective' service requirement states that the maximum queuing-up time for check-in should be five minutes for business class and 20 minutes for

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economy passengers. Likewise, the waiting time for security checking should be less than ten minutes for 95 per cent of the passengers. On the other hand, 'subjective' requirements are based on passenger feedback surveys as per IATA, ACI or AETRA guidelines. If a certain specific rating is not achieved within a stipulated period then liquidated damages follow. Further, the concessionaire is required to achieve ISO 9001:2000 certification. This is to be done within two years of the concession agreement coming into force and if the same is not achieved, liquidated damages will follow.

In contrast, in the greenfield sector (Bangalore and Hyderabad), monitoring is solely through passenger surveys. Further (unlike in the brownfield sector), liquidated damages do not necessarily follow; however, if the rating through passenger surveys is consistently below the stipulated norms (over a period of years) and if the targets for rectification are not met, it may become an event of default leading to termination.

While examining the inconsistent approach between greenfield and brownfield sectors, we may lastly take a look at the liquidated damages provisions. In the greenfield sector, even where there is delay in opening of the airport (something which ought to be a matter of serious concern), the concessionaire is allowed a six-month extension if it can show that the delay was allegedly on account of failure by the government in the performance of its obligations (a provision which is easily capable of abuse and likely to lead to disputes). After this, liquidated damages follow at the rate of only US$2,500 per day up to the next six months of delay – surely a very nominal amount considering the consequences of delay (even one aeroplane hovering for landing permission can incur costs greater than the liquidated damages stipulated).

In contrast, in the brownfield sector, the concessionaire faces a prospect of liquidated damages of about US$65,000 per day merely on account of delay in submission of the master plan beyond the stipulated period of six months – even though prior to the agreement it had already submitted an initial master plan (on the basis of which its bid was selected). In fact, brownfield operators run the risk of paying liquidated damages (ultimately leading to termination of the contract) on at least 20 different counts, many of which are beyond their control (eg security delay, check-in delay, etc), which can all result in liquidated damages and finally cancellation of the contract, even though these are matters arguably beyond the control of the concessionaire. Airport security is a matter within the control of the government, and check-in formalities and efficiency is within the domain of the airline concerned. It seems unreasonable to penalise the concessionaire for shortfalls in targets here.

A greenfield operator pays liquidated damages on only one count – delay in opening of the airport. Here, delay for six months mounts up to less than half a million US dollars. Contrast this with the US$10 million a brownfield operator may have to end up paying for a delay of six months for mere delay on account of submission of the master plan.

Absence of Regulator

In infrastructure projects concerning the public, an independent regulatory authority has become necessary. Accordingly, the concession agreements stipulate that an Independent Regulatory Authority would be set up to regulate all aspects of the airport. Vast powers are envisaged to be cast upon the Regulator. The Regulator would lay down and regulate standards, approve charges, impose penalties, etc.

Further, the Regulator would be empowered not only to settle disputes between the public and the government but also contractual disputes between the government and the concessionaire, as it is stipulated that, once the Regulator is in place, the arbitration agreement as per the concession agreements shall stand overridden.

The Regulator is not yet in place and, considering that the Bangalore airport agreement was signed as far back as July 2004, the delay is inexplicable. Further, the Regulator would work only if there is a mechanism to ensure that people of highest calibre, independent of government control, occupy the position. Once the Regulator is appointed, the regulatory philosophy has to evolve and there has to be transparency. All this will take time. We are years away from any of this as the government is still

discussing and deliberating preliminary issues. Even a Bill has not yet been placed before Parliament.

Pure contractual disputes between the government and the concessionaire need not be referred to the Regulator. These need (in the event of dispute) to go to the arbitrator. Overriding the arbitration agreement (by referring these disputes to the Regulator) is bound to discourage foreign players. Resolution of disputes through the Regulator would cause serious problems of lack of confidence (amongst foreign parties) and also result in delay.

The Regulator would naturally be subject to the hierarchy of the Indian legal system. Any decision of the Regulator would be appealable to the appellate authority. One is actually looking at three or four stages in dispute resolution – first, a decision by the Regulator followed by that of the appellate authority, followed by a writ to the High Court, followed by an appeal to the Supreme Court. Given the delays under the Indian legal system, dispute resolution would become inefficient and expensive.

Therefore, perhaps the government should have segregated pure contractual disputes between the concessionaire and the government and reserved these for international arbitration (which would have been as per the expectations of the international investing community also). Under this model, the Regulator would step in only where public interest is involved.

Dispute resolution

Planners (and contract writers) apparently tire out by the time they reach the dispute resolution clause tucked away at the end of the contract. Most dispute resolution provisions do not get the attention they deserve. Here too, we find the concession agreements very unimaginative in their approach.

Briefly, the concession agreements stipulate that dispute resolution shall be through ad hoc arbitration through a panel of three arbitrators, with the venue of arbitration as India. To understand what is wrong with this clause we need to step back and look at the nature of the project. These are no ordinary construction or management contracts. These are mammoth and diverse projects involving public interest as well. What is most significant is that we are looking at a project which is to have a longevity of 60 years. Considering that the history of independent India is just about 60 years it can well be imagined what a long period of time 60 years can be in the history of a nation!

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The technological, political and social changes which may happen in the contractual period of 60 years cannot be visualised and therefore captured within the four corners of any contract (no matter how thoughtfully written). Therefore, the dispute resolution clause must be flexible and geared to handle contingencies which may arise in the working of the contract.

One possibility is that in matters of this type the arbitrators must be empowered to even modify or alter the contract if subsequent developments so warrant. This is no doubt a revolutionary concept but one which may well meet the demands of a situation where parties enter into such long-term commitments and then events overtake them. The dispute resolution mechanism must not be found to be wanting in such situation. Indeed, there is no mechanism for mediation or conciliation or dispute review boards in the concession agreements, all of which could have worked towards a just, fair and expeditious resolution to disputes.

Conclusion

The Indian Government has done well to embark upon the privatisation process. It would seem, however, that we need to pause and debate the approach so far. The government's ambitious plans in this sector need to be accompanied in equal measure with a bold and fair approach. At the end of the day there needs to be a fair bargain for all parties.

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