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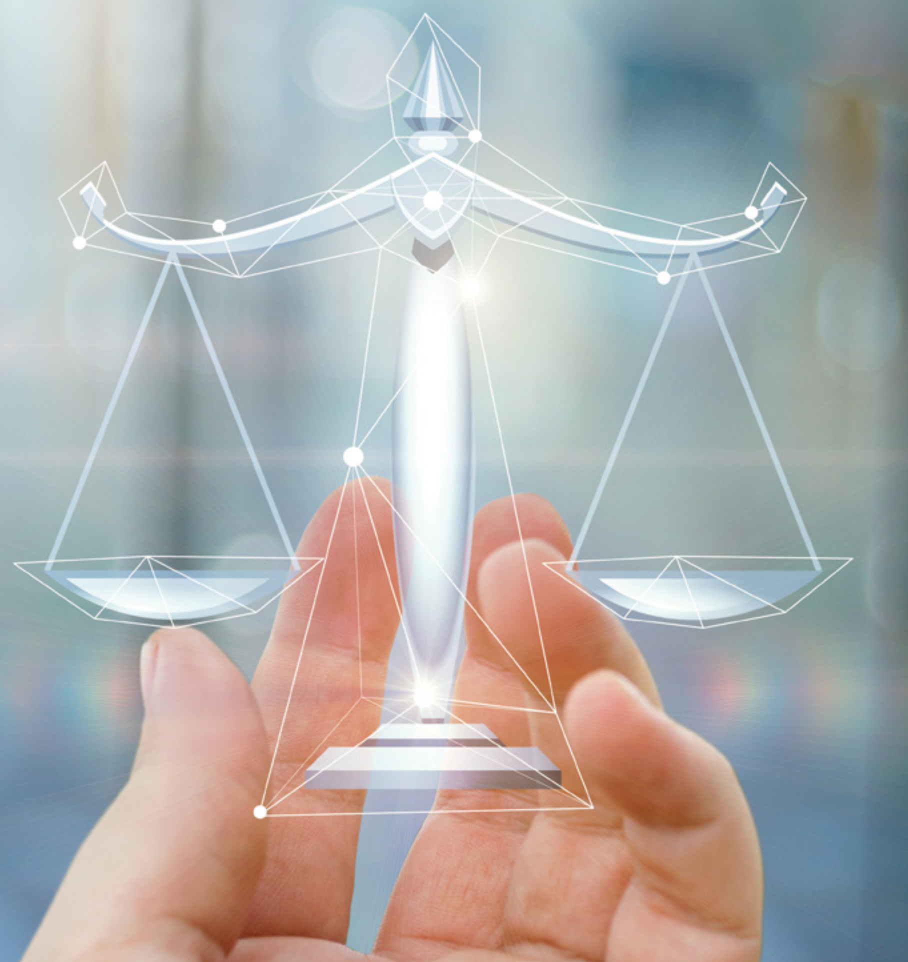
AN ERA OF HYBRID HEARINGS

TECHNOLOGY DRIVEN JUSTICE DELIVERY

Our Guest Author

PSN PRASAD

Hon'ble Member (Judicial)
NCLT, New Delhi Bench



12th Anniversary Special Issue

Raising Project Finance: Untangling the Legal Knots

Dhir & Dhir Advocates & Solicitors 25 YEARS

D-55, Defence Colony
New Delhi -110 024
Tel: 91 (11) 42410000
Fax: 91 (11) 42410091
E: expertspeak@dhirassociates.com

Purusharth Singh

The Indian economy, especially the infrastructure finance sector, is perhaps experiencing its most challenging times in recent history. Infrastructure spending plays a pivotal role in aiding and supporting holistic growth, and compared to other development-linked metrics, it has a higher positive multiplier effect on GDP. However, the global slowdown coupled with our ongoing fight with the Covid-19 pandemic has translated into low infrastructure spending by private entities, and as a result, our GDP growth remains sluggish.

The Indian Infrastructure sector (borrowers and lenders) faces critical financing and commercial challenges, adversely affecting the private sector's capacity to invest in long-term capital. In addition, specific recent developments, including events/judicial pronouncements with significant commercial implications, have raised serious questions over the borrower's intent to invest and develop infrastructure projects in India - the most relevant ones have been studied and summarized in this article.

HIGH CAPITAL COST AND HIGH GESTATION PERIOD

Although infrastructure projects in India benefit from lower operating costs, a high gestation period negates the advantage. Persistent high inflation coupled with longer timelines for developing infrastructure projects, such as roads and energy projects (even renewables), often translates into significant cost-overruns. Although the lenders eventually face the brunt, a typical Indian infrastructure finance agreement would include provisions requiring promoters to cover a portion of such cost-overruns. Significant resources, especially time, are spent on procuring the relevant approvals/permissions required to develop, construct, operate, and maintain the projects during their intended lifecycles.

LEGAL AND PROCEDURAL ISSUES

The Indian jurisprudential landscape is dotted with instances of abrupt and disruptive changes in policies governing the relevant sectors and the industries within. Frequent changes in policies create uncertainty over the future of

infrastructure projects and create an adverse investment climate.

i. Change in Law/Policy: Only during the last few years, several regulatory corrections, including tariff revisions, land acquisitions related policy reversals were implemented.

ii. Threat of Insolvency for Promoters and Guarantors: Recently, the Apex Court while upholding the constitutional validity of a 2019 notification. that made the provisions of the Insolvency and Bankruptcy Code 2016 or IBC applicable to personal guarantors and corporate debtors, allowed creditors to move against personal guarantors under IBC to recover the debt. It held that the discharge of a debt owed by a company to its creditor, by operation of law or due to liquidation or insolvency proceeding, does not absolve the surety/guarantor of his or her liability since this liability arises out of an independent contract. Therefore, the ratification of a resolution plan does not automatically discharge a personal guarantor/promoter of his weaknesses under guarantee.

iii. Limited Non-Recourse Funding Avenues: Owing to the asset-liability mismatch in infrastructure projects developed in India, there is an overall lack of long-term funding avenues. There are instances of Indian borrowers using short-term funds earmarked to meet operations-related expenses for their fixed cost-related expenses or vice versa. Due to significant capital expenditure requirements, Indian borrowers are often unable to generate direct and adequate income streams to self-finance infrastructure projects.

iv. Claims Related Issues: Since the project operations and the related compliances are subject to Indian laws; all project agreements are governed by Indian law. However, getting any relief costs time and money. In addition to claims/notices/disputes initiated by private individuals against parties involved in the development of an infrastructure project also remain susceptible to similar actions by regulatory, state/central, judicial, and quasi-judicial authorities.

v. Other Legal Issues: Lack of comprehensive national law on 'public private partnerships' (PPP) despite the immense potential that takes out finance or HAM (Hybrid Annuity Model – where the state sponsors ~40% project cost and helps the developer during the initial years of operations through annuity payments) holds in India, lack of uniformity of relevant laws including differences between state and central laws, jurisdictional reach/influence of authorities, often contribute negatively.

vi. Limited Scope for Risk Mitigation: Borrowers and lenders of infrastructure

projects often find it challenging to meet the financial conditions linked with disbursements. The commissioning of such projects is delayed leading to frequent applications by relevant developers with the regulatory bodies seeking extension of scheduled commissioning dates. Again, there is a lack of consistency amongst actions taken by various regulators across sectors/industries in India. Non-fulfilment of the milestones prescribed under lending documents (finance closure conditions) often invokes security documents such as performance-linked guarantees (corporate/bank).

LAND ACQUISITION

Land laws being state-specific make infrastructure projects susceptible to state government actions. State governments such as Gujarat have often found allowing the development of state-specific projects while keeping allotment of land to national projects at bay. Historically speaking, procuring relevant permissions linked with land use for infrastructure projects is tedious and time-consuming. Various regulatory hurdles and sector-specific bottlenecks, including consent to establish, consent to operate, other environment clearances/permissions, and an unending list of compliances, need to be met, ultimately leading to significant time and cost overruns.

Planning and execution issues: Owing to absence of sector specific single window clearance systems, planning and execution of projects becomes a cumbersome task.

In addition to most of the issues mentioned above, lenders are also plighted on account of certain financer specific challenges including;

i. Growing stressed assets

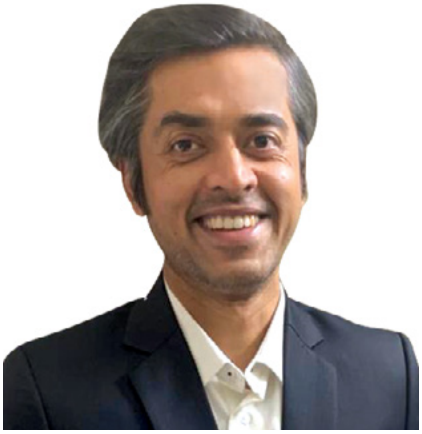
ii. Issue of lending at floating rates linked to MCLR

iii. Stressed assets, rehabilitation

iv. Security enforcement and recovery of dues

IN A NUT-SHELL

The willingness of the private sector to participate in infrastructure financing is hinged upon industry specific regulations. Governments must build a conducive development environment through more transparent procedures that apply uniformly during the entire life cycle of an infrastructure project. There is an urgent need for developing an efficient and innovative financing system built around emerging sectoral trends that can be aided by a comprehensive fiscal and monetary policy reforms.



Purusharth is a Partner and part of the firm 's corporate advisory practice and focuses on Infrastructure Development & Management, Restructuring & Insolvency. He is a multidisciplinary lawyer with a rich experience of advising clients on a variety of complex commercial and financial transactions in this space.