The fallout of Andhra Pradesh's u-turns on infrastructure contracts

Source: BloomberQuint

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The Andhra Pradesh government's announcement regarding the closure of the Amaravati Capital City Startup Area project on Nov. 11, comes on the heels of the same government's vicious assault on existing renewable energy power purchase agreements in the state, as well as the unilateral cancellation of the Polavaram dam project. The High Court of Andhra Pradesh intervened and ensured that the illegal termination of the PPAs and the cancellation of the Pollavaram project were not given effect to. However, the question of whether legally determined tariffs enshrined in lawfully concluded PPA contracts can be unilaterally reduced by the AP government is awaiting determination by the High Court in appeal.

Pertinently, the Amaravati project and the renewable energy PPAs represent a significant private sector investment aggregating billions of dollars that have already been made in the state. Therefore, the timing and overtly arbitrary and opaque nature of executive action by the government of Andhra Pradesh has sent shivers down the collective spines of private investors, not just in Andhra.

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The fear that this contagion may spread to other states is real. As regards the Amaravati Project, for the record, the cancellation of the contract with the Singapore consortium with investment from Ascendas-Singbridge and Sembcorp has been done by "mutual consent" and both have made efforts to avoid communicating a perception of acrimony.

However, a rudimentary analysis of the facts suggests otherwise, or at the very least creates an impression that the private sector consortium succumbed to political pressure. In the world of infrastructure contracts requiring private sector investment, perceptions are usually stronger than facts, especially because the counterparty is always the government.

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Viability of projects put at risk

Even if one were to undertake a nuanced analysis and accept that there might indeed be certain justifiable reasons for the termination of the projects, however, the timing and manner of effecting such termination is anathema and destructive to the fundamentals of creating an enabling environment for private investors in the infrastructure sector. India's future growth in the short, as well as medium and long term, is predicated upon significant private investment in the infrastructure sector. Therefore, the obvious question is whether our legal system is designed to protect investors by ensuring compliance by the dominant counterparty.

While fundamentally the Indian law on contracts is robust in philosophy and principles, however, the burden for enforcement remains on the aggrieved party. Therefore, in delicately balanced infrastructure projects that depend on timely cash flows for viability, any arbitrary withholding of payments by the government as the counterparty can be fatal to the project.

Remedial action needs to be swift and designed to give the benefit of doubt to the project investor. Regrettably, that is not what the Indian law and judiciary deliver. The relatively weak enforcement of contracts in India has long been voiced as an investment risk. Several decisions that have been taken by governments in India over the last few years, both at the central and state level, have created a perception of uncertainty which does little to assure investors generally, more so in capital-intensive sectors characterised by large capital outlays and delayed returns on investment. The World Bank's Ease of Doing Business rankings currently ranks India at 163 on the enforceability of contracts. While this has been a historical lag on India's overall rankings, the ramifications are amplified when applied to the infrastructure sector wherein contractual arrangements play a singular role.

Remedial action

The Government of India has taken certain steps to ameliorate investor concerns. The Specific Relief (Amendment) Act, 2018 which was finally notified in the Gazette and brought into force on Aug. 1, 2018, deserves a special call-out in the present context. This amendment mandates that specific performance of a contract is the remedy of first resort. Therefore, the amendment now mandates that every court must grant specific performance of the contract as a general rule. The Act now also contemplates the appointment of experts to assist the court on technical issues. There are special provisions for the infrastructure sector, such as provisions for ensuring timely and unhindered completion of public utility projects by restricting the grant of injunctions in infrastructure project contracts, special courts to adjudicate such matters, setting of a time limit of 12 months for disposal of all suits filed under the Act, etc. restricting the grant of injunctions in infrastructure project contracts, special courts.

Notably, however, these amendments do not address the primary contagion affecting privately funded infrastructure projects, which is timely payment of tariffs and dues to the private investor by the government. It appears that the central government is taking the Andhra Pradesh government actions quite seriously and is making its own efforts at preserving investor sentiment. One such step that has been generally alluded to is a proposed new law to shield private investors from arbitrary actions by state governments and ensure the sanctity of contracts is respected and enforced meaningfully. The exact contours of this proposed new law have not been elaborated.

My first reaction to this news was that the law already provides that parties including governments must respect and honour contracts. However, what is urgently needed are explicit provisions that preclude governments from acting arbitrarily and capriciously. The usual stratagem for governments has been to make allegations against the private sector counterparty to a contract, and on such unproven allegations, take precipitative action such as withholding payments, or terminating the agreement.
In simple words, the monopolist buyer remains unaccountable and wields disproportionate and arbitrary power.

Preventing ad hoc moves by governments

In my view, therefore, the proposed new law should re-calibrate the enforcement regime to expressly provide a framework to fix accountability to deter opaque and arbitrary decisions. One such mechanism could be to prevent governments, or indeed any party to a contract, from taking any precipitative action merely based on an allegation. The person making the allegation must be obliged to escalate the issue to specialised courts or tribunals (such as the electricity tribunals already provided for the power sector, or specialised dispute resolution tribunals to be created for the infrastructure sector) and such tribunal would be required to address these disputes in a time-bound manner. Thus, the burden of proving the allegation must remain with the person making the allegation.

"The practical challenge in the current regime is that the aggrieved party is burdened to prove the negative, i.e. that he has not been in breach as alleged. This is a logical fallacy as one cannot prove the negative." The government can get away with shifting the onus as well as the financial burden onto the aggrieved party and take advantage of the delays.

Certain disputes can be made mandatorily referable to arbitration. However, in any scenario, the government should be obliged to continue making some minimum payments, such as 80 percent of the amounts in dispute, to ensure that the project does not head into insolvency. This continued payment is especially critical since on the other hand, the insolvency laws now require that a borrower must mandatorily and automatically be declared a non-performing asset within a legally specified time frame, and thereafter be referred to insolvency proceedings in a time-bound manner.

This chatter of a new law stems primarily from the negative actions taken by the Andhra Pradesh government in the context of the power purchase agreements for renewable energy projects, which threaten to jeopardise the central government's larger plans to ramp up investments in the renewable energy space. The target of 450 gigawatts by 2030 is currently one of the world's largest renewable energy programs, and one that would be feasible only with foreign investments. However, this re-balancing is required for all other infrastructure sector contracts too.

Other ripple effects

The central government's urgency to bring in new legislation is justified on several counts. Not only is the current weak enforcement regime threatening further investments in the infrastructure space, but there is a real threat of foreign investors bringing legal action under the bilateral investment treaties and similar bilateral arrangements, to recover damages for losses attributable to arbitrary actions by governments. The preponderance of BIT-related legal jurisprudence would justify such action in the context of the actions taken by the Government of Andhra Pradesh in the Amaravati project and the renewable energy PPAs.

Another law that has not been invoked as yet but would appear to have a direct bearing on these events, is the Competition Act, especially in the context of the electricity utilities that are monopolistic and largely government owned. There are several international precedents where large monopoly utilities have been broken by the anti-trust authorities, of which the 'Baby Bells' created from the monolithic AT&T jumps to mind. In the end, these may not be bad ideas if the if the efficiency in these critical sectors needs to be forced, to make the Indian economy efficient and competitive at a global stage.

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