

## AVIATION BULLETIN



### CONCESSION AGREEMENT: ROAD MAP FOR AVIATION INDUSTRY

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## INTRODUCTION

In the last five years, the world has been evident to the moves that Indian economy has made to integrate itself into a global economy. However, now its time for Indian economy to change gears from a developing to a developed economy and therefore the upgradation and modernization of airport infrastructure and its efficient use has assumed critical importance. The increase in the number of planes, coupled with more foreign and domestic flights, has put immense pressure on the hard-pressed aviation infrastructure. To foster the development of a strong airport infrastructure and to bring in greater efficiency in management of airports, Government of India (“GOI”) has shown keen interest to invite participation of private parties including both domestic and foreign investors to invest and develop the aviation infrastructure in India.

This bulletin provides an insight into the GOI initiative to ensure and encourage the development of airport infrastructure similar to international methods by inviting private investments in the sector primarily through changes in the Foreign Direct Investment (“FDI”), promoting Public Private Partnership (“PPP”) and executing Concession Agreements. It also highlights the key features of the Concession Agreement which plays a vital role in luring the investors to focus and invest in aviation infrastructure.

### 1. FDI and PPP in Airport

In order to encourage private participation in the airport infrastructure sector the FDI norms were liberalized. At present, 100 % FDI<sup>1</sup> through the automatic route is allowed for setting up greenfield<sup>2</sup> airport projects. Further, for existing airports 100% FDI is permissible but the prior approval of Foreign Investment Promotion Board is required for FDI beyond 74%.

The development of any infrastructure projects usually requires large investments and it is not always possible to meet these investment requirements only from the budgetary resources of the government. Therefore, in order to (a) overcome financial hurdles (b) bring in private sector resources, and (c) bring techno-managerial efficiencies, the GOI has been actively promoting PPPs in infrastructure sectors like transport, urban infrastructure including seaports, airports etc.

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<sup>1</sup> Press Note 4 (2006) dated February 2, 2006 issued by the Department of Industrial Policy and Promotion under the Ministry of Commerce & Industry.

<sup>2</sup> As per Ministry of Civil Aviation’s infrastructure policy, a greenfield airport is permitted where an existing airport is unable to meet the projected requirements of traffic or a new focal point of traffic emerges with sufficient viability. It can be allowed both as a replacement for an existing airport or for simultaneous operation.

Further, to promote PPP in airport infrastructure development GOI envisaged support to PPP projects through a special scheme called Viability Gap Funding<sup>3</sup> (“VGF”). Under this scheme, subject to a maximum capital grant of 20% of the total project cost<sup>4</sup> the PPP project is granted to the investor at the stage of construction. This reduces the capital cost by credit enhancement, and makes infrastructure development viable and attractive for private investments. Thus, these economic reforms give a clear indication of the intent of the GOI, to promote cost-effective and orderly growth of airport infrastructure which directly contributes to social and economic development of the country.

## 2. Meaning and nature of Concession Agreement

A Concession Agreement is an agreement between an infrastructure developer (which can be an Indian or foreign private company) and a government entity relating to various infrastructure projects like urban infrastructure including roads, bridges, highways, airports infrastructure, inland waterways, power infrastructure including power generation, transmission and distribution, water supply and sewerage system etc. The party who is granted the concession is called “the concessionaire”. The concessionaire generally pays either a fixed sum or shares a percentage of revenue with the government and, in return, is assigned exclusive rights to develop, construct, and maintain an area which is subject matter of the Concession Agreement. For example, in a case of Concession Agreement airport projects, if the government executes the Concession Agreement with any private investor, then in such a case the project of development, construction, maintenance of the airport is carried out by the investor and, in turn, the right to collect revenues with a commitment to pay fixed fee or a share which is agreed between the investor and the government. However, while granting the rights of operation of airport activities sensitive activities are reserved by the government such as air traffic management services, communication, navigation surveillance etc.

The nature of the Concession Agreement and the type of concessions varies depending upon the project. With certain variations and combinations in the nature of concession granted by the government, various types of agreements may be crafted. These are Build Own/Operate and Transfer where the developer undertakes to finance, construct, maintain and operate a project for a specified period. During the period of operation the developer will usually charge user charges and transfer the project to a specified government entity after the expiry of the period of operation.

### 2.1 Key features of Concession Agreement

Two "greenfield" projects where the Concession Agreements have already been signed are for the international airports at Bangalore and Hyderabad. The basic provisions of these two agreements, executed within six months of each other are similar. Presently, no "Model Concession Agreement" is announced by

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<sup>3</sup> In July 2005, the Finance Ministry announced the scheme for PPP infrastructure support. Under this scheme, VGF means a one time capital grant or deferred grant provided by the financial institution which funds the PPP project at the stage of project construction with an objective of making it commercially viable.

<sup>4</sup> The Finance Ministry issued guidelines for financial support under the VGF scheme on January 23, 2006. Total project cost means the lower of the total capital cost of the PPP Project: (a) as estimated by the government/statutory entity that owns the project, (b) as sanctioned by the lead financial institution, and (c) as actually expended; but does not include the cost of land incurred by the government/statutory entity.

the GOI for future projects though chances are that the Bangalore and Hyderabad models will serve as a basis for future contracts<sup>5</sup>. The key features of Concession Agreement in brief are discussed below:

- i) **Recognition of Rights:** As per Article 3.2, the concessionaire can develop up to 300 acres land of the airport commercially to generate revenue for non-airport activities. In this 300 acres land the concessionaire is free to set up hotels, malls, Special Economic Zones, manufacturing factories, country clubs, golf courses, power plant etc. Thus, a huge chunk of prime land comes to the concessionaire on a long-term lease, virtually free of cost. Such a long-term lease right allows lucrative options to investors to invest in such projects.
- ii) **Exclusivity:** Article 5.2 insulates the concessionaire against competition by stating that no new airport would be allowed to be set up within 150 kilometre radius for a period of 25 years from the date of airport opening. Further, the GOI ensures that no other airport in India gets any unfair competitive advantage as compared to the Bangalore airport. However, time will tell whether any legal challenges will be raised against this protection against competition.
- iii) **Support:** According to Article 5.4, the GOI will not take any steps which result in its shareholders or lenders being 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 will comply with the agreement as if they are a party thereto and the GOI shall ensure that all statutory permissions required in relation to the project are granted promptly, thereby facilitating expeditious action at government level. This wide support of various government agencies will hopefully, clear the path for obtaining regulatory permission which even in the present liberalized environment can prove to be a tedious process.
- iv) **No Intervention in Construction or Operation:** Under Article 8.14, the GOI commits not to intervene or interrupt in the design, construction, completion, commissioning, maintenance, monitoring or developing of the airport unless it is on account of national emergency or for public safety. If intervention is on account of public safety, it shall be limited in time and for a period to be mutually agreed between the parties. The concessionaire will have complete autonomy to carry out all the operational activities without any government interference.
- v) **Airport Opening:** Pursuant to the Article 7.5, the target date for airport opening is 33 months from the date of financial closure and from this date (i.e. date of airport opening) the concession period starts running. In other infrastructure sectors like roads or ports, the concession period commences from the execution of the agreement. The target date laid under the agreement is the greatest incentive and to put this clause into implementation, coercive measures are laid to ensure timely completion of the project. However, in the aviation sector the provision for delays are less stringent on the concessionaire. If delays can be attributed to the government, the period of 33 months (laid for completion of the project) can be extended by six months which safeguards the investor from any penalties on account of delay in completion of the project.

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<sup>5</sup> <http://civilaviation.nic.in/> visited on January 19, 2008.

## CONCLUSION

India is firmly on the path of privatization in the aviation sector. According to the Committee on Infrastructure<sup>6</sup> which was constituted in 2004, investment of about US \$ 9 billion is expected over the next 5 years, in the development of airport infrastructure. The GOI has also planned the development of other greenfield airports with private sector participation in destinations like Goa, Kerala and in other emerging metros. Slowly, private equity firms are getting lured by investing opportunities in airport infrastructure. However, the government needs to ensure the healthy growth of airlines, together with better aviation services, passenger cargo and infrastructure facilities of global standards. Thus, to meet these obstacles and to accelerate growth, GOI is relying on PPP as without the adequate infrastructure, the projection for growth in this sector will be difficult to achieve.

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<sup>6</sup> The Committee on Infrastructure was constituted on August 31, 2004 under the Chairmanship of the Prime Minister to monitor and ensure airport development around the country.