



# Building the future

**Foreign investors are flocking back to India's once-pariah infrastructure sector. They must tread carefully, but this time the opportunities are real**

*Ben Frumin reports from New Delhi*

**O**ne minute. That's all it took on 15 January for Reliance Power to raise US\$3 billion and fully cover its initial public offering (IPO). By the end of the first day of what easily became India's largest IPO, the company, which plans to develop more than 28,000 MW of power generation capacity in India over the next decade, had received orders for more than 10 times the number of shares it had made available.

"It illustrates a confidence the world investor has in India," said Shardul Thacker, a partner at Mulla & Mulla & Craigie Blunt & Caroe in Mumbai. "It shows the fact that there is now no longer a country risk. All that is behind us, and India is looked upon as a major player for industrial growth and development in the global market."

Akshay Jaitley, a partner at Trilegal in New Delhi, puts it in

even simpler terms: "People can't not be looking at India."

Concerns over investment risks in Indian infrastructure may not have totally disappeared; memories of notable debacles linger in many investors' minds. (Exhibit A: The shutdown and eventual restructuring of the now-infamous US\$3 billion Dabhol power project.) But in spite of these concerns, infrastructure has once again emerged as one of the hottest sectors for foreign investment.

"The sector is key to the success of other sectors and hence is being given a lot of importance by introducing new policy initiatives," says Sunil Seth, a senior partner at Seth Dua & Associates. "Infrastructure is a real priority for the government right now in India," adds Gautam Bhattacharyya of Reed Smith Richards Butler. "Let's face it. The current infrastructure in much of India isn't good

enough. And it's quite clear that they have to have [foreign] investment."

### Throwing open the doors

Faced with this reality, the government has swept away many of the old barriers to foreign investment in infrastructure. There is still much to be done, particularly in sectors such as aviation, telecommunications, broadcasting and atomic energy, but many of the key infrastructure sectors are already open to foreign direct investment (FDI) through the "automatic route".

Under this route, Indian companies can, in certain sectors, issue shares (often up to 100%) of their paid-up share capital to foreigners. No approvals from the government of India or the Reserve Bank of India (RBI) are required. Investors must simply present the necessary documents and forms to the appropriate regional office of the RBI within 30 days of receipt of inward remittances and 30 days of the issue of shares to the foreign investors.

Among the sectors that allow 100% FDI through the automatic route are generation, transmission, distribution and trading of power; construction and maintenance of roads, highways, vehicular bridges, toll roads, vehicular

tunnels, ports and harbours; hotels and tourism; greenfield airports; mass rapid transportation systems; water supply, sewage and municipal services in townships, housing, and construction development projects; oil exploration in both small and medium-sized fields; petroleum product pipelines; and the establishment of special economic zones (SEZs) and free trade warehousing zones.

Also through the automatic route, domestic airlines are 100% open for non-resident Indian investors and capped at 49% for other foreign investors (equity participation by foreign airlines is prohibited); existing airport projects are capped at 74% private ownership; and private sector petroleum refining is uncapped for Indian companies and capped at 26% for public sector undertakings.

Foreign direct investment in most parts of the telecommunications sector is capped at 74%. FDI of up to 49% is allowed through the automatic route but government approval is needed beyond that.

### Regulatory roadblocks

Sectors that are not covered by the automatic route require specific approval from the Foreign Investment Promotion Board and include defence production (FDI is capped at 26%), FM radio (capped at 20%), and the establishment and operation of satellites (capped at 74%). "Regulator requirements (or sectoral policies) prescribed by governing regulators, government departments or the Ministry of Commerce and Industry also apply to certain sectors or types of projects," explains Manisha More, an associate in the energy, infrastructure and project finance team at White & Case in London.

Foremost among these sector-specific regulations are, according to Seth at Seth Dua & Associates, the Ministry of Civil Aviation regulations on greenfield airports; the Mines and Minerals (Development and Regulation) Act, 1957, for mining; the Electricity Act, 2003, for power projects; and the Special Economic Zones Act, 2005, and the Foreign Trade Policy for special economic zones and free trade warehousing zones.

But sector-specific caps and regulations are not the only stumbling blocks.

There are plenty of other legal hurdles relating to land acquisition, obtaining the relevant concessions and contracts for captive raw materials or fuel supply, creating an enforceable security structure, and complying with onerous regional laws, explains Michael McNeill, a partner at Baker & McKenzie. Wong & Leow and co-head of the firm's Asia-Pacific oil and gas group. Developers also have to deal with lacunae in regulations, uncooperative bureaucracy and the slow pace of judicial enforcement.

But as history shows, even the most insurmountable regulatory roadblocks can often be circumvented through the use of creative legal solutions. Back in 1992, in the early stages of India's liberalization, Hutchison Telecommunications overcame the hurdles arising from then-applicable sectoral caps and regulations by structuring its India telecoms venture through layers of holding and subsidiary companies, More explains.

The subsequent sale of Hutchison's stake in the business to Vodafone in 2007 was among India's largest inward investment deals, and just one of a number of recent infrastructure transactions that grabbed the international headlines.



**KEEPING BUSY:** Construction materials are in high demand.

The current infrastructure in much of India isn't good enough.

Gautam Bhattacharyya  
Partner  
Reed Smith Richards  
Butler



### Landmark projects

The scale and number of projects is daunting, says Ravi Bishnoi, a partner at FoxMandal Little. Simply looking at build-operate-transfer road projects, just a sliver of India's infrastructure sector, 82 developments (32 complete, 50 in progress) valued at around US\$5.9 billion, have been awarded through public-private partnerships (PPP), Bishnoi continues.

Contracting and consulting firms from countries as diverse as Turkey, Thailand, South Korea, Russia, Germany, Malaysia and Japan are involved.

Yet even in sectors crowded with groundbreaking infrastructure deals that leap legal hurdles and rewrite precedent, certain projects stand out.

One is the expansion of Mumbai airport. Changes in the law to permit private participation in public-sector projects were needed before it could go ahead. More at White & Case points out that serious concerns of various stakeholders, such as airport employees, had to be addressed, as did land acquisition issues related to the expansion of the facility.

This land acquisition, which included slum clearances, generated much bad publicity, but also drew praise from some who saw the move as necessary and determined. "The way they pushed it through [set] a significant precedent and it is a good precedent," says Jane Niven, regional general counsel for Jones Lang LaSalle. Compare that, Niven says, to the expansion of Delhi's international airport, which remains "a complete and utter nightmare. And because the government won't do what Mumbai did, they will continue to have problems, and it will never get resolved."

Another notable deal was the IPO last year of Power Grid, India's national transmission system for electricity. Rich Baumann of Dorsey & Whitney says the central government let Power Grid go public "because India needs huge amounts of financing for infrastructure, but also needs to spend huge amounts on other things, such as education and healthcare.

"The central government has, in effect, decided that infrastructure must, in many instances, finance itself," Bauman explains, "including through the capital markets, because it can, given the demand for Indian shares."

Proceeds of the Power Grid deal reached US\$738 million, with Dorsey & Whitney acting as international counsel, Amarchand & Mangaldas & Suresh A Shroff & Co as domestic counsel to the issuer and J Sagar Associates as domestic counsel to the banks. "Look to see more capital markets financing of infrastructure in India in the future – electricity generators, airports, and maybe many more assets," Baumann predicts.

Yet another groundbreaking deal was the development

## Structuring for success

Some of the leading law firms for India infrastructure work

### Indian law firms

Amarchand Mangaldas  
AZB & Partners  
DSK Legal  
Economic Laws Practice  
FoxMandal Little  
J Sagar Associates  
Khaitan & Co  
Luthra & Luthra  
Mulla & Mulla  
Nishith Desai Associates  
Seth Dua & Associates  
Titus & Co  
Trilegal

### International law firms

Baker & McKenzie  
Chadbourne & Parke  
Clifford Chance  
Field Fisher Waterhouse  
Fulbright & Jaworski  
Herbert Smith  
Jones Day  
Linklaters  
Milbank Tweed Hadley & McCloy  
Morgan Lewis & Bockius  
Norton Rose  
Pinsent Masons  
Reed Smith Richards Butler  
Slaughter and May  
Thelen Reid Brown Raysman & Steiner  
Vinson & Elkins  
Weil Gotshal & Manges  
White & Case

*NOTE: The above list, which is not exhaustive, is based on the recommendations of corporate counsel and other legal professionals who were interviewed or contacted as part of the research for this story. Each of the firms listed above received several independent endorsements of their work in the Indian infrastructure sector. Firms are listed in alphabetical order.*

several years ago of the first private port in Gujarat. Mulla & Mulla, along with Norton Rose in Singapore, acted for the Port of Singapore Authority, which was a joint venture partner in the project. The result is one of the most sophisticated container handling ports on India's west coast.

Mumbai's mass rapid transport system (MRTS) also stands out, according to Vishnu Sudarsan, a partner at J Sagar Associates, which represented the project's developer.

"The project documents serve as a model template for future MRTS projects to be developed on a PPP basis in the country," he explains. "From a regulatory standpoint, this project is unique and challenging as a robust regulatory framework addressing the operational and management risks and user fare-related issues is yet to be evolved for MRTS projects in India."

Other significant deals include a joint venture between Verizon and Videocon on international and national long distance telecommunication services; a US\$1 billion investment by Emaar Properties of the UAE in a joint venture with MGF for real estate development projects; and the investment by Genting Group of Malaysia in a 355 MW gas-fired power project.

Seth of Seth Dua Associates, one of the law firms that advised on this deal, explains that it "marked a significant move in terms of the involvement of foreign players in the production of power, which has so far been in the hands of the government or a few state-owned public-sector undertakings."

It will be important to choose an Indian partner that has a good ethical reputation.

Bob Nelson

Partner

Thelen Reid Brown Raysman & Steiner



## Lessons from history loom large

Another of India's legendary power projects is, of course, Dabhol. But rather than a cause for celebration, this deal serves as a potent warning of what can go wrong.

The natural gas power plant was shut in 2001 after a payment dispute between majority owner Enron and its only



**BRIDGING THE GAP:** Can infrastructure projects unite the public and private sectors?

customer (and a minority stakeholder), the Maharashtra State Electricity Board (MSEB). When Enron collapsed, General Electric and Bechtel bought Enron's 65% stake and subsequently sold the inactive plant to a group of Indian lenders and the state-run utility. The process involved more than 40 different litigations over four years in five countries, not to mention several international arbitrations.

"The controversy and the problems surrounding this project demonstrated, among other things, the significance of 'cost' and the vulnerability of agreed and executed project documents to subsequent renegotiation," says More at White & Case.

"You do look at Dabhol and try to learn certain lessons from it," adds Kartik Ganapathy of Nishith Desai Associates in Mumbai. "One of these is that the government could come back and renegotiate."

Concrete signs of change exist since Dabhol, however. Jaitley at Trilegal notes that such projects are now being completed with a speed and ease unthinkable in the recent past. "I don't think you're going to get a Dabhol in India again. There's just too much political capital to be lost."

Still, lessons from past deals must be applied to current transactions. "For example, a key lesson from the Dabhol dispute was arguably the importance of being a low-cost service provider, and not relying on a contractual undertaking to enforce pricing which might be too steep for the market to bear," explains Joseph Anderson, the Singapore managing partner of Morrison & Foerster.

### Building strong foundations

The careful structuring of infrastructure projects at the outset is an important step in ensuring that problems don't arise further down the line.

In many cases, having a joint venture with an Indian entity is quite useful, as this partner will "know the ropes" in India and in the state where the project is to be built, says Bob Nelson, a partner at Thelen Reid Brown Raysman & Steiner. "It will be important to choose an Indian partner that has a good ethical reputation ... so as not to run into undue problems with respect to improper payments, and that has a good track record for treating joint venture partners fairly," he continues.

Richard Rogovin, a partner at Frost Brown Todd, suggests that infrastructure projects may be most successful when Indian parties have a controlling interest. This is important, he says, because these projects are locally regulated and designed and "Indian partners in such ventures have a vested interest in the quality of the work and can resist foreign pressure to downgrade materials and workmanship only if they have final approval over such issues."

Nelson adds that if a potential joint venture partner, or one of its affiliates, is also a customer for the project, it is important to ensure that its ownership stake is significant enough to outweigh any conflicting interests it may have as a customer. "In Dabhol, one of the problems was that Maharashtra State Electricity Board's affiliate only owned 14% of the Dabhol project, so MSEB's issues with

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# Advising the investors

## The right mix of local and international advice is crucial

Law firms play a critical role in the structuring and financing of infrastructure projects. But which law firms should investors and developers turn to for advice, and how should they split the work between Indian and international legal advisers?

Manisha More at White & Case notes that the division of roles varies on a case-by-case basis but suggests that international counsel is better suited to advising on issues such as drafting, negotiating and managing project documentation; drafting and negotiating the project financing documents; and reviewing all legal instruments from a bankability perspective without advising on local law issues.

By contrast, Indian law firms typically play a pivotal role in structuring the investment in tandem with FDI norms, advising on all the local laws, obtaining investment approvals and ensuring regulatory compliance, explains Amit Gupta at LexCounsel.

Ravi Bishnoi at FoxMandal Little adds that Indian firms' duties also include giving advice on ascertaining the assets and liabilities of a target company in cases of acquisitions, apprising foreign investors of project risks, suggesting remedial measures to dilute these risks, structuring and negotiating project documentation, apprising foreign investors about practical experiences of carrying out operations in India, and advising investors on required approvals, permissions and tax issues.

International law firms, on the other hand, bring cross-border experience and perspective to the transaction. "Typically, the international firm will be helping the client to set the overall template for the development and financing of the project," says Bob Nelson at Thelen Reid Brown Raysman & Steiner, noting that international and domestic firms must be able to work together seamlessly.

However, the "domestic firm is the entity on the ground which actually implements the structure and

the proposed strategy from a legal and regulatory compliance perspective," says Gupta. "Further, with the opening of the Indian economy and increasing number of foreign investments, domestic law firms are well equipped to single-handedly structure, set up and manage infrastructure projects."

Akshay Jaitley of Trilegal believes that the role of international law firms in infrastructure projects has diminished. He notes that large foreign firms are often retained as an "insurance policy" on huge projects, but that increasingly they are being passed over for local outfits. "It's because we are just better than we used to be," he says. "We are better and we are cheaper."

Jaitley even recounts examples of international firms getting more India-related work recently only "because the Indian law firms are too busy [to take the work on]. That is quite remarkable."

Some international clients, however, aren't ready to count on Indian law firms for all aspects of their infrastructure work just yet. Jane Niven, regional general counsel at Jones Lang LaSalle, speaks of a continuing struggle to find Indian law firms with a commercial bent and sufficient experience to handle these sorts of deals.

"One of the biggest issues I have with Indian law firms is that they still operate as if it's the first half of the twentieth century," she says. "They're incredibly legalistic. They're incredibly focused on the law and they don't have a commercial bent at all. And as a result, I've been quite disappointed with the way deals had been done."

There are bright spots though, even for Niven. She names three Indian law firms whose work she has been quite pleased with: AZB & Partners, Titus & Co and Trilegal.

*(For more firms that have been recognized as leaders for infrastructure work, see Structuring for success on page 15.)*

electricity pricing trumped its concerns for the profitability of its investment in the project," he explains.

Tax is another key consideration in the structuring of any infrastructure project and it is beneficial if the jurisdiction through which the investment is made has a favourable double taxation avoidance treaty with India. "Mauritius is the most time-tested route, although some investments are now being routed through Cyprus as well as through Singapore," says Nelson.

"Under the India-Mauritius Tax Treaty, all capital gains realized in India by a Mauritius resident company are exempt from taxation in India," explains Thacker at Mulla & Mulla. "Since Mauritius does not levy any tax on capital gains, this is a very useful way of eliminating capital gains taxes in India and Mauritius."

The chain of ownership above Mauritius (or another entry point into India) depends on both tax and corporate

considerations that are based in part on the home jurisdiction of the ultimate owner, as well as where the owner intends to keep and deploy profits from the infrastructure investment, adds Nelson.

### Avoiding disputes

In a complex infrastructure project with several stakeholders, a number of difficulties and disagreements might arise. These commonly include funding disputes, a divergence of business policies and practices between the partners, or a decline in the interest or priority accorded to the project by one or more partners, warns More at White & Case.

Serious disagreements might lead to deadlocks, which could be headed off by including provisions for "put and call" options, or provisions for arbitration and buyouts in the original agreement, adds More.

**I don't think you're going to get a Dabhol in India again.**

Akshay Jaitley  
Partner  
Trilegal



Amit Gupta, a senior associate with LexCounsel in New Delhi, believes that the chances of disputes between joint venture partners can be significantly reduced by structuring the shareholders' agreement in a way that gives the foreign investor appropriate representation on the board of the joint venture, and requiring that this representation is mandatory for the formation of a quorum of directors and shareholders during meetings.

It is also important that all parties have a thorough understanding of their respective functions and obligations

from the outset. "A clear allocation of roles and responsibilities is of utmost significance, and the reciprocal rights and obligations of the parties should be clearly articulated in the project documents," says Sudarsan at J Sagar Associates.

But as is true of all business ventures, investors are wise to plan for the worst from the start. Sujain Talwar, a partner at Economic Laws Practice in Mumbai, stresses that overseas arbitration provisions are a vital component of any joint venture agreement. In the event of a dispute, these will enable the parties to avoid the paralyzing delays that commonly afflict cases brought before the Indian courts.

### Different perceptions

Aside from worrying about regulatory compliance, corporate structuring and potential disputes, investors must be mindful of differences in public and state government perceptions of privately financed infrastructure projects.

It is critical, says Nelson, to create a sense within the community that a project is acceptable. "Typically, there are various parties that will be adversely affected by development of an infrastructure project, or at least fear that they might be. It is important to ... develop programs at grassroots and higher levels in order to address those concerns."

This is especially important because infrastructure projects are particularly susceptible to injunction applications by environmentalists or competitors. "Every developer then needs to take the constant time implication of

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these interruptions into account and strategize on the means to either avoid or mitigate the risks,” says Talwar.

Niven at Jones Lang LaSalle has noticed that perceptions of private infrastructure projects often differ between one part of India and another.

“If you’re in Delhi, I think it’s very much [believed that] public-facing infrastructure must be the domain of government,” she says. “But if you are in Bangalore or Mumbai or Hyderabad, that’s not the attitude at all. It’s where can we partner with private investors to get this through as soon as possible.”

But attitudes are changing. “Outside of Delhi, there is a growing recognition that the government doesn’t have the strength to be able to push some of these infrastructure projects through,” continues Niven.

And even within the government, there is a growing consensus that its role in infrastructure should be one of facilitator rather than leader. Dr Montek Singh Ahluwalia, vice-chair of the Planning Commission of India, recently told *India Business Law Journal* that the role of the government in developing the economy “is increasingly that of a referee”, except in sectors like health, education and railways.

**Opportunities beckon**

This change in attitude is not only welcome but also necessary if India is to succeed in developing the infrastructure that will be so vital in supporting and driving its economic growth.

Outside of Delhi, there is a growing recognition that the government doesn’t have the strength to be able to push some of these infrastructure projects through.

Jane Niven  
Regional General Counsel  
Jones Lang LaSalle



Roads alone require investment of about US\$48 billion, says Bishnoi at FoxMandal Little, while airports need some US\$9.1 billion, ports US\$12.2 billion and power generation US\$132 billion. Indeed, there are plans in the pipeline for coal-based ultra mega power projects that would each generate at least 4,000 MW. These will be awarded to

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**STUCK IN TRAFFIC:** Will public-private partnerships get things moving?

developers through competitive bidding.

The golden quadrilateral (nearly 5,900 kilometres of roads linking Delhi, Mumbai, Calcutta and Chennai), still requires huge cash flows, Bishnoi adds, as does a 7,300-kilometre road project linking Srinigar to Kanyakumari and Silchar to Porbander.

Private consortia are already building new international airports in Bangalore and Hyderabad, with a total investment of about US\$600 million. Bishnoi says 25 other city airports are being considered for private investment, adding that with a total investment of US\$9 billion needed for airport developments over the next five years alone, "there is potential growth with regard to airports and prospects for future investors".

Ports also represent a significant opportunity for savvy international investors. "It's an area that is seriously underdeveloped and all the land around the ports would be very attractive for logistics companies," says Niven.

Acutely aware of the pressing need to upgrade India's creaking infrastructure, the government has set ambitious targets for investment. Bishnoi notes that these include plans to increase infrastructure development spending from 5% to 9% of the country's GDP, a move that holds much promise for prospective investors.

But if any of those investors remain deterred by the horror stories of yesteryear and are seeking a way to hedge their risks, Nelson at Thelen Reid might have a solution: "Combining infrastructure investment with real estate investment, whether through the development of SEZs or otherwise, can be a good way ... of mitigating risks across sectors and delivering projects that have broad-based appeal," he explains.

"Returns may also increase once greater leverage is allowed through the increased use of foreign debt, which is much more cheaply priced than Indian debt." ■

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