

Public -Private Partnership viz-a viz Companies Act, 2013

Dr.Rajinder Kaur
Assistant Professor,
Department of Law,
Panjab University,
Chandigarh

Anudeep Kaur
Research Scholar
Department of Law
Panjab University
Chandigarh.

Abstract

According to World Bank there is no broad international consensus on what constitutes a public-private partnership (PPP or P3). Broadly, PPP refers to arrangements, typically medium to long term, between the public and private sectors whereby some of the services that fall under the responsibilities of the public sector are provided by the private sector, with clear agreement on shared objectives for delivery of public infrastructure and/ or public services. The Government of India defines a P3 as "a partnership between a public sector entity (sponsoring authority) and a private sector entity (a legal entity in which 51% or more of equity is with the private partner/s) for the creation and/or management of infrastructure for public purpose for a specified period of time (concession period) on commercial terms and in which the private partner has been procured through a transparent and open procurement system. In the developing economies like India where infrastructure demand is more than the availability and the government are unable to fill the gap between the same. To fill this gap and meet the demand of infrastructure the government has adopted the scheme of "Public-Private Partnership" scheme or P3 option. The P3 concept is not only emerging as the first choice to Indian government but it is world widely preference for all the infrastructure development projects, especially in roads & highway development. The Government awards the project of specific contracts to bidders on the basis of their eligibility requirements, terms and conditions. The first part of the paper discusses the concept of P3. Second Part of the paper focuses on one of the basic conditions i.e. Special Purpose Vehicle ('SPV') which is floated by the Companies for domicile purposes and to execute such project. The second paper of the paper takes into consideration the analytical study of Section 295 of the Companies Act, 1956 and the new provision i.e. Section 185 the Companies Act, 2013 which was notified w.e.f. September 12, 2013 with special reference to Public-Private

Partnership.. While concluding the paper the fact is critically analysed that whether the new Companies Act, 2013 is emerging as PPP friendly or not.

Key Words: Public-Private Partnership, Companies Act 2013, Section 186, Section 295, Companies Act, 1956.

Introduction

Public Private Partnership means an arrangement between a government / statutory entity / government owned entity on one side and a private sector entity on the other, for the provision of public assets and/or public services, through investments being made and/or management being undertaken by the private sector entity, for a specified period of time, where there is well defined allocation of risk between the private sector and the public entity and the private entity receives performance linked payments that conform (or are benchmarked) to specified and pre-determined performance standards, measurable by the public entity or its representative.¹ These schemes are sometimes referred to as PPP, P3 or P3.

Reasons for Public Private Partnership

A wave of privatization and deregulation has been sweeping infrastructural sector around globe over the last decade or so.² Public Private Partnership offers a win-win-win solution for the public sector, the private sector and members of the public.

PPP allows Government to tap on to the private sector's capacity to innovate. Public Private Partnership offers more business opportunities to the private sector. The private sector will be engaged to deliver a full suite of services (e.g. design, construction, operations and maintenance) which were traditionally performed in-house by public agencies or performed by multiple private companies.³

¹<http://www.pppinindia.com/Defining-PPP.php>

² Raj Kapila and Uma Kapila (eds.), India's economy in 21st century: a collection of select articles 319(Academic Foundation, New Delhi, 2ndedn, 2002)

³ Public Private Partnership Handbook By Ministry of Finance, Government of Singapore please refer <http://app.mof.gov.sg/data/cmsresource/PPP/Public%20Private%20Partnership%20Handbook%20.pdf>

It is generally recognized that Public private partnership programme offer a long term, sustainable approach to improving social infrastructure, enhancing the value of public assets and making better use of tax payer's money.⁴

TYPES OF PPP MODEL

1. ***Design Build (DB)***: Where Private sector designs and constructs at a fixed price and transfers the facility.
2. ***Build Transfer Operate (BTO)***: Where Private sector designs and builds the facility. The transfer to the public owner takes place at the conclusion of construction. Concessionaire is given the right to operate and get the return on investment
3. ***Build-Own-Operate (BOO)***: A contractual arrangement whereby a Developer is authorized to finance, construct, own, operate and maintain an Infrastructure or Development facility from which the Developer is allowed to recover his total investment by collecting user levies from facility users. Under this Project, the Developer owns the assets of the facility and may choose to assign its operation and maintenance to a facility operator. The Transfer of the facility to the Government, Government Agency or the Local Authority is not envisaged in this structure; however, the Government may terminate its obligations after specified time period.
4. ***Design-Build Operate (DBO)***: Where the ownership is involved in private hands and a single contract is let out for design construction and operation of the infrastructure project.
5. ***Design Build Finance Operate (DBFO)***: With the design–build–finance–operate (DBFO) approach, the responsibilities for designing, building, financing, and

⁴AkintolaAkintoye, Matthias Beck, *et.al.* (eds.),Public Private Partnership:Managing Risk and Opportunities 3,(Blackwell Science Ltd., U.K, 2003)

operating & maintaining, are bundled together and transferred to private sector partners. DBFO arrangements vary greatly in terms of the degree of financial responsibility that is transferred to the private partner

6. **Build- Operate- Transfer (BOT):** Annuity/Shadow User Charge : In this BOT Arrangement, private partner does not collect any charges from the users. His return on total investment is paid to him by public authority through annual payments (annuity) for which he bids. Other option is that the private developer gets paid based on the usage of the created facility.⁵

The Public Private Partnership legal construction can cover three types of arrangements.

- Firstly, it can be used to introduce private-sector ownership into state-owned businesses through a public listing or the introduction of an equity partner.
- Secondly, it can become a private finance initiative, where the government takes advantage of private-sector management skills by awarding long-term franchises to a private-sector partner, which assumes the responsibility for constructing and maintaining the infrastructure and for providing the public service.
- Thirdly, it can cover the selling of government services to private-sector partners, which can better exploit the commercial potential of public assets.

In these three arrangements, the private-sector consortium typically forms a special company—called a ‘special purpose vehicle’ (SPV)—to develop, build, maintain, and operate the assets for the contracted period. In cases where the government has invested in the project, it is usually—but not always—allotted an equity share in the SPV. Within the Public Private Partnership, it is the SPV that signs the contract with the government and with subcontractors to build the facility and then maintain it. SPV provides a good framework for raising funds, linking participants legally and assuring supply, production and marketing of products. SPV brings together various parties like lenders, financial institutions, public sector and export credit agencies, suppliers and off-takers. There is often a lack of precedents to identify attributes of a SPV and the process is further hampered by undeveloped financial and

⁵<http://swapsushias.blogspot.in/2013/09/types-of-public-private-partnership.html#.VAN0gXojb1U>

legal structures of a country. Thus, there is a need to establish clear attributes for a SPV to raise the funding options of PPPs.⁶

COMPANIES ACT, 2013

There are different perspectives of the Companies Act, 2013 are emerging from various quarters since its notification in the Gazette. Section 185 of the Companies Act 2013, which came into effect on 12 September 2013 and repealed Section 295 of the Companies Act, 1956, has turned the nice, cozy world upside down. To start with, Section 185 applies to private companies and not just public companies. Application of Section 185 to private companies is in line with the 2013 Act's policy of whittling away the distinction between public and private companies. However, Section 185 doesn't stop at that. Unlike Section 295 of the 1956 Act which only required companies to obtain the central government's approval for loans to their directors or Entities of Interest (the list of Entities of Interest hasn't undergone any change) or for providing security in respect of such loans, Section 185 of the 2013 Act contains an express prohibition on such loan transactions which cannot be overcome with a government approval, cumbersome and time consuming though such approval might have been.⁷

ANALYSING SECTION 185 OF COMPANIES ACT 2013

Section 185 is a prohibitory provision and is mandatory in character, which is evident from the negative words 'no company shall'. It is well settled that when a statute is couched in negative language it is ordinarily regarded as peremptory and mandatory in nature.⁸ As stated by Crawford "Prohibitive or negative words can rarely, if ever, be directory. And this is so even though the statute provides no penalty for disobedience."⁹ In *Mannalal Khetan v. Kedar Nath Khetan*¹⁰ (SC), the Supreme Court has held (concerning Section 108 of Companies Act 1956) that the words "shall not ..." are mandatory in character. Negative,

⁶Special Purpose Vehicle (SPV) of Public Private Partnership Projects in Asia and Mediterranean Middle East: Trends and Techniques, Article provided by Faculty of Economics and Administration, University of Malaya in its journal International Journal of Institutions and Economies please refer <http://ideas.repec.org/a/umk/journl/v2y2010i1p64-88.html>

⁷ Please refer <http://www.livelaw.in/secured-bank-loans-subsidiaries-made-difficult-new-companies-act-2013/>

⁸Principle Of Statutory Interpretation by justice G. P. Singh 11th edition, 2008 pages 390 to 392

⁹Vijay Narayan Thatte v. State of Maharashtra 2009 AIR SCW 53153

¹⁰ (1977) 47 Comp Cas 185

prohibitory and exclusive words are indicative of the legislative intent when the statute is mandatory. Negative words are clearly prohibitory and are ordinarily used as a legislative device to make a statutory provision imperative. The words "shall not register" (in section 108 of the Companies Act) are mandatory in character. The mandatory character is strengthened by the negative form of the language.¹¹

Section 185 applies only when any company (public or private) proposes to give a loan to any of the parties mentioned in the Explanation appended to that section, or when a company proposes to provide a guarantee or security in connection with a loan, on behalf of any of the parties mentioned in the said Explanation. The section completely prohibits such loans, guarantees and securities and no company can give such loans and provide such securities even with the approval of members of the company or the Central Government. As noted before, subsection (1) prohibits any company, directly or indirectly advancing a loan or providing any guarantee or security in connection with any loan, to any of its directors or to any other person in whom the director is interested or give any taken by him or such other person. The expression 'to any other person in whom director is interested' is defined in the Explanation below subsection (1). Accordingly, the prohibition contained in subsection (1) will apply to a loan/guarantee/security give by a company ('the lending company') to any of the following parties and, therefore, a company cannot give any loan/guarantee/security to any of these parties, despite that the lending company may be able to give loan/guarantee/security to any of these parties under section 186 since, as will be noted below, this section shall prevail over section 186.¹²

- (1) any director of the lending company;
- (2) any director of the holding company of the lending company;
- (3) any partner of any director of the lending company;
- (4) any partner of any director of the holding company
- (5) any relative of any director of the lending company;
- (6) any relative of any director of the holding company;

¹¹ A Concise Analysis of Section 185 of Companies Act 2013 By Dr K. R. Chandratre in Chartered secretary- The Journal for Corporate Professional Vol XLIV Aug 2014.

¹² Ibid

- (7) any firm in which any director of the lending company is a partner
- (8) any firm in which any director of the holding company of the lending company is a partner;
- (9) any firm in which any relative of a director of the lending company is a partner
- (10) any firm in which any relative of a director of the holding company of the lending company is a partner
- (11) any private company of which any director of the lending company is director;
- (12) any private company of which any director of the lending company is a member;
- (13) any private company of which any director of the holding company of the lending company is director
- (14) any private company of which any director of the holding company of the lending company is a member;
- (15) anybody corporate at a general meeting of which 25% of more of the total voting power is exercised or controlled by any director of the lending company;
- (16) anybody corporate at a general meeting of which 25% of more of the total voting power is exercised or controlled by two or more such directors of the lending company, together
- (17) anybody corporate at a general meeting of which 25% of more of the total voting power is exercised or controlled by any director of the holding company of the lending company;
- (18) anybody corporate at a general meeting of which 25% of more of the total voting power is exercised or controlled by two or more directors of the holding company of the lending company, together;
- (19) anybody corporate, the Board of directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.¹³

COMPANIES ACT, 2013 AND PUBLIC PRIVATE PARTNERSHIP

¹³ Ibid

Today most of the work in infrastructure development is carried out on a Public Private Partnership (PPP) platform, especially in roads & highway development. Under this model the clients which are usually Government Entities (eg. NHAI, MSRDC, PWD, State Governments or Municipalities etc) award project specific contracts to bidders based on certain eligibility requirements, terms and conditions. One of such conditions is to float a Special Purpose Vehicle ('SPV') to domicile and execute such project. Thus in last few years, most of the infrastructure companies had floated many such SPVs. Generally, the Company to which bid is awarded ("the Promoter" or "the Holding Company") floats such SPVs and exercises control & direction over it. Such SPVs can be either subsidiaries or joint ventures of the Promoters.¹⁴

Infrastructure development is highly capital intensive business with a long gestation period to recover the cost of the project. To fund the Project cost, such SPV borrows substantially from Financial Institutions/ Banks. The project funding is available for the period of 15 to 17 years and repayment of project loans are ballooning in nature. There are three aspects of such infrastructure funding:

- Under the Project funding arrangement, larger part of the Project Cost is funded by the Banks/ FI with a reciprocal obligation on the Promoter/s to fund the remaining part of the Project Cost, by way of equity. Such equity infusion can be by way of equity share capital and sub-debt or quasi-debt which is unsecured interest free loan repayable only after complete repayment of Project loans from Lenders i.e. Banks .
- The Lenders also seek guarantees for termination payments and in some cases shortfall guarantees, from the Promoter/s.
- The Lenders have a charge on the Project documents and toll rights and the Promoter/s also pledge their holding in the SPVs with the Lenders.

Section 295 of old Act Versus Section 185 of New Act

The erstwhile section 295 of the Companies Act, 1956 prevented Companies from giving loans; guarantees; securities to Directors of lending company and also to certain entities in which such Directors are interested. However such prevention was not applicable

¹⁴ Construction Federation of India(CFI) representation: "Request to Exempt Applicability of Section 185 of the New Cos. Act on `Loans by the Holding Co. for benefit of SPVs available under 1956 Companies Act" to Ministry of Corporate Affairs ,16.12.2013.

to giving of loans by a Bidding Holding Company to its subsidiaries (ie. SPV) includes providing guarantee or security for the subsidiaries. Thus, Section 295 enabled successful bidders to extend the much needed financial support to its own project housed in its subsidiary SPV Company.¹⁵

Section 185 the Companies Act, 2013 which was notified w.e.f. September 12, 2013, does not provide for such exemption. Additionally, it requires that:

- such loans can be given to the SPVs only if they are in the ordinary course of business of the Promoter/s and it shall be given at a Bank Rate (of RBI);
- such guarantee or securities can only be given on behalf of the SPVs to the Lenders of the SPVs, if they are in the ordinary course of business of the Promoter/s.

In case of highway projects implemented through the Public Private Partnership route, the infrastructure company that is awarded the project through the bidding process needs to float a Special Purpose Vehicle for execution. The SPV is either a subsidiary or joint venture of the holding company. To fund project cost, the SPV borrows from banks and financial institutions. Generally, project funding is available for a period of 15 to 17 years¹⁶.

Under present project funding arrangements, a large part of the project cost is funded by banks and financial institutions. The holding company awarded the project has to fund the rest of the project cost by way of equity. Such equity infusion can be through equity share capital and sub-debt or quasi-debt which is unsecured interest free loan repayable only after complete repayment of project loans from lenders. Guarantees for termination payments, and in some cases shortfall guarantees, also have to be provided to the lenders. The right on project documents as well as toll rests with lenders. Besides, the holding company has to pledge its holding in the SPV with lenders.¹⁷

Highway developers point out that it will be impossible for the SPVs floated for the purpose of executing highway projects to pay interest on the loans advanced by their holding

¹⁵ Ibid

¹⁶ Highway developers: <http://www.projectsmonitor.com/pm-specials/infrastructure/highway-developers-seek-changes-in-new-companies-act/> as accessed on 14 Aug 2014

¹⁷ Ibid

companies at bank rate, as stipulated in section 185 of the Companies Act, 2013, over and above the interest payable to banks for the loans advanced.¹⁸

CONCLUSION

Infrastructure Projects, in addition to being highly capital intensive, are also long gestation in nature and returns are largely skewed towards later years of the Project. The SPVs, being newly formed entities, are not in a position to bear the cost of loans given by the Promoter/s at a Bank Rate, over and above the service of project loans given by the Lenders. Also, the Lenders do not allow charging of interest on such loans extended by the Promoter/s to the SPVs. Further, it is pertinent to note that Companies Act. 2013, has been enacted for furtherance of legitimate needs of evolving business models of Corporate India. The successful Bidder does not float the subsidiary SPV Company for the Project, by choice. It is compelled by bid conditions to float a SPV subsidiary for execution of the Infrastructure Project. Had it not been for such compulsion, the Bidder / Holding Company would have treated the Project as its division and the funds it would infuse by way of loans or guarantees/securities provided for the Project would not have faced the rigour of sec 185 of Companies Act. 2013.¹⁹

This certainly appears to be an inadvertent consequence of section 185 not enabling the successful bidder to provide the much required financial support for its own Project that is compulsorily housed in its subsidiary. This difficulty can be overcome by providing concession to the infrastructure sector from the compliance of Section 185 of the Companies Act, 2013 by reinstating in section 185 the exemption provided under the erstwhile Section 295 of the Companies Act, 1956; ie. Loans given by the Holding Company to subsidiaries or securities/guarantees provided for the benefit of the subsidiaries should be exempted from applicability of Section 185.²⁰ The National Highways Builders Federation has suggested amending the Companies Act, 2013, so that in case of the infrastructure sector, loans advanced by a holding company to its subsidiary companies as well as guarantees and securities provided by the holding company in respect of loans advanced to its subsidiary companies don't come under the purview of section 185 of the Act.²¹

¹⁸ Ibid

¹⁹ Supra note 14

²⁰ Supra note 14

²¹ Supra note 16

In the case of private companies section 185 is acting as an unduly harsh and impractical statutory prohibition and would have the effect of stifling business growth in the country since it is unavoidable that a company funds a new project undertaken by an independent company incorporated as an associate company and banks are not ready to provide funds unless a corporate guarantee or security is provided by a parent or group company. Genuine difficulties in the implementation of the new Act should be brought to the notice of the government and one hope that the government would be receptive and introduce necessary changes.²²

²² Supra note 10