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Analysis

M&A Considerations for Roads Secondaries in India | Beyond Traffic and Concession Life



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Key Takeaways

- Roads secondaries in India no longer dependant on traffic projections and residual concession life
- Asset-level fundamentals are now front and centre – i.e., award process (bid v. direct), return profile, ABAC compliances at the time of award, state guarantee
- Most assets carry live claims/ counterclaims against authorities – so, a tax-efficient, regulatorily compliant pass-through structure to the seller is key
- Diligence should examine hidden expropriation risks carefully, since termination compensation under concessions may fall significantly short of expected equity IRRs
- Contractual protections for competing roads and additional highways are rather limited; diligence will need to go beyond a standard 3-year lookback
- Standard W&I will not always hold – award-stage issues (Noida Toll Bridge being the cautionary tale) and expropriation risks surface years later; so, state and early NHAI concessions need contingent risk cover
- InvIT acquirers cannot refinance SPV-level debt in a hassle free manner unless InvIT-level financing is locked in prior to the secondary

In March, Vinci agreed to acquire Macquarie's toll roads platform for ~$1.7 billion, marking its return to the Indian market after more than a decade. This is not a one-off trade – the secondary market for road assets has been active for a while. Last year, KKR-backed Vertis Infrastructure Trust acquired 12 road projects for ~$1.1 billion. Other investors like Brookfield, NIIF, Cube Highways and Edelweiss have all been active on one side of the table or the other. At the same time, developers too have been looking to monetize assets and redeploying capital into newer projects.

As the market deepens, it is important to recognise that a secondary road transaction in India is more than just buying an operating asset. Buyers anchor on what they can see – traffic projections, toll collections, residual concession life – and treat the rest as standard infra M&A. It is not. Each asset carries its own backlog of claims, expropriation exposure, potential competing road issues and structural quirks that a standard DD will not identify.

In this piece, we highlight 6 key considerations which buyers should keep in mind before proceeding with a road acquisition.

Begin Diligence with Bid Level Fundamentals (incl. ABAC), not Toll Collection

One of the first places to start is to examine if there are any issues with the underlying concession. This would entail going back to how the project was awarded, whether a proper bidding process was followed, whether the authority had the necessary statutory powers, whether the concession terms were defensible from a public law perspective, and whether there were any ABAC allegations at the time of award. If something surfaces later on these aspects, the risk is that of losing the concession itself.

To note, this risk is not theoretical. The Noida Toll Bridge/ DND Flyway dispute is a useful reminder of how concession-related issues can surface long after. Briefly, the concession had been granted to Noida Toll Bridge Company Limited for the Delhi-Noida direct flyway. Here, the Supreme Court restrained further toll collection and held, among other things, that aspects of the concession were contrary to public interest on account of the absence of competitive bidding and an unfair toll recovery mechanism. Our detailed analysis of this case here.

Even setting aside the highly contextual facts of Noida Toll Bridge case, the broader lesson is important – irregularities at the time of award could have consequences many years later, particularly if public interest is involved. This is further compounded by the fact that the compensation frameworks under most concession agreements do not align with equity return expectations and, in any event, will never reflect the price paid by a secondary acquirer for the asset.

That said, this risk tends to be higher in older state-level concessions and some early NHAI projects, which were awarded when the procurement frameworks were still evolving. In many such cases, the process followed at the time may not meet today's standards/ expectations, even if it was considered acceptable at the time.

But that does not mean that these assets should be avoided – if anything, they could end up being bargain opportunities. What it does mean is that buyers will need to look beyond the

awarded, the authority's statutory powers, the return profile (evergreening return structure or not), historic challenges and risk mitigants. Acquirers may also have to go beyond a standard W&I policy by seeking specific cover for concession-related issues or by appropriately pricing in the uncertainty upfront.

Careful Pass-Through Structuring of Historical Claims

Most road assets are usually in the midst of a host of claims against the concessioning authority – change in law, delayed land acquisition, force majeure (e.g. Covid-19), competing roads etc. Some claims may be paid out in cash, while others may be compensated through an extension of the concession period. Considering the inherent uncertainty involving these claims, buyers are keen to avoid the hassle of assessing and valuing each claim. To that end, these claims are set aside and are to the seller's account.

The NHAI, however, has this requirement that during divestments, all claims must be completely passed to the buyer, and the seller must have no "residual rights" over these.[1] Considering this diktat, it becomes critical to carefully structure these claims (from a tax and regulatory perspective) to ensure a commercial flow back of all benefits/ liabilities to the seller. Parties typically address this on 2 fronts – control of the claim and transfer of its economic benefit.

On control of the claim, parties generally agree that while the buyer runs the claim, the seller continues to receive all material information and also retains the ability to provide strategic inputs which the buyer must consider.

On the economic transfer, this is typically done in the form of cash-based purchase price adjustment or through use of bespoke instruments which accrue value only upon the crystallization of claims (along with a built-in put option). Cash claims are typically transferred back-to-back to the seller. Concession period extensions are harder, since the benefit accrues to the SPV over time. Parties usually either agree on a lump sum payment once the extension is granted (calculated as the present value of the expected cash surplus which will accrue to the SPV during such extended period), or alternatively provide for periodic payments tracking the additional revenue generated over the extended period. Equally, parties explore escrow arrangements if the claims against the seller are far more significant than those the other way around.

Hidden Expropriation Risk – Managing the Unknown

There are two sides to expropriation risk, and buyers usually focus on only one. The visible side is straightforward – review the concessionaire's track record, look for defaults, recurring O&M issues or termination notices, and assess whether the authority could take the asset back. The less obvious side is harder to spot – the authority may already be considering termination of the concession for economic or political reasons, reclaiming the road, and building a larger one in its place. For an incoming buyer, this is where real value can be lost.

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[1] NHAI Policy Circular No. 8.4.38/ 2023 dated 13 February 2023.

Yes – termination compensation is still payable by the authority in these cases. However, the catch is that such compensation may not even match the acquisition equity value in many cases, particularly when a significant portion of the concession life has already run. Therefore, buyers need to manage this by focussing on 3 things: negotiate limited time contractual protections against the seller regarding the life of the concession, engage directly with the concessioning authority to understand what is developing on the ground, and undertake forensic due diligence to assess how likely the risk really is.

Competing Roads and Additional Tollway – What are the DD Focal Points?

Possibility of competing road networks coming up is particularly relevant in India. While concession agreements do include protections against competing roads and additional tollways, these are often limited in scope and duration. For example, in BOT projects, restrictions on the government developing competing roads typically apply only for a defined period (often 10 years from the appointed date), after which the protection falls away. In the TOT space, while the restriction is throughout the concession term, the compensation is limited to concession extension and granted only if the toll collection falls short of the target figures on certain testing dates.

Given this, diligence will need to go beyond the standard 3-year lookback that buyers typically undertake. It is important to review historical correspondence between the SPV and the authority, board papers, and any available NHAI records or policy decisions. In many cases, early indications of competing developments or requests for approvals may sit in documents that are several years old and not immediately visible in a standard data room review. Claiming compensation could be challenging in these cases since such developments are considered as publicly available information at the time of awarding the concession which have to be factored in by the concessionaire.

That said, while contractual protections may be limited, the few cases that have been litigated on this issue offer some comfort. Courts and arbitral tribunals have taken concessionaire-friendly views, construing concession agreements purposively. The reasoning is that the underlying commercial bargain in a road concession assumes that there will be traffic on the road. Where an act of the government compromises this expectation, courts/ tribunals have looked at the contractual protections more purposively and granted relief to the concessionaire even where the authority's conduct did not strictly fall within the contours of the contractual protections.[2]

W&I Insurance – Bespoke Cover makes way for Standard Policy

Many of the considerations mentioned above may not always be covered by an off-the-shelf insurance solution. A standard W&I policy in an Indian M&A context is built for general representations on title, authority, financials, tax, contracts and the like. It is not, by design, intended to cover known risks or sector-specific concerns of the like that arise in a road secondary trade.

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[2] For instance, in NHAI v. IRB Ahmedabad Vadodra Super Express Tollways Pvt. Ltd., the arbitral tribunal considered whether the end points of a competing road must coincide with the end points of the project highway for it to qualify as a "competing road". The tribunal held – a view subsequently upheld by the high court – that the "end points" should be construed broadly as the cities being connected (here, Ahmedabad and Vadodra), rather than specific chainage points. Similarly, in NHAI v. GMR Ambala Chandigarh Expressways Private Limited & Anr., the court ruled in the concessionaire's favour that strengthening an existing peripheral road (thereby making it viable for commercial traffic) created an alternate route, resulting in a diversion of traffic from the project highway and affecting toll revenue.

Take concession validity. This risk is prevalent in older assets where there are residual concerns about the manner of award or where there have been serious ABAC allegations. One way of having this risk addressed is to obtain a forward-looking representation regarding the concession surviving its residual life and back it up with corresponding indemnities. However, this may not be very straightforward since sellers (especially financial investors) are reluctant to give such forward looking representations and indemnities.

Therefore, a separate contingent risk policy may have to be explored in high-risk scenarios. This is basically cover for an identified risk where the insurer takes a view on the specific facts after doing their own diligence and prices the policy accordingly. For a sufficiently large acquisition, acquirers may have no other option but to take on the cost of additional cover instead of exposing themselves to the risk of losing concessions. Using bespoke insurance in a competitive bid process (which is how most assets are sold) could eventually be the difference between a winning and losing the asset.

InvIT Acquirers: Refinance SPV Debt at Closing and not Post-Closing

A key consideration for InvITs acquiring assets through secondaries is the mechanism of retiring external debt at the SPV level. The commercial rationale is fairly straightforward – InvITs backed by strong sponsors can typically access cheaper financing than a standalone SPV. By raising debt at the trust level and downstreaming it to the SPV, the InvIT could replace SPV borrowings with cheaper trust-level financing. This in turn facilitates greater equity returns by allowing unitholders to access the spread.

Practically, however, there could be a timing mismatch in fast paced trades. Existing SPV lenders generally require repayment at closing, while the InvIT may not have fully tied up its own financing by that point. The straightforward solution is to have the InvIT deploy unitholder funds into the SPV, use those proceeds to retire the SPV's external borrowings, and become the sole lender. Once InvIT-level financing is secured, the trust could then downstream external debt into the SPV, which in turn would repay the InvIT.

This, however, runs into a regulatory restriction. InvIT regulations prohibit distributions to unitholders that are funded by external debt.[3] In the above case, while cash is technically fungible, one could still argue that any funds ultimately reaching unitholders are indirectly sourced from borrowed money.

Notably, this constraint is unique to InvITs – a conventional acquirer would not face a similar limitation and could refinance more freely. Therefore, in fast paced bids, InvIT acquirers should plan around this restriction by either tying up InvIT level financing in parallel (to be drawn down on closing) or obtain lender approval to continue the facility for a defined period post-closing after which it can be refinanced directly with InvIT-level debt.

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[3] The 'framework for calculation of net distributable cash flows' in the InvIT Master Circular states the following – "*Further, it is expressly provided that no Trust or SPVs can distribute any cashflows by obtaining external debt, except to the extent clarified in note 2 and 7 (this will exclude any working capital / OD facilities obtained by Trust/ SPVs as part of Treasury management / working capital purposes as long as they are squared off within the quarter).*"

Conclusion

The Indian roads secondary market will get busier. But the deeper point here is that the assets being traded are heterogeneous in a way the M&A playbook is not yet pricing. The next material losses in this market may not come from getting traffic wrong – that risk is probably well understood and well-diligenced. They may come from concession-stage exposures that standard cover does not reach, from claim transfers that misfire on structuring, and from refinancing assumptions that ignore InvIT-level constraints. The buyers who win will be the ones who treat each concession as the specific public-law instrument it is, rather than as a generic operating asset.

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