

Chapter-VI
Smart City Project, Kochi

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6.1 Introduction

Information Technology/Information Technology Enabled Services (IT/ITeS) has become one of the most significant growth catalysts for the Indian economy over the years. During this booming phase, Government of Kerala (GoK) established two successful IT parks - Technopark, Thiruvananthapuram and Infopark, Kochi (Infopark).

In January 2006, GoK formed a joint venture company with the status of a Special Purpose Vehicle (SPV) termed Smart City (Kochi) Infrastructure Pvt. Ltd., with TECOM Investments FZ LLC, Dubai (Tecom) for setting up a knowledge based IT/ITeS township in Kochi. Tecom is a subsidiary of Dubai Holding, an investment company owned by the Government of Dubai. Tecom develops infrastructure for Internet and Communications Technology (ICT) companies through its subsidiary Dubai Internet City (DIC).

GoK entered (September 2005) into a Memorandum of Understanding (MOU) with DIC for above township in Kochi which is subsequently followed up with a Framework Agreement (FWA). The FWA was executed (May 2007) with GoK, Infoparks Kerala, Tecom Investment FZ-LLC and SPV to implement the project. The scope of the project includes construction of built-up area of 6.22 million sq. ft. IT/ITeS office space, 0.55 million sq. ft. commercial area, 2.11 million sq. ft. residential area and other spaces as approved at an estimated investment of ₹ 1,700 crore.

This project was to take off within a period of 10 years in 8.8 million sq.ft¹ built up space and was expected to generate 90,000 jobs by providing IT infrastructure to IT/ITeS companies. Keeping the objective in view, GoK leased out (in 2007 and 2008) 246 acres of land to SPV for 99 years under FWA in return for a one time lease premium of ₹ 104 crore.

Since transfer of a large extent of land was involved in the project for development of infrastructure, a Performance Audit on the project was conducted for inclusion in this Report.

6.1.1 Capital structure and share holding pattern of SPV

The initial authorised share capital of SPV was ₹ 680 crore with an initial paid up capital of ₹ 120 crore comprising of equity shares of ₹ 10 each. The shares are subscribed by the parties in the ratio of 84 *per cent* by Tecom through its permitted affiliates and 16 *per cent* by GoK. The Board of Directors (BoD) is to make capital calls for funding the cost of the project as may be necessary from time to time.

The SPV had called up 7.5 crore shares to enhance share capital by ₹ 75 crore (in 2011). The present total paid up capital of SPV was ₹ 195 crore.

¹ This does not include other spaces.

6.1.2 Agreements governing Smart City project

The rights and obligations of the partners within the joint venture are governed by mutually agreed terms in a formal agreement. The agreements that governed the relationship were Memorandum of Understanding (MoU), the FWA and lease deeds.

- Memorandum of Understanding - The MoU signed on 9 September 2005, was only an understanding between the parties, which was to be replaced by a legally valid the FWA within 90 days from such date, unless agreed otherwise by both the parties in writing. Though the validity of MoU expired on 9 December 2005 it was not extended further.
- Frame Work Agreement – Using the MoU as a basis, both the partners worked out the modalities for implementing the project and specified the mutual rights and obligations in the FWA. A formal legally binding document was signed on 13 May 2007.

The FWA was the most important document that governed the formation and operation of the project and the future relationship between the partners.

6.2 Audit objectives

The objectives of the performance audit were to assess and evaluate whether the:

- project was conceived in a transparent manner;
- selection of partners of the project was in a transparent manner;
- objectives of the project could be achieved within the specified time frame;
- acquisition/transfer of 246 acres of land for the project was transparent ensures the interest of the State and the period of lease was justified;

6.3 Audit criteria

Audit criteria includes:

- Memorandum of Understanding (MoU).
- Frame Work Agreement (FWA).
- Lease deeds.
- Orders issued by various departments of GoK/Government of India (GoI) with reference to Smart City Project and other Special Economic Zones(SEZ)².
- Articles of Association and Memorandum of Association of SPV.
- Board Minutes and Annual Accounts of SPV.
- SEZ Act 2005, SEZ Rules 2006 and Minutes of Board of Approval for SEZ (GoI) in India.

² SEZ is an area notified by GoI under SEZ Act, 2005. These areas possess special economic regulations that are different from other areas and companies functioning there will get tax incentives.

6.4 Audit scope and methodology

A Performance Audit was conducted between January 2013 and September 2013 covering the period from the formation of the project till September 2013. An entry meeting was conducted on 17 April 2013 with the Principal Secretary, Information Technology Department (GoK) wherein the scope of audit, objectives and criteria adopted for audit were discussed. Records regarding the initial discussions for the Smart City project, the MoU (2005), the FWA (2007), lease deeds, orders issued by various departments of GoK/GoI with reference to Smart City Project, financial statements of SPV for five years from 2007 to 2011, adherence of SEZ Act, 2005 for the project were scrutinised. The audit findings and conclusions were discussed at an exit meeting held with the Principal Secretary (IT) on 13 January 2014 and the remarks of the Government side have been suitably incorporated.

Audit findings were drawn after scrutiny of the available data by issuing audit enquiries and obtaining replies thereon received from the IT department (GoK) and entities³ related to the project. Audit relied upon information collected from Government controlled other IT parks like Technopark and Infopark with regard to employment potential and space requirement.

6.5 Audit findings

The major findings observed during audit were as follows:

6.5.1 Project conceptualisation

GoK encouraged and attracted the IT industry through its two successful IT parks and helped the State to emerge as one of the fastest growing IT sectors in India.

Technopark, Thiruvananthapuram established in 1994, with a project area of about 180 acres is the third largest IT park in India, provides direct employment to 42,500 employees. Infopark Kochi established in 2004 has employment strength of 18,500 and is still pursuing/undertaking several other projects to boost the IT industry and also the employment opportunity in Kerala. Infopark has campuses at Cherthala and Koratty also. Infopark has constructed a built-up area of 1.2 million sq ft for IT/ITeS companies across its three campuses. Out of this 2.2 lakh sq ft is yet to be occupied in Infopark Cherthala.

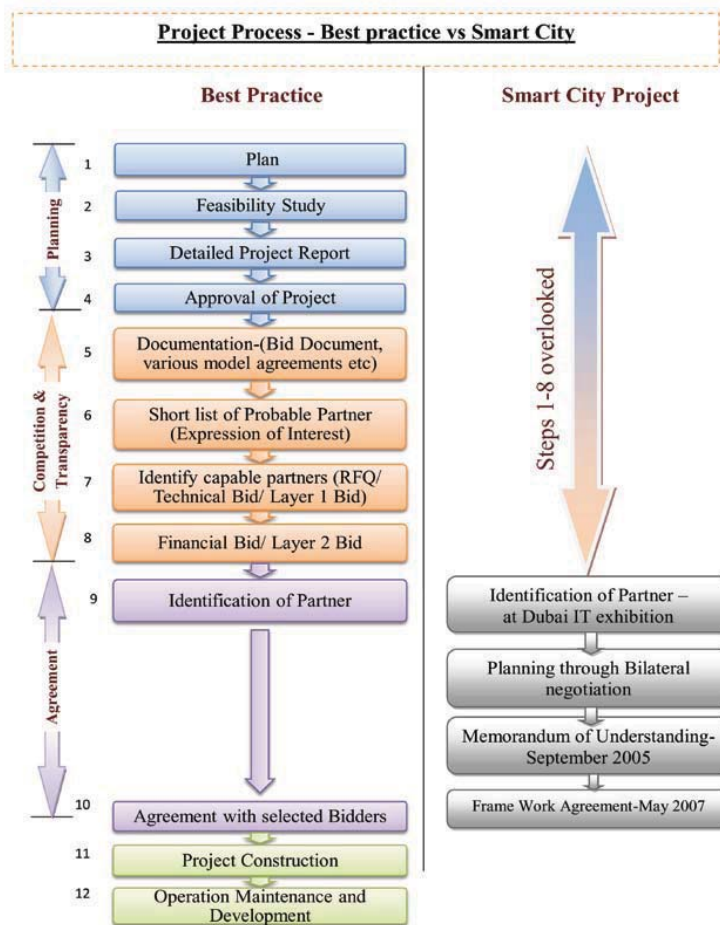
In this scenario, justification and necessity of taking up another IT city with a new SPV within immediate vicinity of Infopark Kochi and using the services of Infopark to acquire the land for the new venture is not appreciated and no records articulating the justification was provided to Audit. No feasibility study has been conducted for the project. Further, justification for taking up a meagre 16 *per cent* equity capital in the SPV by the GoK was also not on record.

³ Infopark, Kerala Industrial Infrastructure Development Corporation (KINFRA), KINFRA Export Promotion Industrial Parks Ltd.(KEPIP) and other related institutions such as Offices of Registrar of Companies, Development Commissioner for SEZ (Kochi), Kerala State Electricity Board (KSEB) and Kerala State Electricity Regulatory Commission (KSERC).

6.5.2 Non-transparency in selection of partner

GoK identified the partner, in an exhibition at Dubai. In the selection process, all established practices were overlooked as explained below.

Normally in mega projects, the partner is identified after a series of steps to ensure proper planning, transparency and competition. However GoK initiated the Smart City-Kochi Project without inviting any expression of interest/proposals of other players in the field. It held direct negotiation with Dubai Internet City (DIC) at an exhibition which was visited by a team of officials and awarded the “Smart City-Kochi” project to “Tecom Investment” without conducting any feasibility study or other evaluations as indicated in the diagram below:



GoK tried to justify the action stating that DIC was selected as they are the largest Information and Communication Technology (ICT) business park in the Middle East owned by Government of Dubai and more than 850 companies operate out of it. As part of their programme of “Going Global” DIC had plans to set up an IT Park in South India in association with premium IT companies. GoK had accepted the proposal of DIC after having discussion

at various levels and evaluating the proposals in its totality. However, the files relating to the credentials of DIC were not made available for scrutiny.

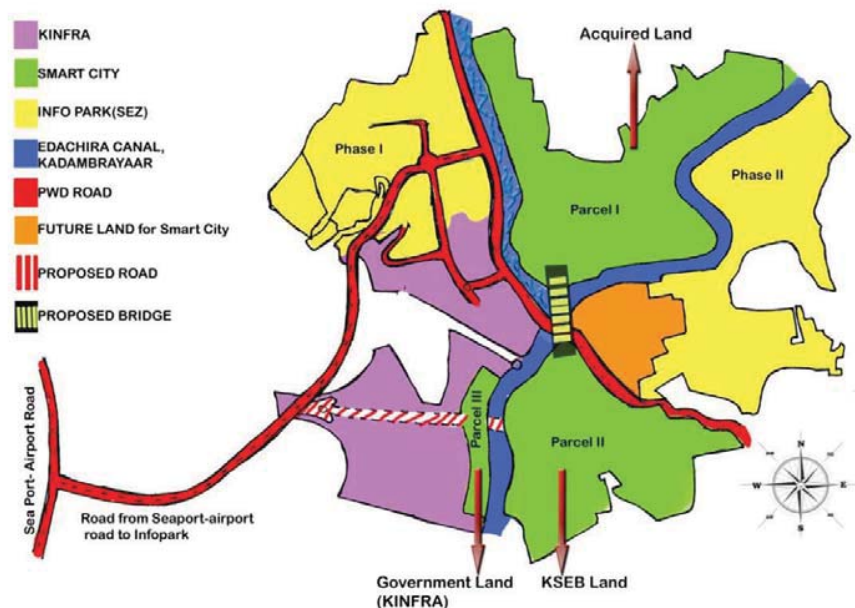
GoK stated that Tecom is a subsidiary of Dubai Holding –a Dubai Government undertaking. However in absence of the share holding pattern, audit was not able to establish the real identity of the owners/promoters of Tecom.

Parties were identified without following the established procedures and practices. After Tecom was identified, GoK had a series of negotiations to chalk out the modalities for implementing the project which led to MoU and the FWA. The IT department of GoK however did not produce copies of minutes of discussion/negotiations with DIC to Audit.

6.6 Land issues

GoK leased out 246 acres of land⁴ in three non-contiguous parcels in 2007 and 2008 for a one time lease premium of ₹ 104 crore and annual rent of ₹ one per acre. SPV paid the amount on 15 November 2007 and 29 July 2008 and took possession of the land. Out of this, Parcel I measuring 131 acres received SEZ status in March 2011. In addition an extent of 167 acres was identified as future land to be given when required (details in Annexure XII).

Proposed site of Smart City project



Land being a highly priced finite resource in Kerala, GoK should have ensured that land acquired and handed over to the private partner was not more than what was essential for the project. However GoK not only handed over the land that was more than required but also at a cost below the market value/acquisition cost. Besides, the SPV/Tecom enjoy the right to convert 12 per

⁴ Parcel I - Acquired from private parties
Parcel II- from KSEB
Parcel III - from KINFRA

cent of the total leased land as free hold at any point of time which gives scope for the manipulation of the objectives of the project. These points are described below:

6.6.1 Short realisation of land value

Information Technology department, GoK had informed (July 2006) Dubai Internet City (DIC) that Government was willing to acquire land and hand over the same to DIC, provided DIC pays for the land at market prices or at prices normally realised from IT firms.

The lessor (GoK) received ₹ 104 crore as one time lease premium being the full consideration for 246 acres of land. The one time lease premium charged by GoK works out to ₹ 42.27⁵ lakh per acre.

Infopark, Kerala which develops IT parks in Kerala also lease out land to IT firms for establishment of IT parks at Kochi. The rate of lease in the adjacent areas of Smart city for 90 years was ₹ 69 lakh per acre during 2007. On one occasion, Infopark Kerala opted for bid system and got ₹ 5.50 crore per acre (2008) for five acres of land leased to a client (M/s Brigade Enterprise) for 90 years. Considering the rate of ₹ 69 lakh per acre by Infopark as the market rate in 2007, the rate fixed by GoK for the SPV was only 61 per cent i.e. ₹ 42.27 lakh per acre. In view of the lease premium received for adjacent land of Infopark, the total amount short realised on 246 acres works out to ₹ 65.75 crore.

It was also noticed that land belonging to KINFRA which was adjacent to SPV for IT/ITeS was transferred at the rate of ₹ 1.50 lakh for one Cent at Kakkanad, Kochi. In reply the department stated that high cost lands are not viable, that Government has to support large infrastructure development to create jobs and cost of operation in Kochi compared to other cities like Bangalore was high and rent receivable was low. The remarks of the department are not tenable as the land transferred to Smart City was at the rate of ₹ 42,000 for a Cent as against ₹ 1.50 lakh for a Cent leased by KINFRA and much less than the lease premium received by Infopark. Further remarks are awaited.

6.6.2 Additional liability for KSEB land in Parcel II

KSEB possessed 194.87 acres of land for Brahmapuram Diesel Power Project (BDPP) out of which 100.65 acres (Parcel II) of land was transferred to R&DM department in July 2007 for the purpose of handing over to Smart City project on lease basis subject to the following conditions:

- Value of the land will be determined and paid by Government to KSEB later; and
- Additional compensation ordered to be paid in land acquisition appeal cases in respect of lease land shall be paid by GoK through R&DM department.

⁵ ₹ 104 crore/246 acre

R&DM department fixed the land value to be given to KSEB for the transfer of land as ₹ 7.57 crore (April 2008). The compensation was not accepted by KSEB for the reason that the transferee was a purely commercial entity and the compensation was less than the market value. The matter continues in dispute. As against a demand of ₹ 43 crore by Power department/KSEB, Government had fixed the compensation at ₹ 7.57 crore creating a probable additional liability of ₹ 35.43 crore.

6.6.3 Non-assessment of land required

In projects involving transfer of large extent of land, Government should have made an assessment justifying the allotment of land. GoK did not conduct any study to assess the requirement of land to achieve the stated objective as discussed below.

SPV envisaged construction of 8.8 million sq.ft. of built- up space so as to create 90,000 jobs. The construction was to be based on a master plan approved by the BoD of the SPV. Even after a lapse of seven years of execution of the FWA, the department did not prepare the master plan (January 2014). In the absence of a master plan, audit was not able to ascertain the requirement of the built up space and the necessity of 246 acres of land for the project.

Hence, Audit tried to assess the land requirement for 8.8 million sq.ft. built-up space on the basis of Kerala SEZ policy, which stipulates 70 per cent of SEZ land to be utilised as processing area and balance 30 per cent as non-processing area. Adopting Floor Area Ratio (FAR) of 1.5 to 2.5 as stipulated by Kerala Municipal Building Rules, 60,984 sq. ft. of built up space could be constructed in one acre as shown below:

One acre = 43,560 Sq.ft	
Processing area as per Kerala SEZ Policy	30,492 sq.ft. (70 per cent of total area) ie 70% of 43,560 sq ft
Built up space available for an FAR of 2 for one acre of land	60,984 sq.ft. (30,492x2)
i.e. in one acre 60,984 sq.ft. built up space can be constructed.	
Therefore for constructing 88 lakh sq.ft. (FAR 2), only 144 acres of land was necessary.	

IT department failed to explain the basis of estimation as there were no records available with the department on which the estimate of required land was arrived at. In reply, department stated (January 2014) that land provided were in line with development plans and taking Municipal Building Rules and Floor Area Ratio (FAR) as the basis for IT Parks of international standards which require Floor Area Ratio of not more than 1.5 to 2. The reply is not tenable as it would violate the criteria of 70:30 ratio for land utilisation as per Kerala SEZ Policy. Further even after complying with the FAR of 2 as mentioned in the reply, the allotment of 88.06 acres of land in Parcel II and 13.94 acres in Parcel III was not necessary.

Further, there was no connectivity among the parcels of land allotted to SPV. As the SEZ Act stipulates contiguity as a pre-condition for granting SEZ status, the second and third parcel of land were not eligible for SEZ status. The SPV received SEZ status only for Parcel-I (131 acres).

6.6.4 Grant of freehold rights

As per para 5.4 of the FWA, upon completion of master plan, SPV will identify plots to be converted to freehold⁶ and such plots will be converted to free hold by GoK forthwith without any further consideration or charges. Cumulative area of the plots converted to freehold will not exceed 12 *per cent* of the total land area at any point of time.

As per SEZ Rules the land inside SEZ is not alienable⁷, while that outside is alienable. The SPV has received SEZ status for Parcel-I (131 acres). Thus, it enjoys absolute free hold right of 29.52 acres on the remaining 115 acres of land without SEZ status. Further due to the clause “*at any point of time*”, SPV will have a claim for 12 *per cent* of future land also. Thus this clause gives SPV undue advantage in terms of retention of land. SPV also reserves the right to identify the plot to be converted as free hold as per the FWA.

Thus GoK favoured SPV, where Tecom is the major share holder (84 *per cent*), to obtain 12 *per cent* free hold right of the land at any point of time. The department stated that in order to develop a Smart City as an IT township, limited free hold rights are to be enjoyed by the developer. Since the free hold is not saleable and not alienable within SEZ, no undue benefit would be gained by the developer. The reply is not tenable as 115 acres is outside the SEZ and hence, it is alienable.

Development Issues

6.7 Delay by SPV in implementation of development plan

Even though the GoK had provided 246 acres of land for the project in terms of the FWA in 2007, the initiative by SPV was not proactive. A few instances are as follows.

- **Delay in Registration:** The lease deeds for the 246 acres of land were originally executed between GoK and Smart City Kochi in two parts on 15 November 2007 (131.41 acres) and 29 July 2008 (114.59 acres). But the SPV delayed registration of the lease deeds on the pretext of seeking exemption from stamp duty and registration fees (₹ 9.36 crore at the rate of seven *per cent* stamp duty and two *per cent* registration fee). SPV obtained stamp duty and registration fees exemption for the lease deeds vide Government Orders (GO) dated 14 October 2008 and 8 February 2011 and thereafter registered the deeds on 23 February 2011 only.

In response, the department stated that registration of original lease deeds were not delayed for non-receipt of stamp duty exemptions but for other reasons. The reasons were however not explained by the department. The fact remains that these documents were registered only in February 2011 (delay of 40 months and 32 months respectively).

⁶ Freehold refers to ‘absolute right’ over the title of property which gives the title holder all rights to alienate the property.

⁷ Alienation includes sale, gift, bequest under a will, mortgage, hypothecation or lease.

- Department of Commerce (DoC), GoI issued formal approval during April 2008 to Smart City Kochi for setting up of a sector specific SEZ for IT/ITES in Cochin and notified (1 March 2011) an area of 53.1809 ha. (131 acres) of land as SEZ. However seven years after signing of the FWA and six years after getting formal SEZ approval for 131 acres of land, no progress was made either in the construction of building or in employment generation except fencing the boundary, construction of a pavilion and appointment of consultants. SPV has not even appointed full time CEO/company secretary/office staff till 2010.
- GoK expressed (3 September 2010) its discontent to SPV for the delays in achieving Closing Date, registering the lease deeds in time and SPVs interpretation of free hold land and cautioned the SPV to expedite the implementation of the project. The reference made by Government was not acted upon by SPV even after three years and this confirms the indifferent approach of SPV towards the objective of the project.
- The request of SPV to acquire about 19 Cents of *patta* land, for rehabilitation of four families living in the project area, at SPV’s expenses was agreed to by GoK vide GO dated 29 November 2008. The land had been identified by Infopark and the land acquisition was ordered under Fast Track Project. It was decided to fix the price of land at ₹ 1.09 crore at the rate of ₹ 4,65,854 per Cent. Delay by the SPV in making payment for acquisition is delaying rehabilitation of the four families and initiation of development activities in Parcel II.

6.8 Impact of ‘Closing date’ and ‘Minimum infrastructure’ with penalties for default (Article 1.1 and 7.1) of the FWA

A most crucial milestone in the implementation of the project was fulfilment of conditions set forth in the FWA regarding “Closing date”.

As per the FWA “Closing date” means the date following the Developer Status⁸ Attainment Date on which all of the following events have occurred. The SPV obtained developer status on 21 April 2008.

Table showing the present position of Developer Status attainment date			
Sl.No.	Requirements	Responsibility	Present status
1	Completion of Minimum Infrastructure like one MLD water, 10 Mega Watt Power and 24x7 road access through PWD road (Article 1.1).	GoK	The SPV failed to identify the location.
2	Receipt of the SEZ Notification in favour of SPV (Article 4.1).	GoK to assist	GoI – Department of Commerce has provided SEZ status on 1 March 2011 for 131.41 acres only.
3	Receipt of statutory approvals for	GoK to assist	Obtained on 21 April 2008 vide letter No. F.2/74/2006 SEZ dated

⁸ Developer Status denotes a letter of approval from GoI to a person or State Government to allocate space or built up area or provide infrastructure service to approved units under an agreement as per Section 3(10) of the SEZ Act, 2005.

Table showing the present position of Developer Status attainment date			
Sl.No.	Requirements	Responsibility	Present status
	construction (Article 4.1).		21 April 2008 – Para 3 (xviii).for 131.41 acres only
4	Execution of the lease deed (Article 2.6).	GoK	Executed on 15 November 2007 and 29 July 2008 which was cancelled on 23 February 2011 and re-executed and registered on 23 February 2011.
5	Completion of the acquisition and transfer of the land in favour of SPV (Article 2.6).	GoK	Original registration 15.11.2007 – 234.54 acres 29.7.2008 – <u>11.46 acres</u> 246.00 acres <u>On re-registration</u> 23.2.2011– Deed I – 131.41 acres Deed II – <u>114.51 acres</u> 245.92 acres
6	Transfer of 16 per cent share in SPV in favour of GoK (Article 3.3.1).	GoK	GoK had invested an amount of ₹ 31.20 crore in SPV towards share capital.

Out of the above mentioned six conditions, only three (4, 5 and 6) have been fully achieved so far (September 2013). Audit observed that the obligation of SPV as per the FWA begins only on the compliance of conditions by GoK, which however could not be attained without reciprocal commitment on the part of SPV. The conditions agreed upon in the FWA were inadequate to bind the SPV for performing their obligations. This flaw in the agreement enabled SPV to unjustifiably delay the implementation of the project.

Due to non-incorporation of penalty clause for the default by Tecom in achieving the Closing date in the FWA, GoK was unable to take any legal action against Tecom. Audit has further analysed the various reasons and impact of the delays in the following paragraphs.

6.8.1 Delay in providing minimum infrastructure

As per the FWA, steps for providing minimum infrastructure by GoK were to be started within 15 days of signing the FWA and were to be completed within six months [Article 7.1.1 (b)]. Since the FWA was signed on 13 May 2007 the work was to be started on 28 May 2007 and should have been completed by 12 November 2007. While the work was to be completed by GoK the requirements were to be intimated by SPV. GoK agreed to this without ensuring counter obligations on the part of SPV/Tecom and without considering the implications of the stipulation.

GoK was to supply 10 MW of power to the SPV. Audit noticed that as SPV had not forwarded its energy requirement plan to KSEB or KEPIP, GoK could not take any step to provide power connection. As per Article 1.1 of the FWA, one MLD water was to be supplied to Smart City from KEPIP. GoK had

directed⁹ KINFRA to provide one MLD of water from the Water Supply Scheme of the KEPIP to the periphery of the Smart City Project. The work was awarded to KITCO by KEPIP. Since SPV didn't finalise the route for pipeline, the work could not be taken up and KITCO was forced to short close the work after incurring an expenditure of ₹ 6.20 lakh on purchase of pipes.

Thus, though GoK initiated steps from January 2008 itself to provide the minimum infrastructure; it could not complete it due to lack of co-operation from SPV/Tecom. Due to the deficient agreement conditions GoK alone became responsible for the failure to provide minimum infrastructure and SPV/Tecom was absolved from penal action in spite of the non-co-operation on their part.

6.8.2 Continuous liability of GoK under the FWA

Audit analysis of the FWA also revealed that in addition to completion of "minimum infrastructure" further obligations were imposed on GoK under the FWA. They were:

- GoK has to continue the development of infrastructure commensurate with the requirement of Development Plan in such a manner that the required amount of power and water supply are made available at the periphery of Smart City when the facilities built by SPV are ready to draw on the said utilities (Article 6.2).
- In addition to this, GoK has to complete acquisition of land for the new four lane road connecting the sea-port – airport and complete the road within two years(Article 6.3)
- Assist (Article 6.5) the SPV in :
 - ❖ completion of fencing at the site
 - ❖ obtaining a permanent source of water supply
 - ❖ obtaining relevant approvals and permissions necessary for the construction of the linkages between different parcels of land to make them inter linked
 - ❖ obtaining relevant permission to construct and operate a power generation system and
 - ❖ obtaining fast track approval for all licenses, permits and registrations required to establish requisite hospitality facilities of international standards within Smart City as per development plan.
- Further, GoK has to ensure supply of adequate power to SPV without disruption and construct, develop and maintain adequate link roads to the airport – seaport road as per NH standards (Article 6.5).

As seen from the above, various provisions in the FWA were imposing responsibility on GoK and the responsibility of SPV/Tecom was specifically limited to development of infrastructure within the notified SEZ area. These clauses were used by the project developers (SPV/Tecom) in their favour by prolonging the implementation of the project by not even providing minimum

⁹ GO(Rt)No. 01/2008/ID dated 2 January 2008.

infrastructure like substation and construction of water tank within the project area.

6.8.3 Responsibility of GoK with regard to Parcel II of land

- Diversion of PWD road presently going through the middle of the land proposed for Smart City project in second parcel of land of 100.65 acres. Even though the decision to divert the PWD road was taken by the Government during November 2008, the land was identified only during March 2012 i.e., after a delay of around three and half years. But till date (March 2013) no physical transfer of land has taken place.
- Shifting and re-construction of KSEB installations within 100.65 acres. For the re-location/shifting of KSEB installations (sedimentation, tank, pumping station, filter house, four families living in 19 Cents of land), GoK had released ₹ one crore in April 2009 and ₹ 50.50 lakh in April 2013 towards the share of Smart City. In reply to an enquiry regarding delay on shifting of utilities, Office of the Member (D&GE)¹⁰, KSEB, Thiruvananthapuram had stated (4 July 2013) that the shifting could be started only after getting GO for mutual exchange of land as suggested by District Collector, Ernakulam for which a decision was pending with Power department. GOK. Further the proposed land to be transferred to KSEB for relocating the installation has been identified, but the same has not been swapped with the land of SPV so far (November 2013).
- Demolition and shifting of installation and air monitoring station to outside the project area.
- Establishing contiguity between two parcels of land by way of construction of bridge

In response to the above observation, GoK stated that the closing date had already been achieved by 1 March 2011 the project would be completed by 2021. Though the closing date is stated to be achieved by 1 March 2011, the same had not been achieved as the minimum infrastructure remains to be provided. The remarks of the department are thus not tenable.

6.8.4 Non-adherence to Development Plan

As per the Development Plan in the FWA, the SPV has to complete the project within a period of 10 years by constructing 8.8 million sq.ft. of built up space so as to generate 90,000 jobs. However, the 10 year period starts only with the “attainment of the Closing date” as defined in the FWA (“Closing date” analysed in detail in para 6.9).

In this connection, Audit observed that -

- The closing date as defined in the FWA was not achieved so far (March 2014).
- Even if the closing date is attained in 2014, the SPV will have a permissible period of 10 more years to complete the project. Thus the

¹⁰ D&GE – Distribution and Generation (Electrical).

project is likely to be completed only after 2025 and GoK cannot enforce SPV to expedite the implementation of the Project.

The physical progress achieved during this period (2007 to 2014) is limited to:

- Construction of a 10,900 sq.ft pavilion (2012) for the office and barbed fencing of the leasehold land.
- Appointment of a Project Manager (Synergy Bangalore) and designer B+H Architects (Toronto) to design the first phase building. Design of the building of about six lakh sq.ft. has been completed.

The progress achieved so far (March 2014) does not correspond with the schedule fixed for completion as per Development Plan. Thus, the project expected to deliver much to IT/ITeS industry remained standstill without any precise time schedule for commencement.

6.9 Other deficiencies in Frame Work Agreement

Other deficiencies noticed during the scrutiny of the FWA are mentioned in succeeding paragraphs-

6.9.1 Deficiencies in legal opinion

The Law department of GoK approved the draft FWA on 27 February 2006 with comments regarding “events of force majeure” and venue of arbitration only. The vital aspects regarding “Closing date”, low one time lease premium, period of lease, ‘best efforts’ to create 90,000 jobs, the clause in the FWA that the GoK shall not make any efforts that diminishes the value of Smart City, adequate representation of Government in BoD, transfer of 246 acres of land without adequate cost etc. were not considered by Law department even though these aspects were the corner stones in the implementation of the project. The agreement was referred (February 2010) to the Advocate General by GoK to seek his advice on certain clauses in the agreement. It was observed by him that the clauses pertaining to closing date, and 12 *per cent* free hold rights were deficient and required re-consideration. He also opined that GoK had not taken care to specify the consequences of failure on part of Tecom while Tecom had taken care to incorporate such a clause on failure of GoK. Thus the vetting by the Law department was not comprehensive. It was also noticed by audit that the FWA was modified after vetting by Law department (Ref. Para 6.10.3). The IT department replied (January 2014) that Government has obtained necessary legal opinion and framed the FWA. The remark was not tenable as specific opinion on Closing Date, implication of 12 *per cent* free hold rights and ‘best efforts’ etc. were not obtained from Law department.

6.9.2 Dilution of agreement conditions

The primary objective of the State in the project was generation of employment opportunities. Section 5 of Special Economic Zone Act, 2005 (Central Act) stipulates that the Central Government while notifying any area as SEZ should be guided, among other things, by requirement of creation of employment opportunities.

Report on Land Management by the Government of Kerala with special focus on land for Aranmula Airport and Smart City Kochi

Audit scrutiny revealed that Government may not be able to ensure the much proclaimed employment generation of 90,000 jobs as the terms and conditions as well as liability of SPV was diluted in the FWA vis-à-vis MoU as detailed below.

I.No	Subject	MoU	FWA
1	Reference	Article 1.4	Article 9
2	Commitment	DIC undertakes that SPV shall together create 33,300 direct jobs in the Smart City in phases as follows	“Tecom shall make best efforts to generate at least 90,000 jobs in 10 years from closing date”
3	Phases fixed to achieve objectives	Three phases - five years, seven years and 10 years	Phases not provided
4	Penalty for shortfall	The SPV shall pay to the GoK a penalty calculated at the rate of ₹ 6,000 per job as applied to shortfall in targets at the end of five, seven and 10 years	Not provided

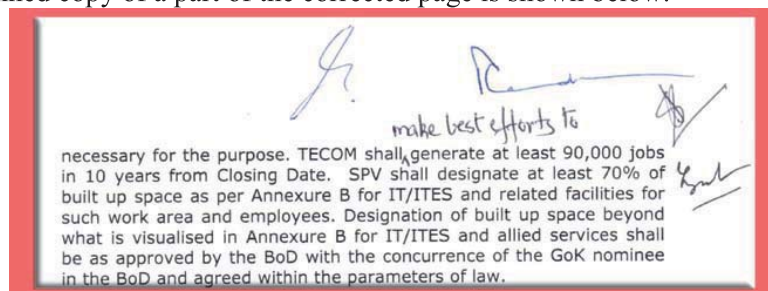
In this connection Audit observed the following:

- The words “make best efforts to” in the FWA absolved the Tecom (SPV) from its obligation to provide employment and slackened their statutory liability.
- The phases of generation of employment, number of direct and indirect employment, penalty for not achieving the target, etc., were not specified in the agreement.

The department replied that the use of the term ‘best efforts’ would no way allow Tecom to escape from its responsibilities. The remarks of the department are not tenable as a dilution had been made to the original clause. Moreover, no legal opinion was sought for before making the modification ‘make best efforts to’ ascertain the impact of insertion.

Audit also noticed that the words “make best efforts to” was inserted subsequently by hand in the original typed FWA which goes against the MoU provisions. There was no record to prove that this modification was examined by Law department.

A scanned copy of a part of the corrected page is shown below.



6.9.3 Clauses favourable to Tecom on default

There were heavy commitments on Government for attaining closing date requirements, assisting in obtaining SEZ status, assurance regarding water, power, four lane road, making available exemptions, concessions etc. for IT

companies working in the project area for the successful functioning of the project. However, similar condition insisting the developer to commence and complete the built up space and create employment generation were not provided for in the agreement.

As per the FWA, any failure on the part of GoK to fulfill its commitment (Article 7.1.1) would constitute “GoK closing default” or “GoK land default¹¹”. Similarly any failure to create 90,000 jobs or construct 8.8 million sq.ft. built up space would constitute a default on the part of Tecom.

In case of default, any party could take over the project completely by paying for the share held by the other party. However, these conditions favored Tecom as the possibility of taking over the project by GoK could arise only after ten years of closing date. Also in the event of default by GoK, Tecom and/or its permitted affiliates were not to be subjected to any penal consequences for non-commencement and non-completion of construction of IT/ITeS buildings as per Development Plan. The department did not give any specific reply to the point raised and stated that all steps would be taken to accelerate the pace of the project.

6.9.4 Non-provision of penalty, Security Deposit and Insurance in the FWA

Provisions for penalty, security deposit and insurance are kept in projects to guard against loss due to defaults. However in the FWA, there was no provision for penalty, security and insurance for ensuring the timely construction of infrastructure/built up space. Thus, if the developer were to fail to adhere to the timeframe, there was no option to levy penalty or recover costs from the Security Deposit and risk of any act or omission of the developer.

6.9.5 Absence of Independent auditors, engineers and valuers

The FWA should normally provide for appointment of Independent Auditors and Independent Engineers to enable them to monitor the project activities and act on their behalf to evaluate and co-ordinate construction, technical and commercial activities. These provisions were not considered while framing the FWA. Neither the GoK nor the SPV could effectively monitor the delays in achievement of milestones in the absence of appointment of IA/IE.

In response to the above, Government replied that the affairs of SPV are managed by a Board and the decision regarding the project was taken by the Council of Ministers and IT Secretary. It was also stated that Audit and Executive committees, statutory and internal auditors were appointed in addition to a qualified house team of engineers. The remark is not tenable as it does not address the issue of independent auditors and Engineers as the details of constitution of any of the committee were not produced to Audit for verification. The minutes of Audit Committee, Reports of independent auditors and internal auditors were also not made available to verification.

¹¹ GoK land default denotes failure of GoK to complete the process of acquisition and transfer of the land to SPV

6.10 Financial impact on Government exchequer

GoK had deposited ₹ 87.28 crore in five instalments between April 2008 and September 2013 with Infopark for meeting the expenditure in connection with land acquisition for parcel I. As per details furnished by Infopark, it had incurred ₹ 86.09 crore during the period between April 2006 and September 2013 for meeting land cost, administrative expenses and interest on KSIDC loan.

In addition to the above expenditure, GoK had to pay/bear indirect/implicit cost of ₹ 43.53 crore as mentioned in para 6.6.2 on additional liability for land in Parcel II.

Audit noticed that apart from the above ₹ 129.62 crore¹² for acquisition and transfer of land in Parcel I and II, actual cost to be incurred on the following has not yet been ascertained:-

- Cost of 13.94 acres of Government land (Parcel III).
- Future liability by way of compensation arising out of land already acquired.
- Construction of four lane road from seaport airport road to Smart City.
- Cost of acquisition of land for the above road.
- Cost for laying electricity line to the periphery of Smart City from the existing substation of KEPIP.

As against the above financial commitment, GoK received ₹ 104 crore¹³ from the SPV as one time lease premium as full and final amount for the 246 acres of land. Later GoK paid ₹ 31.20 crore in cash to acquire 16 *per cent* share in the SPV in which GoK has no effective control.

Had the transfer value of the land been fixed considering the market value prevailing in the State, Government could have fetched more revenue. Due to failure to monetise the realistic/market value of land which was transferred on lease for 90 years, Government suffered a huge loss of revenue which was beneficial to the SPV.

6.11 Other findings

6.11.1 Board of Directors

As per the FWA, the BoD at any time comprises of a maximum of 10 Directors unless otherwise provided in its Articles (3.1.1). GoK is entitled to nominate two Directors on the BoD as long as the GoK holds not less than nine *per cent* of the share capital of the SPV. The Chairman is to be nominated by GoK from among its two Directors and has one vote like any other Director. The GoK nominees in BoD shall be an officer not below the rank of a Special Secretary to Government or a Minister. The Government (November 2013) nominees were Minister for Industries (Chairman) and Principal Secretary to Government, IT department (Director).

¹² ₹ 86.09 crore + ₹ 43.53 crore

¹³ ₹ 99.15 crore in January 2007 and ₹ 4.85 crore in July 2008

All decisions of BoD shall be by a simple majority of the Directors present and voting. The quorum shall be five members present and voting of which at least three shall be nominees of Tecom and at least one shall be the nominee of GoK. Thus the clauses concerning quorum of Board meeting gave absolute control over decision making to Tecom.

The Chief Minister shall be the chief patron of Smart City. This title is only an ornamental one with no control over the affairs of the company.

6.11.2 Stamp Duty exemption for free hold land

As per guidelines regarding transactions related to SEZ on Stamp Duty exemptions, the upfront exemption of Stamp Duty sanctioned by State Government was subject to final settlement of the SEZ or the Developer was to pay the Stamp Duty and refund the same after the formal SEZ notification is issued.

GoK granted stamp duty exemption to whole area of 246 acres while registering lease deed (February 2011). However, the third parcel of 13.94 acre being not contiguous was not eligible for SEZ status and it was excluded from the revised application for SEZ on 11 January 2013 (as explained in para 6.6.5). Thus the proportionate amount of lease premium of ₹ 5.89 crore¹⁴ for 13.94 acres was thus not eligible for stamp duty exemption. Hence, granting of exemption of ₹ 53 lakh¹⁵ (approximately) lacked justification and tantamounted to extension of undue benefits to SPV.

Government has not initiated any steps to realise the unintended Stamp Duty exemption.

6.11.3 Failure to produce records to audit

The crucial records such as minutes of the meetings held from July to October 2004 between DIC and GoK, proposal from DIC, (13 December 2004) and other correspondence were not provided to audit, despite reminders and several round of discussions with IT Secretary.

Replies to certain queries raised by audit are yet to be received from the IT department (GoK). Audit intended to scrutinise the Agenda Notes and Board Minutes of the SPV. However IT Secretary refused to provide the records to audit violating the provisions contained in Article 59 of Kerala Financial Code Vol. I.

In the absence of these records, audit was not in a position to comment whether Tecom was the best available option and the selection had been made in a transparent manner. The reluctance to provide records raises serious concerns about the transparency of the process. This doubt has been strengthened by the drafting of the terms of the FWA imposing heavy responsibility on GoK and incorporating many terms to the advantage of Tecom.

To understand the basis for fixing the land area as 246 acres and the one time lease premium as ₹ 104 crore with its justification, audit called for the files. IT

¹⁴ 104/246 x 13.94.

¹⁵ Stamp duty seven *per cent* and registration fees two *per cent*.

department did not produce the records relating to method of valuation of the project, records relating to extent of land required, fixation of lease premium, period of lease etc. This reluctance to hand over the files further pointed towards the lack of transparency and raises strong concerns on an attempt to extend undue favour to the SPV. The department stated that all files and documents were submitted to audit. The reply is incorrect as the initial records pertaining to the minutes of various discussions held between the representatives of GoK and Tecom, project evaluation, DPR submitted by Tecom, fixation of lease premium etc. were not made available to audit.

6.12 Conclusion

There was undue favour given to the SPV at almost every stage of the project starting from the selection of partners without any expression of interest. A low one time lease premium was fixed without considering the market value. Excess land was given. Unlike the IT parks established by Government, the lessor was granted freehold rights over 12 *per cent* of the area of land at any point of time. The agreement conditions in respect of creation of 90,000 jobs were diluted in the agreement and made incapable of being translated into enforceable targets/deliverables. The Government nominee has only a minor role in the Board of Directors.

Agreement conditions in the FWA were strongly tilted in favour of Tecom and against GoK. While legal action was possible against GoK for defaults in providing minimum infrastructure, it was not possible against Tecom for lack of co-operation in this regard. This led to indifferent approach of SPV which did not identify suitable locations inside the project area for the installation of sub-station, construction of water tank for storing one MLD water (one million litre per day) etc., as required in the FWA, delaying Government's efforts in providing minimum infrastructure.

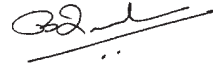
Neither the Government nor the SPV is able to spell out any precise timeframe within which the project can achieve the objectives. Even after seven years from signing the agreement, construction of 8.8 million sq.ft. built up space and creation of 90,000 jobs are far from sight.

6.13 Recommendations

Audit recommends that:

- Projects and schemes of mega size should be planned, designed and executed in an open and transparent manner, safeguarding the financial and socio-economic interests of the State;
- When prime industrial land is provided to boost economy, GoK should ensure that the land provided is only as per requirement;
- Government should include clauses in agreements to ensure that the land is not used for real estate development purposes by private developers; and
- Government should prescribe a monitoring mechanism to ensure that physical progress goes in tandem with the periodical milestones fixed. A high power body may be constituted for a continuous monitoring mechanism which may address the hindrances in the achievements of the milestones so that undue delay could be avoided and desired results achieved.

Thiruvananthapuram
The



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Countersigned

New Delhi
The



(SHASHI KANT SHARMA)
Comptroller and Auditor General of India