

VOX POP

# Make contract more binding on authority: Experts

**Our Experts**

**PK Dosi**, Director (Tech), Sadbhav Engineering, which has an order book of Rs 9,241 crore of EPC projects, of which the roads segment accounts for 56 per cent

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*Views are personal*

**What are the issues in road contract agreements?**

**DOSI**

With the introduction of PPP model predominantly since 2009, the risks of the project in DBFOT pattern have entirely shifted to the concessionaire with limited protection in the Concession Agreement. The imbalance of the risk allocations regarding traffic, cost of construction, time frame and vague provisions in respect of handling delays and appropriate remedies thereof has caused a severe setback to the PPP Model.

The recent setback in BOT projects can largely be attributed to premature bidding by NHAI without completing the preparatory works of various clearances and acquiring land required for the implementation of the project and intense aggressive bidding by the contractors to grab the projects for sake of executing the works without proper and appropriate assessment of traffic and related fee revenue over a concession period of 20-30 years.



The cap in the MCA on returns to concessionaire needs to be removed.

**HOSHING**

Road contract agreements presently do not envisage changing business cycles over the 20-30 years long life of the concession. The contract document should provide for several eventualities such as:

- a. In case of no profit in the long run, well-carved out exit mechanism for the Concessionaire and Lenders need to be in place
- b. Protection of investor and lenders' interest
- c. Ways to curb irrational bidding
- d. Ways to control project cost through due deliberation on defining the scope of work
- e. Support mechanism by Authority in case of downside in traffic prior or subsequent to target date

Further, the existing contract documents focus on project-level management, whereas the long-term need is to bring in portfolio-level management. For instance, if a developer makes profit in one project, he is required to pay tax on the same even though he might be facing loss at the portfolio level. Instead, tax could be levied on the portfolio-level performance to support the developer in managing its portfolio better.

**SINGH**

Main issues in road contract agreements:

- In most projects, NHAI has failed to provide minimum 80 per cent land and environment, forest and railways approvals within the time frame in the MCA. This obligation is circumvented by seeking waiver from the concessionaire.
- Provisions in the MCA related to capacity augmentation, COD, revision of toll rates, etc, are ambiguous, and NHAI has never provided clarity on them; resultantly, the interpretation of these clauses varies from bidder to bidder—this is partly responsible for the irrational biddings we have witnessed.
- The provision of the MCA does not allow the promoters to exit the project completely upon COD, creating liquidity crunch.
- The total project cost determined by NHAI is always on lower side and as per MCA the lowest cost is considered for the termination payment. This provision is primarily responsible for the weakening interest of the lenders in funding the road projects.
- The quantum of damages provided in the MCA does not reflect the actual loss.
- The MCA caps the returns to the concessionaire in case the actual traffic goes beyond certain limits, by

way of reduction in the concession period or by taking all the revenue for the traffic beyond the traffic cap.

**AGARWAL**

Several concessionaires have left some of the major highway projects midway or without executing the same due to funding crunch, high borrowing costs, slowing economic growth and delay in getting mandatory government approvals. Some of the major issues in road contract agreements are as follows:



- Getting clearances from government agencies.
- Agreements are entered into between NHAI and a concessionaire without adequate feasibility test, resulting in financial viability mismatch at execution stage. As a result, at the execution stage, the concessionaire starts making fresh demands / concessions and thus delaying a project.
- For deficiency in maintenance of highways, NHAI is entitled for penalties. However, there is no recourse to the users, who are ultimately paying for the project, continue to pay the fee/ toll despite not getting the due service.

**What issues are easily fixable?**

**DOSI**

The key issues which can be addressed are:

- Careful preparation of project reports and bid documents by the Authority and bidding of the project only after obtaining necessary clearances and acquisition of land.
- Publication by central and state authorities of long-term road development along with its implementation strategy in order to address issues of alternate roads/competing roads.
- Empanelment of experienced and qualified transport analysts to carry out long term traffic forecasts.
- Making tight norms for eligibility as developer with special emphasis on financial capabilities.

**HOSHING:**

Issues such as bureaucratic processes can be fixed in a relatively shorter time period by streamlining the process bringing in transparency and efficiency, removing the unnecessary layers of bureaucracy from the system.

Also, decisions such as change of scope should be effected in a systematic and efficient manner, such that it does not cause undue delay in project completion and adversely affect the project viability.

The concessionaire should be adequately compensated for the loss it may have to bear on account of any change of scope.

**What are particularly tricky issues that may need complex changes?**

**DOSI**

With the introduction of PPP framework, the erst-while contractors have become road developers as well without having adequate financial capabilities and exposure to the risks associated therewith. This has led to irrational and aggressive bidding in last 2-3 years. The bidding framework of BOT projects therefore needs to be revisited in order to curb the tendency of aggressive bidding. Negative cash flows on the projects have put the developers under severe financial crisis and debt trap.

**The bidding framework of BOT projects needs revision to curb aggressive bidding.**

**The Model Concession Agreement (MCA) (for BOT and DFBOT projects) for National Highway development is being revisited. What are your suggestions for changes?**

**HOSHING**

**Land availability:** NHAI's internal procedural changes are being effected to ensure existing RoW + 3D (declaration of land acquisition) of 90 per cent land before appointed date.

**Opinion:** Since substantial delay occurs during payment of compensation for land acquisition, ensuring 3G (finalisation of compensation for land acquisition) of 90 per cent land is necessary to be in place before appointed date. Also, such changes must be made part of the revised MCA and thereby contractually binding on the Authority.

**Financial closure:** Time period for achieving financial closure should be based on project size. Also, NHAI should give comfort to the project lenders.

**Toll non-compliance:** Toll non-compliance is becoming a major issue, especially in certain northern / western states. NHAI needs to take it up with the law ministry to either make toll non-payment a criminal offence by amending applicable laws or agreements; eg, Motor Vehicle Act or State Support Agreement. Also there is need to provide additional O&M grant to the concessionaire to share loss in revenue. Stringent penalty should be applicable on overloaded vehicles using the toll road and significantly deteriorating the road quality, and the proceeds of the same should accrue to the concessionaire.

**Declaration of COD:** Time frame for approvals for COD from PD, RO and NHAI HQ should be standardised and incorporated in the Concession Agreement.

On Independent Engineer's recommendation for

Extension of Time, NHAI RO and HO must respond with clear justification within defined time frame.

Provisional Completion Certificate for six-laning projects is a vital requirement for banks, as stipulated by RBI on project completion dates. Hence, the clause needs to be reinstated in the Concession Agreement for six-laning projects. Delayed completion beyond two years leads to banks classifying project loans as NPA: partial completion certificate in such instances would help reduced risk perception of road sector among lenders.

**Validation of User Fee by the Authority:** Since revision of toll rates is done in accordance with the pre-determined mechanism defined in the Concession Agreement, the PD may be accorded as the final authority for Approval of toll rate revision to avoid undue delays to the extent possible. NHAI internal audits and systems can ensure that PD approval is fair to public and as per CA terms— reducing one level of approval process will help streamline process.

**Revision of Total Project Cost linked to Termination Payment:** Authority TPC is proposed to be revised based on IE recommendation, before Appointed Date. Earlier, TPC fixed by the Authority based on outdated DPR.

**Opinion:** IE recommendation on TPC must be made binding on the Authority. Any variation in TPC should be subject to Dispute Resolution procedure.

**Authority Support necessary for Refinancing:** Projects opt for refinancing for enhancement of debt tenure and reduced debt cost due to completion of construction risk

Authority liability limited to Original Debt as per Financing Package; refinancing not envisaged in the Concession Agreement. If adequate support provided for availing refinancing, it could substantially improve the financial viability of a project.

- Periodic Review at five year interval of fee revenue for adjustment to concession period and minimum revenue guarantee by Authority at various stages.
- Flexibility in premium sharing structure as per cash flows of the project by keeping NPV of the premium same at a defined discount rate.
- Explicit provision for extension of concession period for various delays and compensation events beyond the control of the concessionaire.

## SINGH

We have already submitted our suggestions to NHAI on several provisions of the MCA mainly covering the following main points:



- Minimum 80 per cent vacant land free of utilities, encroachments etc should be available prior to signing of the contract and 100 per cent land and all clearances should be available prior to the appointed date.
- Quantum of damages provided in the MCA needs upward revisions to capture actual losses of the concessionaire in case of delay due to NHAI.
- Developers should be allowed to exit completely upon COD.
- Revision of capacity augmentation clause giving more clarity.
- Total project cost should be the actual cost incurred by the concessionaire for completion of the project with due vetting from the NHAI.
- To allow part procurement of the applicable permits as concessionaire's condition precedent.
- MCA should provide termination payment even in case the agreement is terminated during construction period due to concessionaire's default, to protect lenders' and concessionaire's investment in the project.

## AGARWAL

The MCA should take care of the following:

- Before floating a tender for a highway project, NHAI should submit copy of relevant project report to all concerned government departments / agencies and should get their in-principle approvals. The procedural part of obtaining approvals alone should be in the scope of a concessionaire.
- Proposals from prospective concessionaires should get vetted by an agency, recommended by RBI, who should assess the financial viability of an offer, source of funding assumed by such concessionaires etc. Suitable weightage should be given to a viability.
- The MCA speaks about compensating the concessionaire for any financial loss due to change in law. There should also be an inbuilt mechanism to readjust the financial terms for any significant change in the Government's or RBI's credit policy, which otherwise is not due to change in law.

## The risk allocation in BOT projects should be reworked in case of State Highways.

### DOSI

Some suggestions for consideration while re-drafting MCA are:

- 100 per cent land acquisition for bypass/realignments and greenfield projects.
- Obtaining environment clearance and forest clearance prior to bidding.
- Time frame for fulfilment of conditions set by NHAI and enhancing the rate of damage for delay.
- Flexibility in change in ownership provision to allow exit from project after completion of work.
- Provision for compensation for delay in granting of completion certificate and user fee validation causing loss of fee revenue.

- MCA has clause for termination of agreement in extreme cases. However, there should also be an inbuilt mechanism so that in case of inadequate maintenance for a certain period, collection of fee / toll should get suspended.

## What can state level BOT / DBFOT contracts learn from NHAI's MCA?

### HOSHING

State level BOT/ DBFOT contracts need to evolve in respect of the following:

- Flexibility to define policy such that it helps address the problems affecting the sector.
- Evolution of balanced risk sharing mechanism between the Authority and the Concessionaire
- Provision of adequate financial support by the Authority at all stages of the project



**Do contract norms—defect liability, maintenance, premium bidding, renegotiation, etc—need a revamp across the infrastructure sectors, and across models of delivery?**

## Or should we be careful about one-size-fits-all norms?

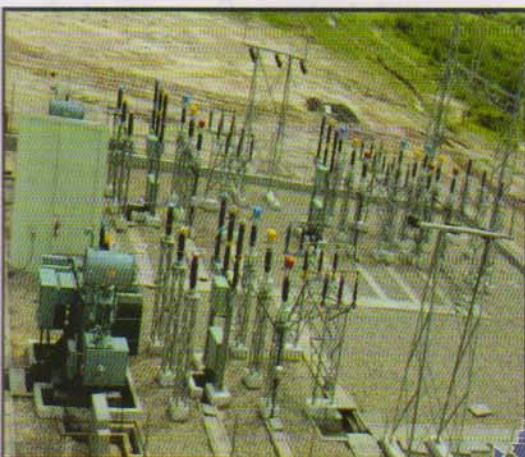
### DOSI

The contract norms should be different for different categories of highways, in view of their importance, traffic and operational requirements. The risk allocation in BOT projects should be reworked in case of State Highways which normally do not carry through traffic and may have easily available alternate routes to avoid toll plazas.

Contract re-negotiation should be built into the MCA, considering the long duration of 20-30 year period with uncertainties.

### SINGH

All the norms of the MCA which are being proposed for revamp in the road sector needs to be changed across the infrastructure sector since the proposed changes are primarily related to structuring of the agreement in balanced manner to protect interest of all the stakeholders, viability and sustainability of the DBFOT projects and on macro level can be easily made applicable in other sectors as well.



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