Ministry of Finance
Department of Economic Affairs
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Public Private Partnership Appraisal Committee (PPPAC)
24th Meeting on June 8, 2009

Record Note of Discussion

The 24th meeting of the Public Private Partnership Appraisal Committee, chaired by Finance Secretary, was held on June 8, 2009. The list of participants is annexed.

2. The Chairman welcomed the participants and invited Joint Secretary (Infrastructure & Investment) to present the agenda. Joint Secretary (Infrastructure & Investment), DEA indicated that the PPPAC, in its 20th meeting, held on December 31, 2008, decided to review and assess the experience of Public Private Partnerships (PPPs) in National Highways Development Project (NHDP). Accordingly, a quick assessment of the projects which were recently bid out was undertaken and presented to the PPPAC in its 21st meeting held on January 7, 2009. It was further agreed that a detailed analysis of the experience of PPPs in NHDP would be undertaken by the PPPAC secretariat. Hence, a detailed examination of the PPP programme in NHDP was undertaken, in pursuance of the decision of the PPPAC.

3. The objectives of the detailed examination were:

i. To generate MIS with relevant details of all the PPP projects of NHDP for its use for planning, oversight and decision making.
ii. Analysis of PPP projects awarded by the NHAI before and after PPPAC was set up.
iii. Review of NHDP projects in terms of their viability and other related issues.
iv. Review of policy issues relating to cost, traffic, toll policy, examination of documents (RfQ, RfP and MCA), etc.
v. Examine the effects of current market recession on BOT projects under NHDP and NHAI views thereupon.
vi. Examine other operational issues, including temporal analysis/process flows.
vii. Highlight emerging policy directions for the future.

4. Joint Secretary , DEA elucidated the genesis and development of the NHDP and the enabling policy framework. Out of the total awarded projects in NHDP, 96 projects were on PPP mode of delivery. Out of these, 71 were awarded before the

PPPAC was set up and were based on the old MCA. After the setting of PPPAC, 25 projects had been awarded. Over time, the size of the projects has increased- it averaged around 60 km before the PPPAC was established and was around 100 for projects cleared by PPPAC. A modest amount of net VGF (4 percent of Total Project Cost {TPC}) had been expended on the projects which were awarded before the PPPAC was established. The VGF requirement for the projects awarded, subsequent to the setting up of PPPAC, was 14 percent of TPC. A direct compare of the two levels of VGF was not feasible since the bid variable was now revenue share. Hence, the NHAI would receive sustained revenues over the concession period, subsequent to the service commencement, on the awarded stretches.

5. It was indicated that the PPPAC had cleared 81 NH stretches. Of these, 17 were bid out and awarded before January, 2009; 64 were bid subsequently, of which eight have been awarded and five more are in the process of award. The study undertaken examined the causes for award as well as inadequate response for each of the projects bid after the PPPAC was set up. The analysis indicated that the traffic was above a particular level (14,000 PCUs for four laning projects and 23,000 for six-laning projects) in all 25 awarded projects except four. These four projects which had lower traffic coupled with lower costs had been awarded based on the Old toll rules which allowed complete linkage of tariffs with WPI. Hence, even lower traffic growth allowed adequate returns through the tariff structure. Thus traffic emerged as the most critical factor effecting bid response.

6. In the projects which were not awarded, traffic on 23 stretches did not justify four/six laning. The detailed analysis brought out that:

i. Traffic is the most important parameter affecting project viability; the traffic threshold is 14,000 PCU (tollable) for 4 laning for a unit cost of Rs 8 crore/km with VGF of 40 percent of TPC. The traffic threshold is 23,000 PCU (tollable) for 6 laning for a unit cost of Rs 10 crore/km with VGF of 10 percent of TPC.

ii. Location/State is important. Projects, even with good traffic, in Orissa, Jharkhand, Bihar, UP and Kerala did not evince a bid response. Two projects in Kerala got a response from local EPC contractors.

iii. Bias was created by the RfQ for 'credential shopping' due to the restriction on the number of shortlisted bidders and the macro economic crisis which resulted in many shortlisted foreign bidders not participating at the RfP stage.

iv. Bunching of projects during off-load in the market and the economic slowdown was responsible for the tepid response to the projects.

v. Traffic, location and concession period emerged as the significant variables through econometric analysis. Cost per km or cost was not found to be significant in 14 out of 15 models. In one model, cost was marginally significant.

7. Based on the study, the following was being recommended for consideration for implementation of the NHDP:

i. Only those stretches may be taken up for upgradation where the traffic is adequate and justifies capacity augmentation.

ii. Where these conditions are not met, it may be prudent to postpone upgradation till a more appropriate traffic volume is reached.

iii. Changes were recommended in the mode of delivery of highway.

   a. Committee, headed by Secretary, RTH, as approved by the CCEA in its decision dated June 8, 2008, may decide on whether traffic justifies upgradation to 4/6 lane. Appropriate thresholds may be decided in this regard.

   b. For traffic levels not justifying four laning, the first option may be two-laning with paved shoulders on toll basis, with two stage augmentation to four lane. Where traffic threshold is not met but upgradation to four laning is required due to other reasons, the options are: annuity and EPC. The *inter se* choice between these two options needs to be made on the basis of a VfM analysis, the models for which can be developed very quickly.

   c. For traffic levels justifying four laning, BOT (Toll) option may be adopted as per extant practice. If tolling was not successful, the option may be Annuity or EPC, with the choice being made on the basis of VFM analysis.

   d. For NHDP Phase V projects, which do not justify six-laning on traffic considerations, a VGF grant, higher than 10 percent of TPC may be considered along with phased augmentation (in terms of construction of service lanes, etc.).

   e. Appraisal and clearance of Toll/ Annuity projects may be by PPPAC as per extant practice.

iv. Restructuring of highways through extensive cost cutting may not result in better bid response or optimal results. The six restructured and re-bid projects had not got the desired response in the recent past. Traffic (minimum threshold) was required to meet O&M expenses. Adhoc cost reductions in *prima facie* "unviable projects" also implied selective application of Manual of Specifications and Standards (MSS) and a bias against lesser-developed and low traffic volume areas. Furthermore, the life cycle cost of the project would be higher through such cost reductions and thus negate the short term gains, if any. Any cost cutting which resulted in compromise on safety was likely to be identified subsequently during 'safety audit' prescribed by the MCA, which would entail public expenditure to meet safety shortfalls. Hence, restructuring of highways may be undertaken with extreme caution, keeping safety considerations paramount since cost reduction alone cannot justify project viability in the absence of strong traffic/location fundamentals.

v. All project related parameters, such as structuring, project cost, bid documents require PPPAC clearance, before bidding, as per guidelines. Hence, all restructured projects should be cleared by PPPAC before bidding.

vi. Provisions of MCA/DCA were examined and certain changes recommended for better bid response and equitable sharing of risks:

   a. Article 25 may be amended to allow for the entire grant to be disbursed during the construction period as 'equity support'.
   b. The provision for 'O&M' support may be retained in square brackets to allow for project wise requirement.
   c. In Article 29, the effect of concession period, as a consequence of increase/decrease in annual traffic beyond the projected traffic may be left in square brackets.
   d. Article 29.2.3 may be made valid only in respect of projects with concession period beyond 18 years.
   e. Footnote 22 (Article 29) may be amended to provide for a rate of growth of traffic to be decided on past trends and traffic survey.
   f. The definition of PCU may include both tollable and non-tollable traffic.
   g. Exit policy provisions may allow dilution of equity upto 10 percent after 5 years from COD.
   h. OMT model may be considered for reckoning of premium in case of insurmountable operational difficulties with the current framework of revenue share.
   i. Updated figures of traffic and cost may be used/indicated in the project DCA. Figures for cost and traffic not more than 6 months old at the time of market offer.
   j. Traffic count may be taken at the toll plaza location.

vii. Modifications in RfP : Clause 2.1.18 may be removed for future projects. The RfP may clearly specify the extent of VGF to be permitted for the project.

viii. The land acquisition process may be streamlined so as to expedite handing over of the 'right of way' on the appointed date in accordance with the MCA.

ix. Capacity building in NHAI for evaluation of bid documents, project structuring and bid procurement. Reliance on consultants to be removed. Training programmes for officers may be organized.
x. Establishment of MIS on traffic, actual and projected cost, details of VGF disbursed at all levels and other contract management aspects allowing direct feeds/inputs and review by Independent Engineer, Project Management Unit, NHAI, MoRTH and PPPAC.
xi. Bunching may be avoided in off-loading projects to the market.
xii. Concession agreements may be signed at the earliest.
xiii. Other approaches for enhancing viability of road projects and alternate mechanisms for financing EPC and annuity modes of implementation may be identified.

8. The Chairman invited the members of the PPPAC to share their views on the findings of the study and the recommendations.

9. Secretary, Planning Commission emphasised the need for an innovative solution and development paradigm which would, through optimal use of available resources, result in holistic progress of developed areas as well as under-developed, resource rich areas. It was observed that establishing connectivity through a network of roads was critical in areas which were lesser developed to provide the critical impulse for development in the region. In these backward areas, the BOT (Toll) framework with VGF, up to 40 percent of total project cost, may not prove to be an effective instrument for developing a network of Highways. Hence, based on the experience of the recent years, there was a need to shift from the established mode of implementation of Highways to a simpler and faster way for infrastructure development. Allowing a committee headed by Secretary, RTH to determine whether the BOT mode would result in market response towards the project would facilitate this process.

10. Secretary, Planning Commission stated that many of the constraints to a strong market response for the projects had subsequently been addressed through modifications in the bid documents. Furthermore, there was greater stability and liquidity in the economy. Hence, bidding projects over a dispersed area in a phased manner was likely to attract a response for the projects.

11. Secretary, RTH observed that the study broadly supported the proposal of MoRTH for critical review of NHDP which was under consideration for deliberation by the Committee of Secretaries (CoS) and stated that the Ministry was in agreement with the recommendations of the study. It was emphasised that considerable time was spent in implementing the established procedure of first offering, even an unviable projects, on BOT (Toll) framework; then BOT (Annuity); before finally awarding it on the EPC basis. Besides the time lost, considerable organisational capacity of the limited staff of DoRTH/NHAI are also expended in the process. Accordingly, it would be appropriate that projects that do not justify capacity augmentation/ development on BOT (Toll) basis are directly bid on EPC basis. Further, in view of comprehensive assessment of the programme which has already been done by PPPAC secretariat and the ensuing discussions on its recommendations, the Ministry would consider directly taking their proposal to the CCEA, after consultation with the Cabinet Secretariat.

12. Joint Secretary, DEA clarified that the recommendations in the study regarding the possible mode of implementation varied from the process proposed by MoRTH. Instead of directly proceeding with EPC, the study recommended that a 'Value for Money (VfM)' analysis may be undertaken to establish whether the project should be implemented in BOT (Annuity) or EPC framework. It was emphasised that undertaking the VfM analysis before finalising the mode of implementation of a project was an internationally accepted practice. Further, the framework for the VfM analysis was fairly simple and therefore could be adopted for NHAI projects. If required, the PPPAC secretariat could demonstrate the same.

13. Chairman, NHAI emphasised the need for taking a corridor/cluster as the unit of planning instead of the current approach of implementing short project stretches on unit-by-unit basis. It was indicated that the Phase I & II of NHDP had been successful since these were connected corridors. Building short stretches, un-connected with each other, did not facilitate harnessing positive externalities or result in sound development geared to meet the future requirements. The success of the two Kerala project stretches validate that adoption of a cluster approach, after a preliminary network analysis, could be an appropriate approach for development of highways.

14. Chairman, NHAI noted that attempting a large scale reduction in the project cost would impact the safety and quality of the project highway. Furthermore, such an exercise was not feasible for the NHDP Phase III stretches, many of which required extensive reconstruction. An attempt to compromise on cost and standards of the stretches was likely to result in construction of highways which would be washed away in monsoons/ floods, and thus, bring disrepute to NHAI and the developers.

15. Chairman, NHAI stated that the Organisation was broadly in agreement with the analysis in the study and noted that an analysis of old and new MCAs in the context of better ability of the old MCA attract bids would also have been of value.

16. Secretary, Expenditure noted that the established mode of implementation of highways required a review and suggested that MoRTH/NHAI should, in the first instance, prioritise their programme and re-establish the targets. The Ministry may also review whether the proposed level of augmentation was necessary, especially the proposed six-laning, where the traffic did not warrant the augmentation.

17. Adviser, Planning Commission stated that availability of resources to undertake the NHDP required consideration. Since the resources available were limited, the PPP framework and efforts towards enhancing project viability were critical. It was stated that the assumption that the cost of a project did not affect its viability did not appear very sound.

18. Joint Secretary, DEA clarified that the study clearly stated that the project viability is affected by the traffic on the stretch and its cost. However, the analysis established the primacy of traffic over the cost of the project. Hence, the decision regarding development of a project stretch and its capacity augmentation should be based on its traffic. Further, the cost of the project was not flexible since project has to be built as per the established technical standards. Beating down the cost in an attempt to enhance its viability would be an exercise in futility since the life cycle cost of the project would increase.

19. Representative of Department of Legal Affairs stated that the Department had no comments to offer since the policy matters under consideration did not require a legal perspective.

20. The Chairman of the PPPAC thanked the PPPAC secretariat for undertaking and presenting a comprehensive study and advised that Report and the deliberations thereon may be sent to the Cabinet Secretariat. He suggested that Secretary, RTH, in consultation with the Cabinet Secretariat, could consider moving a Cabinet Note to expedite decision on the various issues constraining accelerated development of National Highways. Secretary, Planning Commission concurred with the proposed approach.

21. Member (Finance), NHAI observed that the study had examined specific provisions of the MCA and recommended certain changes in the MCA. These recommendations, which had implications on the nature of bid response towards the projects, could be deliberated upon by the PPPAC. Secretary, RTH stated that since the Ministry intended to place the entire matter before the Cabinet, changes in the MCA could also be approved in the same forum.

22. The meeting ended with a vote of thanks to the chair.

Annex

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List of Participants

I. Department of Economic Affairs

i. Shri Ashok Chawla, Finance Secretary (In Chair)
ii. Smt. L.M. Vas, Additional Secretary (EA)
iii. Shri Govind Mohan, Joint Secretary
iv. Smt. Aparna Bhatia, Joint Director
v. Shri Abhijit Phukon, Deputy Director

II. Department of Expenditure

vi. Smt. Sushma Nath, Secretary
vii. Smt. Meena Agarwal, Joint Secretary

III. Planning Commission

viii. Dr. Subas Pani, Secretary
ix. Shri Ravi Mittal, Adviser

IV. Ministry of Law

x. Smt.. Poonam Suri

V. Department of Road Transport & Highways

xi. Shri Brahm Dutt, Secretary
xii. Shri Nirmal Jit Singh, Addl. Director General
xiii. Shri P.K. Tripathi, Joint Secretary

VI. National Highways Authority of India

xiv. Shri Brijeshwar Singh, Chairman
xv. Dr A. Didar Singh, Member (Finance)