LEGAL FRAMEWORK FOR INFRASTRUCTURE AND ITS IMPACT ON CONSTRUCTION INDUSTRY

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The Infrastructure Focus Team of Nishith Desai Associates has been involved in analyzing trends in the infrastructure space. The Team has, at the behest of the Andhra Pradesh Government, drafted the Andhra Pradesh Infrastructure Development Enabling Act, 2001 with the support of Parimal Shroff & Co. The Team has constantly been involved in policy reform initiatives and had done extensive research in connection with the Elevated Light Railways Transport System (ELRTS) in Bangalore. On the Project Finance side, the firm has advised the lenders in connection with the financing of Birla AT&T’s telecom infrastructure.

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PART 1

OVERVIEW OF INFRASTRUCTURE PROJECTS IN INDIA

INTRODUCTION

When India announced its New Economic Policy ("NEP") in 1991, infrastructure was identified as one of the priority areas for rapid development and liberalization. The term "infrastructure" as generally understood includes within its fold power projects, roads, ports, water projects, telecommunication projects, railroads etc., the common feature of all of these being that they are very essential for the growth of trade and commerce and also for improvement in standards of living of a society.

Infrastructure was, prior to the announcement of the NEP, largely the responsibility of the public sector and the Central Government and the various states governments had retained control over the development and operation of infrastructure projects. The NEP however, sought to change this by commencing the process of partial privatization in these sectors by giving more incentives to the private sector to participate in these projects. It was argued by the proponents and supporters of the NEP that liberalization and deregulation of the infrastructure sectors would give a great fillip to the development of several infrastructure projects in a commercially feasible manner. However, in order to ensure that this commercial opportunity to the private sector did not result in disadvantage to the underprivileged sections of society, the Government announced private-public partnerships where the private sector and the Government would be partners in developing and operating infrastructure projects, rather than give the private sector total autonomy in these sectors. There was a lot of euphoria in the days immediately following the announcement of NEP about the revolutionary changes that the infrastructure sectors would go through owing to these reforms.

However, statistics indicate that all has not been well with Indian infrastructure, and a decade after the announcement of the NEP and several ad hoc amendments to the reforms, India still faces a situation of huge unrealized potential in the infrastructure space. None of the sectors have really lived up to their potential in terms of number of successful projects. Even with respect to projects which have closed, the closing of the projects has in many cases, been inordinately delayed. The state of infrastructure in Indian cities and villages clearly hasn’t improved by leaps and bounds from what was initially projected.

So what ails the Indian infrastructure sector? And where do they go from here? This paper attempts to study the issue from a legal perspective and analyze the changes that may be required in the legal framework governing the infrastructure industry in general, and its impact on the construction industry in particular. This paper would, for this purpose, analyze the existing legal framework and identify areas where the same can be rationalized and also identify the opportunities that the Indian construction industry can tap into resulting from such a rationalized framework. Further, this paper also looks at the impact of globalization as necessitated by the WTO Agreements and the various rounds of WTO negotiations, on the Indian construction industry.
EXISTING LEGAL FRAMEWORK

One of the major issues that a private player in the infrastructure space in India today has to contend with is the rather cumbersome regulatory framework that relates to infrastructure projects. A project developer is typically required to deal with compliance of a number of laws, some of them central, some of them state laws and some of them even being laws made by local authorities! Owing to the nature and size of infrastructure projects, they often tend to involve the application of several laws, and depending on the legislative competence relating to the matters concerned (as set out in the Seventh Schedule to the Constitution of India), the States or the Centre make laws in this connection. There does not exist in India today, any single legislation that would facilitate and address all regulatory concerns relating to infrastructure projects in general, or even relating to any specific sector in the infrastructure space.

As a natural fallout of the above, there is also a multiplicity of regulatory authorities the project developer has to contend with. Most of these myriad laws that affect the infrastructure sectors require the prior approval of some specified authority before certain actions can be undertaken by the project developer. This places the project developer in the unenviable position of having to run after several authorities, some of them even local authorities, for getting all the requisite clearances in connection with the project. In fact, in the early days following the liberalization of the infrastructure sectors, there wasn't even sufficient clarity on what was the exhaustive list of authorities whose approvals were required in connection with setting up a project in a particular sector.

To make matters worse, the approvals process is neither streamlined nor expeditious. The biggest challenge infrastructure project developers have faced in India is that of the immense delays in the commencement of the project owing to regulatory and administrative delays in clearing all requisite aspects of the projects. Often, as these various authorities operate under different ministries, co-ordination amongst these authorities is very poor, thereby making it more difficult for the project developer to obtain these approvals in a time-efficient manner. This has often caused huge cost over-runs for the projects, thereby resulting in re-opening of negotiations between the Government and the project developers, and pushing back further the commencement of the project.¹

There is also an absolute lack of conceptual clarity on the principles the Government would have to follow in determining the procedure for selection of project developers, the term of the concession period, the nature of incentives to be extended to project developers, the commitments to be sought from the project developers, the bidding process and so on. The absence of a legislation to address these issues and to lay down clear principles governing the selection of an infrastructure project developer and the rights and obligations of the developer upon selection has resulted in a lack of transparency in the whole process. This has been another reason why several key players in the infrastructure sectors, both Indian and foreign, have not been very enthusiastic about investing in projects in India.

The existence of such a comprehensive legislation would also address other prickly issues like relations between the Governments and Government bodies and the project developers. The most significant, and saddest, evidence of this point can be seen in the deterioration of the situation in the Enron debacle and the no-win situation both the project developers and the Government have reached. The Enron case has presented several interesting and yet unresolved legal issues, and revealed a lack of direction in policy-making that is shocking. With the numerous problems already plaguing the privatization drive on the infrastructure side, the Enron dispute may well turn out to be the proverbial last nail in the coffin, unless some decisive reforms are introduced, in a well thought-out manner. The most crying need for Indian infrastructure today is to send out the right signals to the industry players, so as to encourage them to invest in newer projects. One of the biggest steps that the various State Governments can take in this direction is the enactment of a comprehensive legislation that addresses all the significant issues relating to project development and operation, and which would lay down the operative principles governing the infrastructure sectors as a whole.

**SALIENT FEATURES A NEW LAW SHOULD CONTAIN**

Having discussed the need for a comprehensive legislation relating to infrastructure projects, it is now critical at this stage to identify the salient features of such a law. Accordingly, a legislation enacted for this purpose should contain the following features:

- Each state should have its own legislation with respect to infrastructure projects. Since most of the regulatory matters in any project are matters on which the state Governments are competent to legislate upon, it would be necessary to have state legislations for infrastructure projects. Further, having a separate law for each state in this regard also provides each state an opportunity to compete with the others in a healthy manner in attracting infrastructure projects.

- The law should create a single regulatory authority that would be responsible for administration and monitoring of infrastructure projects throughout the whole state. This authority should be the single point contact for project developers to get all requisite clearances from the state Government and local authorities, an provide a single-window approval for infrastructure projects. The law should facilitate effective co-ordination between this single authority and the various state and local authorities under the various existing laws.

- The law should set out in clear and extensive detail the process and procedure for selection of private project developers/operators for grant of concessions. The processes and procedures so laid down must ensure transparency and clarity of purpose. Such a procedure should be made common for all infrastructure projects in the state where concessions are to be granted to a private party, with the power to the state Government to make slight variations in the procedure for specified sectors based on that sector’s needs.

- The law should also clearly identify the broad responsibilities of a private project developer upon being granted a concession in respect of a project. There should be clear operative guidelines to the extent possible governing the ongoing operation of the infrastructure projects. The law should also seek to identify clear responsibilities of the developer and such information should be made available to all the bidders prior to the selection.
• The law should contain facilitative provisions with respect to Public-Private partnership projects, specifically setting out clear policies on terms of projects on BOO, BOOT or BOT basis. While too much detail in this regard may restrict the flexibility of the Government, it would be very useful for the private players to know the broad policy on the exact role they would play in such partnership projects and how it would impact the ongoing operation of the project.

• In addition to the incentives given to infrastructure companies by the Central legislations (for example, tax incentives for infrastructure companies), the state law should also empower the state Government to announce more incentives to developers either in infrastructure as a whole or to specific sectors. This would help states with dynamic Governments, like Andhra Pradesh, to attract investments in the infrastructure space.

ANDHRA PRADESH INFRASTRUCTURE DEVELOPMENT ENABLING ACT, 2001 (“AP IDEA”)

The Andhra Pradesh Infrastructure Development Enabling Act, 2001 (“AP IDEA”) is the first ever state law to be enacted in India for the purpose of governing infrastructure projects throughout the state. This legislation came into force on August 20, 2001, and is a huge step in the direction of providing a facilitative environment for infrastructure projects within a state. Nishith Desai Associates was involved in the drafting of the entire legislation at the behest of the Government of Andhra Pradesh. The significant features of the AP IDEA are discussed below in brief. As may be seen, several of the salient features mentioned above have been addressed in the AP IDEA.

• Creation of an “Infrastructure Authority” for the entire State of Andhra Pradesh which would have the responsibility of regulating and monitoring infrastructure projects throughout the State of Andhra Pradesh. The decision of the Infrastructure Authority on claims relating to infrastructure projects would be final and binding on all statutory and governmental authorities in the State of Andhra Pradesh. The Infrastructure Authority has also been given a wide range of powers to monitor the project developers, including the power to call for information about the status of the project etc. from time to time. The Infrastructure Authority would also have a wide range of facilitative functions such as de-bottlenecking of the project development process, acting as the single-window clearance authority for the entire state with respect to infrastructure projects, gauging and building public opinion vis-à-vis specific infrastructure projects etc.

• Identification of clear guidelines for selection of project developers for grant of concessions. The AP IDEA also provides for the adoption of certain internationally accepted selection procedures, like the Swiss Challenge Approach and direct negotiation approach.

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2 The preamble to the APIDEA states as follows: “An Act to..............
3 Sec 3. For definition of “Infrastructure Authority”, see Sec 2(m)
4 Sec 13(1)
5 Sec. 13(2), Sec. 13(3) and Sec. 13(4)
6 See Sec. 12
7 See Sections 23 & 24
8 For definition of “Swiss Challenge Approach”, see Sec. 2(aa)
competitive and transparent bidding etc. not only for the primary selection process but also for selection of alternate developers.\(^9\)

- Power has been given to the Government and to the Infrastructure Authority to impose “Abuser Charges”\(^10\) and “Polluter Charges”\(^11\) on errant project developers for either not living up to their concession commitments or for other violations of the Act. This would introduce an element of fixation of responsibility on the project developer for any breaches of the Act, the Concession terms etc. and would act as a deterrent to developers who tend to go behind schedule without good reason.

- The AP IDEA also provides for an interesting concept, namely, that of an unsolicited or \textit{suo motu} proposal by a project developer. While all projects are usually bid for upon a decision in this regard by the Infrastructure Authority, private developers may also on their own initiative, bring a proposal to the Government. The Infrastructure Authority shall consider the same in its entirety and if the proposal is found to be viable, then the entire selection process as would be followed if the Government had initiated the project, would be followed in this case as well and the concession finally given to the most appropriate party.\(^12\)

- The AP IDEA also lay down clear criteria which the Infrastructure Authority is required to take into account in considering whether a project is viable, and also to determine which bidder is to be awarded the concession.\(^13\)

- With respect to disputes between the developers and the Infrastructure Authority and/or other Government bodies, the AP IDEA provides for the creation of a Conciliation Board, and goes on to provide further that any proceedings before the Conciliation Board would be treated as a judicial proceeding under Sections193 and 228 of the Indian Penal Code, 1860 and that the Conciliation Board shall be deemed to be a civil court for the purposes of Section 195 and Chapter XXVI of the Code of Civil Procedure, 1908.\(^14\)

- The AP IDEA also provides for the creation of an Infrastructure Development Fund to finance developmental projects which the State requires.\(^15\)

**HOW INDIA COMPARES WITH OTHER ASIAN COUNTRIES**

In order to get a perspective as to how the Infrastructure sector in India has fared, it would be a good idea to look at some comparative statistics from the neighbouring countries. These countries, though suffering from similar deficiencies in their infrastructure facilities have managed top outstrip India in the provision of better facilities to their people.

\(^9\) Sec. 22  
\(^10\) Sec. 2 (a)  
\(^11\) Sec. 2(bb)  
\(^12\) Sec. 2(cc)  
\(^13\) See Chapters IV and V  
\(^14\) \textit{ibid}  
\(^15\) See Chapter VI
INDIA’S TELECOMMUNICATIONS PERFORMANCE COMPARED WITH THAT OF NEIGHBOURING COUNTRIES\textsuperscript{16}

<table>
<thead>
<tr>
<th>Country</th>
<th>Telephone Mainlines per 100 People</th>
<th>Waiting List as Percent of Mainlines in Operation</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>1.9</td>
<td>15.2\textsuperscript{a}</td>
</tr>
<tr>
<td>Indonesia</td>
<td>5.6</td>
<td>1.5\textsuperscript{a}</td>
</tr>
<tr>
<td>Malaysia</td>
<td>19.5</td>
<td>4.2\textsuperscript{a}</td>
</tr>
</tbody>
</table>

\textsuperscript{a} Data refers to years other than 1997

INDIA’S WATER PERFORMANCE COMPARED WITH THAT OF NEIGHBOURING COUNTRIES\textsuperscript{17}

<table>
<thead>
<tr>
<th>Country</th>
<th>Access to Safe Water (Percent) 1993</th>
<th>Availability\textsuperscript{a} (Hours/Day) 1995</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>85</td>
<td>4</td>
</tr>
<tr>
<td>Indonesia</td>
<td>83</td>
<td>24</td>
</tr>
<tr>
<td>Malaysia</td>
<td>65</td>
<td>18</td>
</tr>
</tbody>
</table>

\textsuperscript{a} Water availability figures are for the cities of Delhi, Beijing, Jakarta, Kuala Lumpur, Lahore and Colombo

PART 2

THE INDIAN CONSTRUCTION INDUSTRY

INTRODUCTION

Construction has always been a very important and lucrative business in India. The demand for urban infrastructure and welfare projects of the Governments, coupled with the ever-growing demand for urban housing, has always kept the construction industry in business. There have of course, been spells when the industry has faced a lull, but the industry has always bounced back with vigour.

India’s construction industry presents an interesting canvas of economic activity. It employs a workforce of 32 million, its market size is estimated at Rs. 2,200 million, making it the second largest contributor to India’s GDP, next only to the agriculture sector.\textsuperscript{18} On the expenditure


\textsuperscript{18} Singh, Ranjit Dr., available at http://www.indianpurchase.com/magonline/construction/200108/article3.htm2302202
side, the construction industry accounts for about 40-50% of the total capital expenditure on the infrastructure sectors.\(^{19}\) This, coupled with the fact that India is a country where the demand for housing and urban infrastructure far exceeds the supply, leaves no doubt that the construction industry is one of the most promising industries, which needs to be given the right incentives and a conducive environment to operate in.

However, if one asks the question “Has the potential of the construction industry been fully tapped?”, the answer unfortunately, has to be an emphatic “NO”! The Indian construction industry suffers from several ills, some of them related to the regulatory and administrative hurdles and some of them related to the lack of clear organization in the industry.

Further, the construction industry has in a way, been forced to ride piggyback on other infrastructure sectors. In other words, business for the construction industry has largely depended on the speed at which infrastructure sectors have grown (with the exception of the housing segment). This has essentially meant, for the reasons discussed in Part 1 of this paper, the construction industry has never really got a fair chance to exploit its potential fully and has largely relied on the real estate segment for its growth.

**LAWS GOVERNING INDIAN CONSTRUCTION INDUSTRY**

As we have discussed the adverse impact of restrictive laws and inefficient administration on the construction industry, it is now pertinent to have a look at the laws that currently govern or influence the construction industry in India. Broadly speaking, the following laws can be said to have a significant impact on the growth of the construction industry in India:

- Transfer of Property Act, 1882
- Land zoning laws in various states
- Land ceiling laws of various states
- Environmental laws
- Exchange control & foreign investment laws
- Income Tax Act, 1961
- Indirect taxation laws (Excise, Customs, Sales tax etc.)
- Stamp duty laws of various states
- Labour laws.

**BOTTLENECKS IN THE CONSTRUCTION INDUSTRY**

There are several bottlenecks affecting the Indian construction industry and preventing it from realizing its full potential. As already stated, the industry is fairly disorganized in comparison with other much smaller industries. This has resulted in an absence of effective and organized industry-level lobbying. Further, the industry is also plagued by a lack of transparency in

\(^{19}\) *ibid*
transactional dealings, particular in real estate transactions. 20 This is primarily because of restrictive laws, high rates of stamp duty, lengthy registration processes, inflexible tenancy laws etc. 21 The administering authorities under many of these laws are also extremely slow and bureaucratic in granting their approvals (prior or post) to transactions involving the construction industry. These factors have resulted in the construction industry not getting the right impetus for surging forward and realizing its potential.

With the recent announcement of the Union Budget, 2002-2003 however, hope seems to loom in the horizon for the industry, at least with respect to the housing and township development segments. The Finance Minister in his budget speech announced that the Government would be taking various measures that would benefit these segments, including rationalization of stamp duty by offering states incentives to do so, putting in place effective systems to expedite the registration process (like introduction of online land records), waivers from customs duties on equipment imported by the construction industry players for use in housing projects, township development etc. 22 It remains to be seen however, whether these measures are given effect to in a timely manner, especially the rationalization of stamp duty and the online land records systems.

The construction industry is not governed by any national level policy but is rather governed indirectly by the National Policies pertaining to various infrastructure sectors, as the construction industry in a way rides on the fortunes of these sectors. A national level policy to govern the construction sector will go a long way in improving the profitability of the industry as it will introduce a higher degree of professionalism and transparency in the industry. There is a crying need for the industry to adopt internationally accepted best practices in the way it conducts business. In the absence of such a “code” of best practices, the construction industry suffers from a sort of backlash arising out of lack of a high level of confidence amongst the potential customers. This is probably another main reason why despite demand far exceeding supply in the housing segment, for example, the industry went through a slowdown after 1995 for about 4 years.

Putting in place a detailed set of well thought-out operative guidelines or best practices for the construction industry players, and if necessary, appointing a specific regulator to oversee the conformance with the same would introduce not only international levels of quality in Indian construction but also give it the halo of professionalism that is today so necessary in order to successfully capitalize on any opportunities in an increasingly globalize world. The opportunities that globalization throws up have been discussed in detail in Part 3 of this paper.

Another significant bottleneck that has historically impaired the rapid growth of the construction industry across all segments is the limited sources of financing available to the industry. The construction industry has thus far been funded largely by private sources of finance, and there has been a lack of institutional funding. However, last year, the IDBI Act was amended so as to

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20 See supra n.1
21 See supra n.1
22 FDI in housing and township development was liberalized upto 100% as recently as February, 2002
give “industry status” to the construction industry.\textsuperscript{23} What this means is the construction industry can henceforth seek institutional funding from financial institutions like ICICI, IDBI etc. While these institutions have been funding infrastructure project development companies for quite a while now, they have not been funding the construction companies as such. This position will now change, and hopefully, this should give the industry a big boost. However, one must bear in mind that despite the “industry status”, these institutions are unlikely to significantly fund construction companies unless they see a move from the industry towards global best practices and professionalism.

IMPACT AN INFRASTRUCTURE LAW WOULD HAVE ON CONSTRUCTION INDUSTRY

The enactment of comprehensive state level legislations governing the infrastructure sectors as a whole is very likely to have an impact on the construction industry as well, for, as already discussed, the construction industry often piggybacks on the opportunities in the infrastructure sectors as construction activity is an inherent and inseparable part of any infrastructure project. It is therefore important to note that the construction industry is an important stakeholder in any reforms to the infrastructure sectors. In other words, any reforms relating to infrastructure projects, including changes to the regulatory framework, would be much more effective if they addressed some of the concerns of the construction industry as well.

The introduction of a state level legislation on infrastructure projects as discussed in detail in Part 1 could potentially bring in the following benefits to the construction industry by suitably addressing the same.

\begin{itemize}
  \item It would, to some extent, remove the difficulties occasioned by procedural inefficiencies caused by a multiplicity of regulators. Since many of the approvals required currently for various infrastructure projects pertain to the contracts to be implemented by the construction industry, this would in some ways directly benefit the construction industry as well.
  \item It would introduce transparency in the selection of contractors by the Government in connection with Government Construction Contracts.
  \item The regulatory framework relating to infrastructure projects could also offer taxation and other incentives for construction contractors.
  \item The same law which sets down responsibilities and quality control standards for infrastructure projects could also provide for similar standards to be conformed to by construction contractors. This would introduce the element of professionalism that would boost the image of the construction industry.
\end{itemize}

\textsuperscript{23} See \textit{supra} n.16
PART 3

GLOBALIZATION OF THE INDIAN CONSTRUCTION INDUSTRY

OPPORTUNITIES IN A GLOBALISED ENVIRONMENT

In an increasingly globalised world, necessitated by the WTO Agreements and the negotiations thereon, most access barriers to trade are unlikely to survive for long periods. Due to the General Agreement on Trades and Services ("GATS") to which India is a signatory, India is required to progressively liberalise its economy and remove the access barriers to its domestic market, with the exception of certain specified sectors. Construction and engineering services are not among such exempted services and would therefore have to be free of market access barriers. Consequently, India has liberalized the norms for foreign investment and has allowed investment under the automatic route in several sectors, including in the infrastructure and in the construction industry for the housing and town planning segments.

This move towards liberalization is likely to continue as evidenced by the Union Budget, 2002-2003. The Finance Minister has announced that the Indian companies will now be able to invest up to USD 100 million, using funds not exceeding 50% of its net worth, in companies abroad. If the proposed investment exceeds the above limits, then the prior approval of the Reserve Bank of India will have to be obtained.

As India opens up to the world, India too would look to exploiting the opportunities for undertaking infrastructure projects abroad. Countries where basic support systems have been completely ravaged due to political exigencies, natural calamities, war conditions etc. present an immediate and lucrative opportunity for the Indian construction industry to establish itself as a serious contender in the global arena. A very relevant example in this connection would be that of Afghanistan, which has immense demand for construction and infrastructure services. According to the estimates made by the United Nations, World Bank and Asian Development Bank, in the coming 5 years, at least US $ 10 billion will be needed for Afghanistan’s reconstruction24, out of which USD 1.3 billion will be needed immediately. A substantial amount of this sum will be required to provide the basic infrastructure facilities to the people of Afghanistan. The core areas of reconstruction and rebuilding in Afghanistan would involve power, roads, transportation, telecommunications, housing, healthcare, education, agriculture and finance.25

CONCLUSION

The potential of the Construction Industry is undisputed. The challenge lies in providing the right impetus and a facilitating environment for the growth of the industry.


25 $ 2 Billion Multilateral Aid Package Mooted, Companies Urged to Tap Afghanistan as reported in Business Standard on January 7, 2001
As discussed earlier in the paper, the construction industry is an integral part of the infrastructure industry and any reform of the infrastructure sector must necessarily result in an impact on the construction industry. It is therefore imperative that in order to boost the construction industry, the bottlenecks, must, therefore be addressed at the infrastructure level.

A pre-requisite for the growth of any industry and to attract private sector (and also foreign) investments is the existence of a benign and stable regulatory framework. This is equally applicable to the construction industry.

The buck however does not stop with the government. The real onus lies on the construction sector to actually use the facilitative regulatory framework to deliver in terms of improving the quality of infrastructure and increasing the transparency in its dealings. Finance is the lifeblood of the construction sector. The infusion of finance would depend upon the extent to which the sector is able to develop and adhere to a code of “best practices” and inspire confidence in the public as well as the financial institutions.

In a globalised world, Indian construction industry is going to face increasing competition on its own turf by foreign players, especially because of the imbalance between demand and supply in the housing and urban infrastructure segments. There are two ways in which the Indian construction industry can address this threat:

1. By looking out for opportunities abroad, where it can effectively compete with the foreign players on cost advantage. However to do this, the industry must beef up on its levels of professionalism and quality control in order to be able to leverage on its cost advantage; or

2. By converting the threat into an opportunity through strategic alliances and merger opportunities with these foreign players. But here again, improving the standards of quality and professionalism to globally accepted levels is critical to the success of this approach. No international participant would want to associate with an Indian construction player, unless they are convinced of the value that the Indian players can contribute.

On a concluding note, regulatory reforms coupled with serious introspection by the Indian construction industry, would provide the panacea for all ills that the Indian construction industry faces today.