The “Non-Compete” Clause and its Alternatives for use in PPP Concessions

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Against the backdrop of continuing reservations of some states on the “non-compete” clause contained in State Support Agreements proposed by the Central Government, it may be useful to look at alternative mechanisms that can adequately protect PPP concessionaires from adverse impacts on project revenues as a result of construction of previously unplanned public facilities. The “non-compete” clause has been essentially designed to provide some degree of comfort to concessionaires and project lenders and help them reach early financial closure, but international experience suggests that the same objectives could be achieved through the use of alternate approaches that do not restrict or limit the ability of public bodies to construct additional infrastructure in the discharge of their democratic responsibilities.

Quite apart from this likely degradation of freedom of States to pursue public objectives, a blanket non-compete requirement, if not carefully crafted, may also run counter to Section 3 of the Competition Act, which expressly disallows anti-competitive agreements that restrict the provisioning of services. A recent study commissioned by the Competition Commission of India has already identified a number of areas of concern in relation to competition levels in infrastructure concessions, and extensive use of non-compete clauses could aggravate the problem rather than leading to best-value decisions.

Requiring states to give-up planned and/or ongoing infrastructure projects, merely to facilitate a PPP, could also run counter to the commonly-expected “due-diligence” responsibilities of bidders to carefully account for expected ground situations at the time of their project-structuring and bid-submission. In addition, such restrictions may have the ultimate effect of actually decelerating infrastructure growth by limiting the ability of States to cater to additional demand, even when such construction results in greater cumulative economic benefits. While it is undisputed that lenders and investors need to be able to make revenue projections based on reasonable assumptions about future demand in order to finance it against a long-term revenue stream; the fact remains that equally, and perhaps more importantly, the public sector needs to be free to invest in new infrastructure in the future to meet actual growth, whether foreseen or unforeseen.

In the history of transportation PPPs in the United States, there has been only one project actually built that prohibited construction of competing facilities—a restriction that was subsequently renegotiated and withdrawn. Instead of the non-compete clause, most of its state regulatory frameworks provide for possible compensation to be paid to the private operator if the construction of facilities not planned when the PPP agreement was executed results in a proven reduction in revenue for the privately owned facility. While some of these states have specific statutory provisions to provide for such compensation, some other state
frameworks achieve this through the insertion of specific clauses in particular contracts for development of toll roads.

In California, the statutory “reasonable compensation” formula applies with certain exceptions such as safety projects, additional high-occupancy vehicle lanes and the conversion of existing lanes to high-occupancy lanes; and under Colorado statute, a non-compete agreement is generally unacceptable, barring very few exceptions. The Transport Department in North Carolina is under statutory responsibility to maintain an existing, alternate, comparable non-toll route corresponding to each Turnpike project.

Under the Indiana Toll Road (ITR) project in the United States, concessionaires were entitled to compensation for an actual decrease in net revenue directly attributable to the opening of a “competing” highway — a competing highway being defined as one that is continuously within ten miles of the ITR for at least twenty miles. Similar provisions and definitions were mandated in the case of contracts relating to the Pocahontas Parkway/Trans-urban Concession and a number of other state highways, skyways and hot-lanes in the country.

In a strictly legal sense, a non-compete clause requires the public partner to prove that it has not constructed a competing facility, whereas a compensation-based provision lays the onus of proof on the private partner to show that it suffered actual and demonstrable harm as a result of such construction. The latter option creates a sufficiently narrow window that is far more effective at containing monopolistic behaviour in the markets for infrastructure supply and demand. The non-compete clause must therefore remain a choice of last resort for policy-planners rather than a blanket ab-initio insistence, even though it is certainly more attractive to investors or project lenders for obvious reasons.

For the reasons outlined above, it is important that governments apply the non-compete restriction selectively on a case-by-case basis after due economic diligence, and only after taking into account long-term supply- and demand-side projections for transportation networks. The “compensation for proximate revenue impact” formula as successfully implemented elsewhere should be explored as a potentially superior option as compared to current reliance on the non-compete clause. Simpler alternatives could also be designed in the form of public-sector entitlement to create additional infrastructure in the event of traffic on a privately-operated facility hitting a specified upper-bound.

While the choice of a non-compete clause may have some merit, the adoption of suggested alternatives could result in equally satisfactory levels of private-sector comfort, without unnecessarily compromising the ability of public bodies to discharge their democratic responsibilities in the provisioning of public infrastructure and citizen services.

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