To

The President,
World Bank
1818 H Street, NW Washington, DC 20433 USA
Tel: (202) 473-1000

Dear Mr. Jim Kim,

Subject: Letter of Development Policy

You would be aware of the request that we had sent to the World Bank, through the Government of India (Department of Economic Affairs) for assistance in the improvement of Water Supply and Sewage service delivery in Shimla Area.

I write to you to share our Development Objectives for the water supply and sewage sector in Himachal Pradesh, starting with the Shimla Area. Shimla is the capital city of the State of Himachal Pradesh and the Greater Shimla Area is a primary economic engine for the State’s growth.

One of our development goals is to provide essential services to all households at their doorsteps. The State has made commendable progress in providing electricity and toilets in all households. Providing reliable piped water supply and sewage services to all households is an equally important governance priority for us. The Government continues to allocate its budgetary resources to support improvements in water supply and sewage sector. Even while making resources available, we are also acutely aware that investments alone will not lead to achieving service delivery. The administrative and service delivery arrangements are outdated and hold us back achieving our service delivery objectives. There is no focus on financial sustainability and therefore the sector continuously relies on Government support. The Shimla Area especially faces an acute combination of inadequate infrastructure, lack of local water resources, weak capacity and poor cost recovery.

Background to the water supply situation in Greater Shimla Area

The Greater Shimla Area is home to approximately 200,000 people. Since it is a capital city and a popular tourist destination, another 160,000 visit the city daily for work, education and tourism during peak season. The existing water supply system has grown organically from a designed capacity of 60,000 people.
The areas outside the Shimla city are witnessing high urbanization but have a water supply and sewage system designed to provide rural standards of supply. The city is unable to supply the required supply of 135 litres per capita per day to its residents and increased tourist flows aggravate this situation. At present, the city receives water supply for 1.5 hours daily or alternate days. The water losses are above 50 percent and the city recovers only 21 percent of the cost of operations and is dependent on Government subsidies. Apart from this the responsibility for supplying and distributing water in the city was divided between many departments. The mixed responsibility had led to issues of coordination, technical division and the persistent problems of possible discord. This is an important factor also responsible for unsatisfactory service delivery levels.

At the end of the year 2015 Shimla witnessed the outbreak of jaundice which resulted in fatalities. The cause of the epidemic was identified as contamination of one of the drinking water sources by the failure of an upstream sewage treatment plant. The Honorable High Court, Shimla, on its own motion took cognizance of jaundice outbreak and commanded the State Government “for creation of a post/statutory body, to be manned by a competent authority and members along with requisite staff in order to deal with entire water supply system of Shimla Town, also to deal with the entire water crisis relating to the State of Himachal Pradesh.”

The Government of Himachal Pradesh constituted a Committee under the Chairmanship of Additional Chief Secretary (Health) to examine the constitution of such authority and different models being followed at other parts of the country, the structure and processes being adopted in Shimla city and to give recommendations regarding constitution of such authority as needed.

The committee, after examining various options proposed that a separate, ring fenced, Greater Shimla Water Supply and Sewage Circle (GSWSSC) be created under the municipal corporation for delivery of all integrated services related to water supply and sewage disposal. The committee also recommended a stage by stage roadmap that included transforming this circle into a company after 1-2 years and addressing all issues related to WSS including infrastructure deficit, human resources, performance indicators, service delivery benchmarks, monitoring tools, enforceable contractual agreements and a customer orientation toolkit. This proposal was approved by the Government through Government Order (IPH-B(A)1-1/2016 dated 12th July 2016) and the Circle was created. This marked the articulation of a comprehensive Government policy towards WSS sector and especially for Greater Shimla Area, which went beyond asset creation and addressed institutional issues.

Since 2016, the GSWSSC has improved the WSS situation in the Greater Shimla Area and has stabilized the water supply operations. Water quality issues have been brought under control and it is being monitored independently now. Repairs and rehabilitation in the bulk water system has increased the bulk supply capacity to 45 mld from 39 mld. The sewage network in the city is being expanded and sewage treatment plants are being rehabilitated. GSWSSC also
entered into a Water Operator Partnership with World WaterNet to benefit from professional support. With these measures the emergency of shortages and poor water quality has been stabilized, though the underlying constraints remain.

Key Objectives of Government’s Reform Program

While the immediate crisis has been resolved and the situation has stabilized, the Government is aware of underlying constraints and that a narrow crisis handling approach is not sustainable. The GoHP is also aware that the issue is not merely inadequate infrastructure. This had been highlighted in the Water Policy of 2013 but had not been operationalized in any part of Himachal Pradesh.

To systematically resolve the water crisis in the Shimla region, the GoHP has now decided to implement a medium term WSS plan, which is a comprehensive roadmap as per the Water Policy and the recommendations of the Committee. The plan would be implemented in the Greater Shimla Area to start with and will be extended to other municipalities in Himachal Pradesh thereafter.

The key feature of the medium-term plan is a stage by stage, comprehensive roadmap covering all aspects of WSS. The medium-term plan establishes WSS standards in Greater Shimla Area, covering service standards, operating efficiency standards and energy efficiency standards. These standards would be applied uniformly across Greater Shimla Area, irrespective of whether an area is characterized as urban or rural. These standards cover both water supply and sewerage and target universal coverage and full water quality and effluent quality compliance. GoHP will provide grants to meet the capital expenditure required to achieve the service standards. Further, under the medium term WSS plan, GoHP will focus on a) Improving governance, managerial and financial autonomy, b) Increasing efficiency of WSS operations, and c) Increasing customer orientation and accountability.

Improving governance, managerial and financial autonomy

All WSS functions of policy making, regulation, asset ownership and service delivery were by and large under a departmental structure. While the desirable separation of powers was lacking, there was also undesirable fragmentation of service delivery responsibilities between various agencies. GoHP intends to correct this situation and separate WSS powers and integrate service delivery responsibility.

GoHP, along with SMC, has incorporated a WSS company, called Shimla Jal Prabandhan Nigam Limited (SJPNL). SMC has a shareholding of 51 percent in SJPNL. The Government of Himachal Pradesh has a shareholding of 49 percent of the company, representing the interests of the Gram Panchayats and other regions of the State where the company may operate in future. The Shimla Municipal Corporation (SMC) has already delegated WSS responsibilities to the company under the Municipal Corporation Act.
GoHP has reviewed its experience with State Owned Enterprises in the electricity and tourism sectors and under the Smart City Mission. Based on this experience, GoHP has decided that to start with, the company would be governed by senior most officers of GoHP and would have two independent directors. Accordingly, the Chairperson of SJPNL is the Chief Secretary to the Government of Himachal Pradesh, reflecting the priority and importance given to SJPNL. The Board of Directors consists of senior representatives from GoHP and SMC. GoHP is in advanced stages of inducting two independent directors, one representing the interests of citizens/civil society and the other a water and sewerage sector professional. The company will also enter into a partnership with a publicly owned global WSS utility. Under the partnership, WSS utility experts with international experience in utility turnaround will advise Managing Director cum Chief Executive Officer. GoHP and SMC have provided full operational and financial autonomy to the Board of Directors and the Articles of Association of the company already reflect this. The composition of the Board of Directors ensures governance and autonomy for the WSS company. Given the unprecedented reforms being taken up, this structure, to start with, would be most acceptable.

GoHP is committed to build the human resource capacity of SJPNL. The WSS operations require high technical experience with familiarity of operating in challenging hilly terrain with high ecological sensitivity and related policy and institutional aspects. This experience rests largely with the Engineers in Government in WSS sector in Himachal and therefore a senior Engineer from the Irrigation and Public Health Department, with experience in similar challenging terrain, has already been appointed as the Managing Director and CEO of SJPNL and will also serve as a Director in the Board of SJPNL. The Board has also framed a human resource policy, organization structure and staffing requirements. The company will hire senior management positions for customer service, contract management and finance from the market. SJPNL has already hired a finance manager and a company secretary from the market. SJPNL needs staff familiar with the local situation and who are trusted by the consumers and stakeholders. Therefore, during the initial years, SJPNL would rely on staff seconded from SMC and other departments of GoHP and will gradually increase hiring of staff from the market. SJPNL has the freedom to hire from the market and fix compensation. The Board has approved internal delegation of powers within the company. SJPNL will also establish a system of performance incentives for its staff based on practices in the electricity and transport sectors. The incentives would be introduced after service levels are improved in Greater Shimla Area and public confidence in SJPNL improves.

To ensure good governance, SJPNL has already framed a corporate governance policy, adopting legal requirements as well as voluntarily adopting good practices. SJPNL has also formalized internal performance evaluation policy and internal performance targets. SJPNL's performance will be evaluated annually and this will ensure good corporate governance and performance orientation within SJPNL.

WSS operations in Greater Shimla Area recover only 21 percent of
the operations and maintenance costs. Given the high cost of bulk water in Shimla, which will be pumped over an elevation of 1400-1600 meters, full O&M cost recovery is unlikely in the medium term. GoHP has finalized a cost recovery roadmap that provides for gradual improvements in O&M cost recovery, reaching 66 percent by 2033-34, with interim milestones of 100 percent recovery of water distribution and sewage costs (excluding cost of bulk water) by 2021-22. To ensure SJPNL is financially sustainable, GoHP has committed to provide O&M subsidies up to Rs 120 crores per year (17.4 million USD) which would be sufficient to meet the cost recovery gap till the year 2030. GoHP and SMC have already approved an increasing block volumetric tariff with automatic annual escalations. Formal stakeholder consultations have confirmed that all sections of consumers, including low income households, express high willingness to pay the proposed tariff and that they consider the volumetric tariff structure equitable. The tariff structure reduces the monthly bill of poor customers by 50 percent compared to the current flat monthly tariff. The tariff structure will also meet the cost recovery roadmap of GoHP. To ensure objectivity, GoHP has finalized the regulatory mechanism for tariff revisions and subsidy calculations. The Board of Directors will recommend tariff revisions and subsidy estimates to GoHP based on the cost recovery roadmap of GoHP taking into consideration formal opinions provided by the independent directors. A formal cost recovery roadmap, tariff structure with preapproved periodic revisions and the assured O&M subsidy ensure financial sustainability of operations. The regulatory mechanism of the Board of Directors recommending tariff revisions and subsidies to GoHP also ensures objectivity of these decisions.

**Increasing efficiency of WSS operations**

GoHP is conscious that the past practice of financing infrastructure has not resulted in service delivery to customers. Therefore, SJPNL will enter into performance-based contracts with operators who have the necessary expertise in providing 24x7 supply to customers and in energy efficiency in WSS operations. World Bank organized a global Webex conference where international WSS experts and operators shared experiences of performance-based contracts. Based on the learnings from this conference and the priorities in Shimla, GoHP and SJPNL have identified three performance-based contracts and the principles that the performance-based contracts should follow. Since energy costs in WSS are high in Greater Shimla, SJPNL has completed an energy efficiency study and has identified improvements possible. Based on the findings GoHP has specified a 20 percent target in reduction of energy consumption. Through these measures, GoHP will achieve a departure from conventional infrastructure financing approach to service delivery approach using performance-based contracts.

**Increasing customer orientation and accountability**

GoHP already has a legal framework for customer accountability under the Himachal Pradesh Public Services Accountability Act (2011). In line with this Act and based on the findings of a detailed Poverty and Social Impact Analysis, SJPNL has developed mechanisms for customer orientation and accountability. SJPNL will establish modern customer service centres and develop a new
connection policy that simplifies procedures for new connections. SJPNL has also developed special provisions for poor and vulnerable, including for providing shared or individual connections, ease of grievance registration, payment modalities, tracking of service standards, grievance redressal and focused outreach to the poor and vulnerable. The tariff structure already has special provision for lifeline consumption and SJPNL will track and limit the share of monthly expenditure of the poor on WSS. SJPNL has finalized a communication strategy to engage with various stakeholders. SJPNL has also developed a grievance redressal mechanism.

SJPNL will also establish a comprehensive database, IT systems and performance evaluation systems to monitor and disclose disaggregated performance information (with emphasis on service delivery to poor and vulnerable) to all stakeholders and the public. It will increase information access to SMC, the poor and vulnerable citizens. The Board of SJPNL will carry out systematic evaluation of SJPNL’s performance, corporate governance, customer grievance redressal and staff satisfaction. The Board will also carry out annual customer survey and disclose corrective actions. The independent directors will assist the Board in these evaluations. SJPNL will publish the results of this evaluation and the corrective actions taken.

SMC and SJPNL will be taking on roles that they haven’t performed before. It is important to build the capacity of SMC and SJPNL so that they perform their roles as envisaged as well as to ensure that SJPNL’s autonomy is not diluted due to micro management or over regulation by stakeholders. GoHP will organize capacity building support for SMC through a WSS expert, and for SJPNL through an institutional partnership with an international publicly owned utility.

The GoHP and SMC have issued Government notifications and approvals as follows:

**Medium-term Program and formation of SJPNL:**
(a) Government notification of Medium-term WSS Program, with a) role and responsibilities of SJPNL, b) WSS service standards including energy efficiency standards, institutional and policy targets, c) GoHP grants for capital investment, d) principles of performance-based contracts, e) cost recovery, tariff and subsidy policy, regulatory mechanism, and f) customer orientation and accountability (2018)
(b) Cabinet resolution for formation of SJPNL (2018)
(c) SMC resolution for formation of SJPNL (2018)
(d) Delegation of WSS functions by SMC to SJPNL (2018)
(e) Approved tariff structure (2018) and also the tariff, cost recovery and subsidy policy (2018)

**On structure and policies for SJPNL:**
(a) Memorandum of Association
(b) Articles of Association
(c) Organisation Structure and Human resource (HR) Policy
(d) Corporate Governance Framework
(e) Internal performance evaluation policy
(f) Monitoring and Evaluation and Grievance Redressal Mechanism
The Board of Directors of SJPNL will implement the approved policies and have already authorized the Managing Director cum Chief Executive Officer of SJPNL to take the necessary actions for Implementation.

The medium-term plan of WSS has acceptability across a wide spectrum of stakeholders. The plan builds on the Water Policy of 2013. It is consistent with the observations and instruction of the High Court. The plan adopts the stage by stage roadmap recommended by the GoHP committee. The concerned departments of GoHP and SMC are represented in SJPNL. The interests of all existing employees of SJPNL, seconded from SMC and IPH are fully protected. The proposed cost recovery roadmap and subsidy policy adequately protect customers from rapid increase in tariff and at the same time ensures sustainability of SJPNL. Low income households have special provisions for access as well as lifeline consumption. Given the shortage of water in Shimla, all customer groups are in favour of the medium-term plan and stakeholder consultations have confirmed this.

The medium-term plan has been prepared carefully over nearly three years. The Committee itself had wide consultations including with Ministry of Urban Development, GoI, World Bank and other development agencies. SMC and GoHP departments had signed a Memorandum of Understanding in 2017 committing themselves to several of the steps included in the medium-term plan. A Technical Monitoring Group headed by the Chief Secretary routinely reviewed steps and decisions leading up to the medium-term plan. An institutions options study commissioned by World Bank reviewed various options of WSS utility structure, PPP, financial sustainability, regulatory mechanisms etc. A global webex conference informed GoHP on several International and Indian examples in performance-based contracts. A poverty and social impact assessment consulted several stakeholder groups. Reforms such as setting up of SJPNL, volumetric tariff, efficient water distribution have been discussed widely in the local media. The institutional options have been widely discussed by the elected representatives of SMC.

The medium-term plan is already under implementation. To demonstrate its commitment, GoHP has already initiated legal actions for implementation. The WSS company is already incorporated and the Board of Directors, chaired by the Chief Secretary is already operational. SMC has already devolved WSS responsibilities to the WSS company. The tariff structure has been approved by SMC and GoHP. Long term subsidies have been committed by GoHP. Human resources policy for SJPNL has been approved. SJPNL is in advanced stage of preparation of performance-based contracts. Therefore, critical reforms have either been implemented or in advanced stage of preparation, signaling the seriousness of the Government.

The package of multiple reforms may be seen by many as challenging and without precedence in the Indian urban water supply sector. At the same time, GoHP views it as an assurance of progress. The medium-term program does not depend on a single action for its success, such as capital investment, tariff.
In summary, I would like to reiterate that the Government intends to improve all aspects of WSS, governance, service delivery and financial sustainability. Over the past two years, the Government and SMC have already taken many steps in this direction and have mobilized support of diverse stakeholders. With a corporate structure, multi-year volumetric tariff, multi-year committed subsidies and capital investments in advance stage of preparation, SJPNL already has a firmer legal and institutional foundation than most other WSS operations in India. We are committed to continuously build the capacity of SJPNL as it expands its operations and engages with local bodies in other regions of the State. We are committed to demonstrate to the citizens of Greater Shimla Area, and to the rest of the State, quality services that are financially sustainable and are managed by an accountable WSS institution responsive to its citizens.

(B.K Agarwal)  
Chief Secretary  
Government of Himachal Pradesh