

Sustainability of Business vs. Sanctity of Contract

The Classical Debate



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Abbreviations

AEL:	Adani Enterprises Limited
APTEL:	Appellate Tribunal for Electricity
CAG:	Comptroller and Auditor General
CEA:	Central Electricity Authority
CERC:	Central Electricity Regulatory Commission
CGPL:	Coastal Gujarat Power Limited
CIRC:	CUTS Institute for Regulation & Competition
CSAs:	Coal Supply Agreements
FSAs:	Fuel Supply Agreements
GAIL:	Gas Authority of India Limited
GCV:	Gross Calorific Value
GSEB:	Gujarat State Electricity Board
GUVNL:	Gujarat Urja Vikas Nigam Limited
IPPs:	Independent Power Producers
ISO:	Independent System Operator
MoU:	Memorandum of Understanding
NCDP:	New Coal Distribution Policy
NDA:	National Democratic Alliance
NGOs:	Non-governmental Organisations
NMML:	Nehru Memorial Museum and Library
NPAs:	Non-performing Assets
PLF:	Plant Load Factor
PPAs:	Power Purchase Agreements
PPP:	Public Private Partnership
RE:	Renewable Energy
RfP:	Request for Proposal
RfQ:	Request for Qualification

SC: Supreme Court
SDR: Strategic Debt Restructuring
SECI: Solar Energy Corporation of India Ltd
SPVs: Special Purpose Vehicles

TPPs: Thermal Power Plants

UMMP: Ultra Mega Power Project
UPA: United Progressive Alliance

Reflections

...Faced with an impossible situation the CERC and APTEL ruled wisely aiming to keep much needed generation capacity operational and viable...Regulation is an out rule of law. If the Supreme Court cannot but look at matters purely legalistically regulatory matters should never reach them. Otherwise the point of instituting tribunals and regulatory bodies is lost.

*Sanjeev Ahluwalia
Advisor
Observer Research Foundation (ORF)*

...The Supreme Court is to interpret law and decide cases based on issues articulated by contending parties. Should private parties not weigh their own risks while signing contracts - long term or short term?

*Sri Ram Khanna
Managing Director
Consumer Voice*

...Bidding design allowed bidders to bid with pass through of fuel cost. Some did that but lost out to those who willingly bid fixed price or partial pass through. These winning bidders were seeking post bidding changes in risk allocation.

*Shantanu Dixit
Group Co-ordinator
Prayas Energy Group*

...The contract design was faulty. It should have constrained the bid to a certain part of the costs necessarily being scalable. However, weak capacity of state to enforce anything is part of the problem no doubt which made nearly everybody chose the non-escalable route.

*Sebastian Morris
Professor of Economics
Indian Institute of Management, Ahmedabad*

...This case demonstrates one of the kinds of ‘risks’ that the thermal power sub-sector faces in India at the moment. Not only are there such (market) risks stemming from price volatility of inputs (coal) and/or actions (in public interest) by judiciary/regulator as is the case here, but there are other kind of ‘risks’ as well.

*Rijit Sengupta
Chief Operating Officer
Centre for Responsible Business (C4RB)*

...Need to win will always be there and precisely for this reason it is absolutely essential to stick to the rule of law and avoid moral hazard...The Supreme Court judgement ensures the basic tenet of competition that the rules of the game should not be changed post-facto.

*Ashwini Chitnis
Fellow
Prayas Energy Group*

...Supreme Court should have commented on a bad contract design by the Government...

*Vijay Kelkar
Former Chairman
Thirteenth Finance Commission*

Preface

The future is uncertain and all one can do is to hope for the best and prepare for the worst. The lack of a strategy to deal with foreseeable risks is no excuse. However, what should be done in case unforeseen risks arise? Who should bear the costs of unexpected turn of events?

A change in Indonesian regulation impeded the ability of Indian coal power producers to use Indonesian coal at previously agreed price. The power producers wanted to pass on the increased cost of coal to consumers in form of compensatory tariff. It is a moot question as to whether this eventuality could have been foreseen as a possible risk. The request of producers was denied by the Supreme Court on the ground that this condition was not included as a force majeure condition under the contract. The inability of power producers to pass on the costs threatens their commercial viability, which in turn, adversely impacts interest of lenders, employees and has broader economic consequences.

Multiple issues are involved in this episode, such as: design of contract; responsibilities of bidder; role of contract awarding authorities; responsibilities of government; interest of consumers, industry and financial institutions; competence of quasi-judicial and judicial authorities, among others.

In order to provide common platform for discussion on such diverse interests, CUTS International ran an online debate on its email forum on the theme. The core of the theme was whether to preserve sanctity of contract (and allow business to suffer) or uphold sustainability of business (and allow contract to be reneged). Subsequent to the online debate, a roundtable discussion was organised. These initiatives witnessed rich participation from stakeholders having diverse perspectives. This publication compiles and summarises views expressed on the subject during the online debate, roundtable discussion, and noteworthy opinion pieces published in credible publications. In other words, this publication can boast of being a single most comprehensive source and repository of knowledge on different perspectives on the theme, and is a recommended reading for all interested in the issue. The effort led by Pradeep S Mehta and his team at CUTS and Arvind Mayaram and his team at CIRC is commendable.

The debate is far from settled. Further research is required on bidding mechanisms, design of contract, and conditions under which contract negotiation can be allowed. Mechanisms for ascertaining project viability and sharing of risk also need to be devised. Also, the extent to which economic efficacy of the system can be considered in judicial decision making needs to be assessed.

While no conclusion has been arrived on the debate as yet, what is certain is the need for balance. The underlying message is that interests of risk taking entrepreneurs need

to be considered without running a welfare state for capitalists. I am sure CUTS and CIRC will take forward the research in this extremely important subject.

Nitin Desai

Former Under Secretary General

Department of Economic and Social Affairs, United Nations &
President, Governing Council, CUTS Institute of Regulation and Competition

Acknowledgment

Efforts of several people have gone into making this book a reality. Involvement in various forms, such as direct inputs, thought provoking discussions, timely reviews, incessant encouragement and guidance have been crucial, in development of this book.

We gratefully acknowledge the assistance of Amol Kulkarni, Fellow and Kanika Balani, Senior Research Associate, CUTS International. We also appreciate the efforts of Madhuri Vasnani for editing, Rajkumar Trivedi and Mukesh Tyagi for preparing the layout of this book.

Last but not the least, this book would not have seen the light of the day without the skilful direction and guidance of Pradeep S Mehta, Secretary General, CUTS International.

Words alone cannot convey our sincere gratitude to each and every individual who have contributed in every small way towards bringing out this book. But it is only words that this world thrives on. We express our sincere gratitude to all such individuals, whether or not named above, without whom the publication of this book would not have been possible.

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1. Introduction

In 2012, Tata Power's Mundra Ultra Mega Power Project (UMPP) and Adani Power's Mundra Thermal Power Project filed a petition before the Central Electricity Regulatory Commission (CERC). The petition was made to revise the quoted tariff for supply of electricity from respective power plants on grounds of increase in the price of Indonesian coal along with other issues such as shortfall in domestic coal supply. Similar petitions were also filed before state commissions of few other states.

However, according to the contract, i.e. Power Purchase Agreements (PPAs) for these projects, the revision of tariff was allowed in two circumstances: change in law¹ and force majeure.²

Tata Power and Adani Power approached CERC claiming that change in Indonesian Laws³ should be treated as force majeure or a change in law event and be compensated for the financial burden imposed on this account. They claimed that compensation was necessary to protect not just projects but also financial institutions, i.e. lenders to projects. The CERC through its order⁴ dated February 21, 2014, allowed compensatory tariff to Tata Power and Adani Power by using its regulatory power under Section 79(1) (b) of Electricity Act 2003. It was decided that compensatory tariff was necessary to protect projects and their lenders, consumers from paying more tariff and thus, safeguarding the interest of the sector at large.

The decision was then challenged before the Appellate Tribunal for Electricity (APTEL) by civil society non-governmental organisations (NGOs), Prayas Energy Group and Energy Watchdog. In its judgement⁵ dated April 07, 2016, the APTEL overruled CERC's judgment but granted relief under force majeure provisions of PPA, on the grounds that change in the price of imported coal due to the Indonesian regulation was a force majeure event. On the direction of APTEL, CERC through its order dated December 06, 2016,⁶ granted compensatory tariff to Tata and Adani Power.

The matter was then escalated to the Supreme Court of India by all parties⁷ – power distribution companies, consumer representatives and power generating companies. The Supreme Court in its judgment dated⁸ April 11, 2017 overruled orders and judgment of APTEL and CERC which allowed compensatory tariff to Tata and Adani Power. In its judgement, the Supreme Court ordered that no compensatory tariff would

¹ a legal action of a government body or a court imposes any cost (or results in benefit)

² an unforeseen event that prevents or unavoidably delays the performance of obligations under the contract

³ Annexure 7.6 – Indonesian Regulations, http://www.cercind.gov.in/2013/Reports/COMREP_CGPL.pdf

⁴ <http://www.cercind.gov.in/2014/orders/S0159.pdf>

⁵ http://aptel.gov.in/judgements/Full%20Bench%20Judgment_07.04.16.pdf

⁶ <http://www.cercind.gov.in/2016/orders/155MP2012.pdf>

⁷ <https://indiankanoon.org/doc/29719380/>

⁸ *Ibid*

be charged from consumers against the increase in cost of coal imports from Indonesia as this change cannot be treated as either change in law or force majeure event. However, the Supreme Court states that changes in domestic laws can be treated as a change in law event.

Figure 1: Synopsis of Events

  <h1>No Relief</h1>		
How did it start? In 2010, Indonesian government changed coal pricing policy to link rates to international benchmarks	What did CERC say? Compensatory tariff allowed for Tata, Adani	What Supreme Court said Ruled against compensatory tariff for cos
Who was impacted? Cos like Tata Power, Adani Power that had projects running on Indonesian coal	What did APTEL say? Ruled in favour of Tata, Adani. Said they should get compensatory tariff	What next for Tata, Adani? Not much legal recourse available. Project viability threatened
What did they seek? Asked for higher tariff to pass on additional burden	What did discoms say? Challenged APTEL and CERC's authority on compensatory tariff	

Source: [Reproduced from Economic Times, April 11, 2017](#)

The verdict of Supreme Court of India requiring two private power companies to comply with the contracts they had signed has stirred a hefty public debate on the issues of relative importance of sustainability of business and sanctity of contract in India's power sector. One school of thought advocates that sanctity of contracts must be preserved to avoid '*moral hazards*'.⁹

Further, it was argued by experts that unforeseen losses of power generating companies should not be borne by the society as companies would have retained windfall gains, if there were any. However, opponents of this view argue that future investments might not be forthcoming unless a more practical view is taken, even if it undoes the sanctity of contract. It was further argued that the matter should be seen from the lens of sustainability of economy, as the Supreme Court's decision might have undesired effect on the health of financial institutions at large. If running a project becomes unviable for companies; it might fallout as Non-performing Assets (NPAs) for lenders which will then affect the economy as a whole.

⁹ Moral hazard is a situation in which one party gets involved in a risky event knowing that it is protected against the risk and the other party will incur the cost. Here in this case, one of the power company knowingly bided with such terms to win the contract and would like to pass on the additional burden to consumers.

Considering the above and to encourage a structured discussion on the issue, CUTS International has been leading efforts in stimulating views, counter views, suggestions and recommendations on the issue through multiple platforms to initiate the deliberations on the aforementioned subject. To this end, detailed analysis and opinions in media editorials were published along with an electronic-debate that was initiated on a CUTS e-forum. Subsequent to the enriching e-debate, Roundtable was organised by CUTS International in partnership with CUTS Institute for Regulation & Competition (CIRC) and Nehru Memorial Museum and Library (NMML) on June 24, 2017 to further discuss underlying issues related to the said Supreme Court decision and deliberate upon the way forward.

This e-book is a compilation of key inputs and published views of experts who have written or spoken on this issue. The book has been structured as follows: Chapter 2 contains the Problematique which comprises different and conflicting perspectives on the main issues, i.e. *Dilemmas in contractual disputes resolution*, Chapter 3 contains reflections from e-debate, Chapter 4 provides a summary of discussions held at the roundtable, and Chapter 5 contains some relevant writings of scholars and commentators.

2. Problematique

Several issues have surfaced after the Supreme Court's judgement on matters of relative importance, i.e. sustainability of business, sanctity of contract, competence of judicial authorities, etc. The issues can be broadly categorised as follows:¹⁰

- **The moral hazards – Dilemmas in contractual disputes resolution**

– Should contracts be enforced regardless of consequences or should public institutions be considered as a greater public good?

The primary concern being raised is whether the sanctity of contracts that were signed through consent of two parties overpowers the sustainability of electricity sector, which is dependent upon the financial health of investors and power companies, or should the case be vice versa.

The above is being stated as the role of institutions such as Supreme Court goes much deeper than ensuring effective enforcement of legal contracts will be enforced regardless of their consequences.

- **The competence of Supreme Court**

The Supreme Court of India has been criticised by some experts for its decisions in matters that it does not, according to them, have competence to make. For instance, in case of matters of power contracts which requires assessing the economic impact of the decision on society at large, this stands true. Given the complexity of such issues, some experts have proposed that Supreme Court should seek services of economists in such matters.

However, it is extremely difficult even for experts in any discipline, to foresee all aspects of complex systems. The experts are increasingly specialised and have better knowledge base than others have in a part of the whole. Therefore, for any expert to come up with a solution that will do justice to the welfare of the whole system is extremely difficult. Moreover, economists and other experts also have their limitations and ideological preferences. Those on the right of the political spectrum evoke the concept of moral hazard to deny relief to consumers, while those on the left are against forgiveness to large investors.

¹⁰ The following excerpt is taken from the Article published by Arun Maira, President, CUTS International in The Hindu Business Line: www.thehindubusinessline.com/opinion/dilemma-in-contractual-disputes-resolution/article9768594.ece assessed on July 20, 2017.

3. Reflections from the Debate

The aforementioned points are some of the most commonly discussed issues pertaining to judgements of the Supreme Court in India. The e-debate conducted and hosted by CUTS¹¹ also dealt with these issues directly or indirectly. The following is the abridgment of the debate along with some of the published views that were circulated in the debate.

It started with the fundamental question – Should contracts be enforced regardless of consequences or should public institutions consider the greater public good? Arun Maira defended that the citizens' trust in the ability of state's institutions to deliver justice is a condition of good societies and it comes from the confidence that, if something undesired happens, all points of view would be considered fairly and justice will be done.

Furthermore, Sanjeev Ahluwalia stated that the Supreme Court, by sticking to the letter of the law, has well illustrated that such matters should be firewalled from legalism. If the Supreme Court cannot but look at matters purely legalistically regulatory matters should never reach them. Otherwise the point of instituting tribunals and regulatory bodies might be lost.

These reflections from debate, led to the discussion that whether enforcement of contracts, regardless of their consequences, or, that public institution such as Supreme Court should consider the welfare of all affected?

The following were some of the published views that were circulated in the debate.

Devendra Kodwani

.....The Supreme Court judgement seems to be fair, if bidding for such contracts to supply power did not include clause for renegotiation of tariffs. The primary fuel, in this case for power generation companies is imported coal, and it is no different from the imported raw material for other manufacturing companies. For instance, iron ore for a steel manufacturing plant.

Further, the power companies must have assessed the political and regulatory risk involved in the import prices. A sound business practice involves factoring in such types of risk and well planned risk mitigation strategy at the time of bidding. It is hard to believe Tata and Adani groups would have been so naive or so unconcerned about business risk of this kind.

¹¹ E-debate on the topic Sanctity of Contract vs. Sustainability based on Supreme Court Judgement against compensatory tariff ran from May 01, 2017 to June 08, 2017 on FunComp – The forum is to stimulate discussion and interaction on various issues pertaining to Economic Governance in India.

However, it is true that in long term contracts the political and other risks can undermine even well planned project cash flows. This has been one of the problems with Public Private Partnership (PPP) projects in India which is acknowledged by *Vijay Kelkar Committee Report*¹² on Revisiting and Revitalisation of PPP Model of infrastructure projects. The committee has recommended including renegotiation clauses in the contract.

*Associate Dean
The Open University Business School*

Anil Bhardwaj

.....I wonder that would these companies have come with request of downward revision of tariff, if the price of commodities crashed globally!!

Prices have crashed several times in past, however; no companies willingly reduced their prices. This seems to be a case where we privatise gains and socialise the losses?

Further, a fair and sustainable way on which tariff should be based including variable costs but it should be set through an agreed formula.

In addition, India is experimenting with the pricing of oil on a daily basis. Likewise, something similar approach can be adopted for power sector as well.

*Secretary General
Federation of Indian Micro and Small & Medium Enterprises (FISME)*

Michael Pinto

.....The basic difference between a power plant and the steel plant cited in *Mr Devendra Kodwani's comment (page 16)* is that in the case of the latter, any substantial rise in the price of iron ore both domestic as well as imported, will lead to a rise of price of the finished product.

However, in the case of power generation there is no such safety valve. The PPA freezes tariffs for the period of the contract. Therefore, if there is a huge rise in the prices of raw material such as coal, this cannot be absorbed unless there is a corresponding increase in the price of the finished product, i.e. power.

Further, risk mitigation measures taken by power companies involve acquiring a captive mine where costs of the raw material can be controlled. But when the government of the country where the mine is located imposes new taxes on the export of the raw material, such mitigation measures becomes useless.

Besides legal arguments, however, there is a need to consider practical impediments like

¹² <https://infrastructureindia.gov.in/documents/10184/0/kelkar+Pdf/0d6ffb64-4501-42ba-a083-ca3ce99cf999>

Can we afford the shutdown of large power generating units and the resultant sickness that this will bring to the industry?

The simple answer is no as this may further increases NPAs of these companies. It would be extremely difficult to repay their loans, if power plants are not operational. Subsequently, it will have a cascading effect on the banking sector and may affects thousands of jobs.

*Former Secretary
Ministry of Shipping, Government of India*

Ashwini Chitnis

.....We feel it is a welcome judgement as it upholds many of the important tenets of fair competition and good governance.

Furthermore, the fixed price contract was a voluntary decision of one of the bidders to win this contract (Tata Power). The bidding guideline had a provision wherein, all the bidders can transparently pass on the fuel price variation risk to the consumer at the time of bidding, if they chose to do. So it is really an issue with bidding strategy and not of contract design.

*Fellow
Prayas Energy Group*

V Ranganathan

.....The point is that long term contracts are unviable. However, such contracts do exist, for instance, contracts in oil and gas industry.

Lately, when gas prices went down, it made the market price much lower than the contract price. Indian oil companies, such as Gas Authority of India Limited (GAIL) and other oil marketing companies lined up before the supplier, in Qatar, to waive off some conditions in the contract, transforming an economic issue into a political settlement issue.

*Former Professor
Indian Institute of Management, Bangalore*

Shyam Khemani

.....I would like to quote in this way as, two presumably ‘sophisticated companies’ competitively bid for the business with presumably known conditions....and now with perfect 20-20 hindsight wish to change terms. It seems more like a ‘post-contractual opportunistic behaviour’.

*Former Advisor
World Bank*

Sanjeev Ahluwalia

..... My view on this is as a practitioner. CERC and APTEL faced with an implausible situation but ruled wisely making it viable for power generation companies to continue their operations. Further, this does not demonstrate crony capitalism behaviour by power companies.

The Supreme Court stuck to the letter of the law. However, such matters should be firewalled from legalism. Regulation is a rule of law; therefore such matters should never reach them, as this will defy the purpose for instituting tribunals and regulatory bodies. Therefore, Supreme Court should have refused to accept the case on the grounds that the issue is related to regulatory discretion which is beyond law.

*Advisor
Observer Research Foundation (ORF)*

Hemant Sahai

.....This is in reference to Anil Bhardwaj comment (page 17).... PPAs have a mechanism to pass on fuel prices to consumer. The basic principle is that fuel cost is a pass through and the power generation companies make no money on fuel. By the same logic the power generation companies cannot be expected to absorb any increases in prices of fuel.

The issue was that, such commercial risk ought not to be burdened on the power generation companies. While normal changes in fuel commodity prices are adjusted, unpredictable costs on account of change in Indonesian law should be allowed to pass through to consumers.

*Founding Partner
HAS Associates*

V S Ailawadi

.....The Supreme Court of India, in its judgment, missed the crucial issue of economic efficacy and the impact of their judgement on future investment in the sector.

In addition, Supreme Court did not take into account the gravity of near term impact, while considering technicalities of the contract. It completely revealed lack of understanding of challenges which power sector may face with the long term (25 years) PPAs.

The real challenge lies with the current PPAs and poor tariff designs which failed to ensure equitable recovery of revenues.

Further, it will have cascading effect on the power sector. When assets get stressed, power generation companies stand to lose credit rating results in higher interest rate. This will eventually increases the cost of capital. This means not only existing plants but new plants may not be able to produce low cost electricity in future.

*Chief Mentor, Corporate & Regulatory Affairs
TATA Teleservices Limited*

Amit Kapur

.....The Supreme Court Judgement is important at many levels. It may address some of the foundational issues listed below in the future:

- promote the practice of informed bidding for infrastructure projects as also procurement of inputs [plant and machinery (EPC), minerals, supplies, services, financing et al]
- prove to be a touchstone on pricing risk in competitive bidding for public procurements (involving long-term arrangements) with imported components
- push for better risk-allocation and mitigation measures built with mechanism to resolve issues in long term contracts

Further, as Pradeep rightly highlighted in his incisive article¹³ on superior court judgement often missing economic impact assessments, though the judgement does not directly deal with the issue of contract design, long term incomplete contracts and their treatment in the contract theory etc.

But having said that, it is a fact that such issues had never arose in the neat and narrows of legalese and perhaps will have to be handled by policymakers in construct of their future contracts.

There are some salutary positives that might have been missed in the euphoria and the din. The court seems to accept the statutory contract framework to resolve such issues.

The court recognised the over-arching and all-encompassing role of the statutory expert regulators – even in competitively bid contracts, viz.

1. As long as the specific situation is provided for in the bidding framework (in this case Competitive Bidding Guidelines and the PPA), the regulator must resolve it as per the said framework. In this case, on facts, the court found that the situation was not covered by force majeure and was covered only to the extent of domestic policy change on fuel as change in law.
2. If the fact situation is not covered by the bidding framework, then the regulator must exercise its powers under the statute that created it. So Section 61 tariff principles shall govern it. The court did find that the change in Indonesian law was not covered or contemplated by either the force majeure or the change in law provisions of the bidding framework.
3. That then leaves the ball back in the court of the regulator to find the answer under the statute. This appears to uphold the jurisprudential foundation of the initial CERC order granting relief.

An issue that was often raised in court and finds place here as well relates to whether companies would agree to share the benefits of coal price decline with buyers. The

¹³ <http://www.livemint.com/Opinion/euUWgC152BPeaONeAzH7m0/Economically-responsible-justice.html>

answer is indeed and a firm yes! In fact the Bidding frame work explicitly recognises and provides for the same and I am aware that at least one of generating companies had voluntarily file petitions and get orders from CERC to reduce tariff for various elements of change in law. In fact they have also claimed the actual monthly/shipment-wise coal price as adjustment (not a notional or the highest).

Away from the judgement, another issue to look at is with such strong powers and role bestowed on regulators, how to strengthen (in terms of skills) and make them accountable (for both timely decision-making and quality of outcomes *vis-à-vis* the statutory and policy objectives).

*Senior Partner
JSA*

Pramod Deo

.....My comments in brief are as follows:

The Supreme Court recently ruled against any compensatory rates for suppliers of electricity (using imported coal) due to any change in international regulations. While reporting this judgement widely the media overlooked one very important aspect of the order: it also upheld the CERC's regulatory power to address tariff issues arising in competitively bid projects under Section 63 of the Electricity Act 2003.

In our 2013 order the central commission saw lot of merit in the generators plea that promulgation of the Indonesian Regulation has led to abnormal increase in the cost of generation of electricity making their projects unviable. Unless the concerns of generators are addressed, the possibility of not discharging their obligations under the PPAs due to the perceived financial burden cannot be completely ruled out. In that event, the state utilities would have been required to invite fresh bids to meet their requirement of power and till the selected project is commissioned, consumers would have been deprived of power.

Moreover, the tariff discovered for new projects then was in the range of Rs. 3.50 to 7.00 per unit which the consumers of Mundra UMPP would have been required to pay. Thus, at the macro level, it would have been a serious setback for the electricity sector and adversely affected the investment in the sector and at the micro level; it would have affected continued and reliable supply of power to consumers.

In view of this, CERC deemed it necessary to intervene in the matter in the interest of consumers, investors, lenders and the power sector as a whole. It should not be forgotten that for such large projects public financial institutions contribute 70-80 percent as loan. If running a power project becomes unviable for investors, then lenders will be left with NPAs. The saga of erstwhile Enron project now taken over by public sector entities and renamed Dabhol project is unending.

The commission, therefore, in its order recognised its responsibility to balance the interest of consumers with interests of the project developers and lenders while regulating tariff of the generating companies. Keeping in view the interest of all, it

directed parties to set down to a consultative process to find out an acceptable solution in the form of compensatory tariff over and above the tariff decided under the PPA to mitigate the hardship arising out of the need to import coal at benchmark price on account of Indonesian Regulations.

Accordingly, the commission directed the generator and the state utilities to constitute a committee to go into the impact of the price escalation of the Indonesian coal on the project viability and obtain all the actual data required with due authentication from independent auditors to ascertain the cost of import of coal from Indonesia and suggest a package for compensatory tariff which can be allowed to the generator over and above the tariff in the PPAs. The committee was asked to keep in view *inter-alia* the following considerations while working out and recommending the compensatory tariff applicable:

- a) The net profit less government taxes and cess etc. earned by the generator's sister company from coal mines in Indonesia on account of the benchmark price due to Indonesian Regulation corresponding to the quantity of the coal being supplied to the Mundra project should be factored in full to pass on the same to the beneficiaries in the compensatory tariff.
- b) The possibility of sharing the revenue due to sale of power beyond the target availability to the third parties may be explored.
- c) The possibility of using coal with a low gross calorific value (GCV) for generation of electricity for supply to the states without affecting the operational efficiency of the generating stations.....

In view of the Supreme Court judgement some hope is raised for two companies directly affected by the ruling, Adani Power and Tata Power, for seeking compensation by approaching CERC again. Also, many other private entities -- CLP, Reliance, GMR, and GVK -- stand to benefit due to change in Indian law in terms of non-availability of fuel or, shortage of coal/gas or, abnormal increase in price of the fuel...

Lastly, we should not get carried away by decreasing prices discovered through 'reverse competitive bidding' for solar and wind. The Central Government while framing guidelines for competitive bidding for solar and wind under Section 63 must factor in market uncertainties and ensure viability of projects.

*Former Chairman
Central Electricity Regulatory Commission (CERC)*

Shantanu Dixit

.....In this set of bidding adopted by power companies, bidding design allowed bidders to bid with pass through of fuel cost. Some did that but lost out to those who willingly bid fix price or partial pass through. These winning bidders were seeking post bidding changes in risk allocation. In addition to many governance issues, allowing such practice would have been anticompetitive and injustice to those bidders who had not assumed post bidding changes in risk allocation.

*Group Co-ordinator
Prayas Energy Group*

Prasanna Srinivasan

.....The Court has, and should, limit its role to interpreting the law and contract. It is up to the government to decide on wider issues about the availability of power and so on. Various posts on this thread have already touched upon issues of bidding deficiencies including:

- a) Private sector locking in a lower rate to win bids with the confidence that they can negotiate upward revisions later, due to the wider economic value of power
- b) The government being unrealistic in locking in rates for 20 or 30 years given energy raw material price fluctuations

Much of the above is linked to a few other matters that need to be addressed, or else such disputes will recur:

- a) Power companies do not have the luxury of peak-load pricing. The latter is in the hands of distribution companies that are, for all the general hype on the energy sector, still largely a government-run operation with state-controlled pricing all over India. With no upside to prices, that is market related, companies cannot buffer risks of the downside. Creating peak time tariffs also will result in consumers (industrial and domestic) placing an emphasis on conservation, quite simply because they pay more. Such differential time-based pricing was used for government-owned telecom companies in the distant past. Further, it can also be compared with other sectors, such as steel, airlines etc. that may also have long-term investments needed - but function on free pricing - higher and lower.
- b) These contracts become centre piece because of the general deficit in supplies other than at low demand periods of the day.
- c) Power companies that have bided fixed prices for long term take-or-pay contracts could be offered prices that reflect higher input prices with a reduction in the take-or-pay quantity. This would ensure that distribution companies will only take power that they need after they have exhausted other sources and are not compelled to pay for power they do not 'take' - as per the initial take-or-pay. The risk thus is distributed without shutting down the asset.

If owners cannot run the unit, they could sell equity to a new promoter in reduced price - thus writing off their investments in part at one time. Revision in tariff then does not become the single point of change or reference to the regulator/court; it is nested in a more equitable system of sharing the risk with a promoter who bid unrealistically. Meanwhile, the power supply will continue to be available to a supply-deficit market.

*Vice President
RIPPONS*

V S Ailawadi

.....While it is correct that investors should enter in contracts with full knowledge of market risks. This is accepted principle where fuel prices being volatile are impacted from market movements, but when government step in to distort prices in market movements. Should we not look into it for the valid reasons?

*Chief Mentor, Corporate & Regulatory Affairs
TATA Teleservices Limited*

Pramod Deo

.....In addition to my previous comment (page 21), I have two more points:

First Point: The Supreme Court judgement is silent on CERC's original compensatory tariff order. It strikes down APTEL's interpretation extending 'force major' to imported coal and CERC's calculations based on those directives. It is well to remember that CERC had not accepted change in foreign law and force major grounds for revision of tariff in both cases. Invoking its wider regulatory powers under Section 79, it went beyond the bidding conditions and proposed a pragmatic way out. There is, therefore, scope for both parties to approach CERC again for relief.

As regards Supreme Court's directive for relief within Clause 13 of the PPA, it is based on the commission's statutory advice to the Central Government; however, state regulators ignored Central Government's advice to reopen all such cases. Perhaps the State government did not want tariffs to go up and the spectre of Comptroller and Auditor General (CAG) is haunting all players.

Since Central Government has not notified bidding guidelines under Section 63 for Renewable Energy, all reverse competitive bidding contracts can be reviewed in the light of Supreme Court's clear observation that the commission has power under Section 79 to '*fill in the gaps*' in bidding process. Even after such guidelines are notified parties could approach CERC on grounds of certain infirmities in such guidelines. It is a moot point whether the commission will be bold enough to address any lacunae in reverse competitive bidding process.

Second Point: We had noted the point made by Prayas. However, the saga of Enron now renamed Dabhol plant shows it is very difficult to transfer an asset where the stake of private sector is only 20-30 percent and contribution of financial institutions (public money) is 80-70 percent to another private entity on same terms and conditions when the bids were called. Based on this experience when the Expert Committee appointed by the Ministry of Power deliberated on framing guidelines for UMPPs, we recommended that in no circumstances assets created should be allowed to lie idle and the plant should be handed over on same terms and conditions to the second best bidder in line. However, if none of the original bidders are willing to take over the project on same terms of conditions 're-bidding' should be organised to ensure that a productive asset created with 'public money' does not remain idle. I must add that a retired banker is a member of this committee and he strongly favoured such a clause in the bid conditions.

In short, CERC was more concerned with the investment of public institutions in these plants and not that of private players.

*Former Chairman
Central Electricity Regulatory Commission (CERC)*

Rakesh Kacker

.....In addition to preceding comments by Dr. Pramod Deo, I have few additional points to make.

1. The argument that bidders chose the fixed price option and therefore when this did not work out they cannot be compensated over and above the bid price is seriously flawed. It is well known that bidding leads to irrational results and that is why there is so much effort in proper auction design. Economic theory also has a huge amount of literature on this; the most well known being the second price theorem.

In India we have not looked at anything beyond the L1 model. There are different models and the one I like is the one the Chinese used for wind power many years back where the winning bid is the one whose price is closest to the average of all bids. This reduces the risk of unrealistic exuberant bidding.

Further, this is a case of bad auction design. Bidders should have never been given the choice of taking a risk which they had no means to manage.

2. The second point is what you do when there is a situation where market conditions are different from what was anticipated at the point of bidding. It is not possible for the private entity to keep making losses and keep running the plant. Because of such a situation we allowed the telecom companies to migrate to revenue sharing in 1999 and the FM radio companies to do likewise in 2005. Worldwide experience has also shown that most infrastructure contracts get reopened in the first year when market realities confront the successful bidder.

The two points are linked. If there is proper auction design and risks are allocated to parties who can best manage them the need to re-open contracts will be minimised.

*Director
India Habitat Centre*

Aashish Gupta

.....This is in response to preceding Rakesh Kacker's comment.

From a Layman's point of view, it affects all citizens equally, I think at the end of the day, government and its actors, courts and all its bodies may have only one ultimate objective - Growth of the nation at a macro level and prosperity of its residents, at a micro level while avoiding or preventing, unfair or undesirable or wilfully bad precedents.

If in pursuit of that holistic objective such instances emerge as one below, where maybe a bad contract design may have resulted:

- From those unaware or unwilling to take an 'out of the box' viewpoint on the contract for fear of rapprochement of any kind, or...
- Overzealous participants under commercial or short term pressure may have further perpetrated that thinking through such bidding such as fixed price contracting.

Then probably the 'right way' may be arrived at, which without creating further financial stress may still try and create strict examples both on the bidder and parties bidding out these projects.

If there are empowered bodies such as regulators and courts, for sure there may be provisions available with them to set the right precedents (from global examples or rationally creative approaches) which can still keep the ball rolling without creating duress while still disciplining the participants.

*Founder
Strategy Pluto*

Sebastian Morris

.....This is in reference to Ashwini Chitnis's comment (page 18). But given the need to win, and high contract failure risk, the design was faulty. It should have constrained the bid to a certain part of the costs necessarily being escapable. Also there are problems even as of now with not just on Case 1 and Case 2 but even in other PPPs (NHDPs mixed hybrid model) of not building in coverage of interest variation risk necessarily into the bid (costs). Weak capacity of state to enforce anything is part of the problem no doubt which made nearly everybody chose the non-escapable route.

*Professor
Indian Institute of Management (IIM), Ahmedabad*

Rijit Sengupta

.....This case demonstrates one of the kinds of 'risks' that the thermal power sub-sector faces in India at the moment. Not only are there such (market) risks stemming from price volatility of inputs (coal) and/or actions (in public interest) by judiciary/regulator as is the case here, but there are other kind of 'risks' as well.

One of the other significant 'risks' that the thermal power sector is confronted with is related to India's commitment targets under the Paris Agreement. Industry icons should therefore think of 'transformative shifts' towards renewable energy, especially to help achieve the target of 225GW by 2022, as envisaged by PM Modi. Minister Goyal has also asserted that when it comes to energy generation, India is endeavouring to move from a highly thermal power generation dependent economy towards renewable energy.

Perhaps strategies and discussions on industrial growth and job creation should be based on such considerations, especially focussed on 'our common future'.

*Chief Operating Officer
Centre for Responsible Business (C4RB)*

Ashwini Chitnis

...This is in reference to Prof. Sebastian Morris' comments (page no 26):

Need to win will always be there and precisely for this reason it is absolutely essential to stick to the rule of law and avoid moral hazard. Such 'risky' bidding strategies also indicate failures of due diligence on part of lenders and financiers. Given such failures, the Supreme Court judgement ensures the basic tenet of competition that the rules of the game should not be changed post-facto.

As far as bad bid design is concerned, and if indeed many fixed price bids were received, there were mechanisms such as the bid evaluation committee, which should have pointed out any systemic issues. But that never happened.

Factually speaking, not all bids were based on non-escalable parameters, in fact the Mundra UMPP is a case in point and certainly it is not the case that only bids with non-escalable parameters were seeking compensatory tariff.

*Fellow
Prayas Energy Group*

4. Roundtable Discussion on Sustainability of Business vs. Sanctity of Contract

Backdrop

Following the debate initiated on the CUTS e-discussion forum, 'FunComp Forum', a Roundtable discussion was organised on June 24, 2017 by CUTS International in partnership with CIRC and NMML in New Delhi. The objective was to facilitate deliberations on issues raised in the e-discussion forum, FunComp.

The discussion was moderated by Nitin Desai, President CIRC Governing Council and Former Under-Secretary General to United Nations. The catalysts to the discussion were Pramod Deo, Former Chairman, CERC; Amit Kapur, Senior Partner, JSA; and Shantanu Dixit, Group Coordinator, Prayas Energy Group.

Others key speakers were Pradeep S Mehta, Secretary General, CUTS International; Shakti Sinha, Director, NMML; Arvind Mayaram, Chairman, CIRC; Arun Maira, President, CUTS International; Ramji Srinivasan, Senior Advocate, Supreme Court of India; and Geeta Gouri, Former Member, Competition Commission of India. In addition, representatives from industry, bureaucracy, academia, and consumer organisations participated in the discussion.¹⁴



The Roundtable instigated deliberations on some of the key issues brought forth during e-debate, related but not limited to the powers of regulator, aggressive bidding mechanisms, utility's finances, contract enforcement, regulatory governance, public policy, and consumer's interest which need much consideration.

In addition, issues having national and economic importance were discussed. These included sustainability of the business, sanctity of contract, long term contracts, bidding mechanism, economic impact assessment of judicial decisions, political economy challenges in power sector.

¹⁴ List of the participants is enclosed in Annexure 1

Summary of Discussion

Set out below is a summary of key points discussed in the Roundtable:

a) **Design of Contract:** The discussion raised concerns on the design of contract which are summarised below:

- i. *Long term contract:* Power companies have PPA of 25-30 years. Such long-term contracts are not feasible and are very risky unless it contains safeguard for both parties in the contract. Most of the power generating companies are based on coal. Therefore, fluctuation in prices of coal will adversely affect the economic viability of these companies. The effect is many folds in case of imported coal. Thus, freezing tariff for such a long time is risky and would become extremely difficult for companies to run their business if there are changes in the price of coal. Further, significant technological and disruptive advancements might make long-term commercial contracts economically unviable in future. It was also highlighted that the price of coal should be set taking in account variable cost through a set formula. Also, it was pointed out that duration of contracts needs to be revisited.
- ii. *Bidding mechanism:* Concerns were raised in the competitive bidding process. In the US, it has been seen in the past that this type of bidding failed to include practical issues, such as price rise. Over and above, there was no bid evaluation mechanism to evaluate the feasibility of the bids made by bidders. Further, there was no platform to raise systemic issues in the bids, if any.
In addition, it was pointed out that power generating companies were involved in aggressive bidding to win contracts, following the strategy of 'bid low today, raise price later'. It was also believed that this decision would promote informed bidding and discourage bidders in future to engage in aggressive bidding.
- iii. *Clause for negotiation:* There was no clause for post contractual negotiation under this PPA. Such situation makes it extremely difficult for companies to sustain in case of unforeseen changes in the market. Further, it is not possible to assess every single risk before engaging in the contract. Owing to such situation, it becomes imperative to allow post contractual negotiation. Therefore, it was argued that a provision for negotiation should be given in contract.

b) **Role of Decision and Policymakers:** It was pointed out that terms of contract were known to these companies and opting for fixed price contract was a voluntary decision of Tata Power, one of the eleven qualifying bidders who were allowed to bid for UMPPs. The bidding guidelines allowed bidders to transparently pass on the entire fuel price variation risk to consumers at the time of bidding if they chose to do so. But this choice was waived off by the Tata Power. It was pointed out that such choice should not be left in the hands of the bidder, as was done in the aforementioned case.

Therefore, it was argued that the government should include a provision for negotiations in the contract and must not leave any 'risk' to the businesses which

they cannot manage. Further, government should strike a balance between the economic viability of the business and consumer welfare.

- c) **Potential Anti-Competitive Behaviour:** The discussion raised concerns on the post contractual opportunistic behaviour shown by companies. There have been instances in the past where rules of the game were changed post bidding. As a result, power producers knowingly entered into unviable contracts with a hope that such contracts will negotiate in future. As authorities could not afford to shut down power plants, these companies find themselves in a temporary position of power. Using this position of power, companies hold authorities and consumers in a hostage like condition; authorities were left with no choice but to increase the tariff as these companies would not run their plants by incurring losses. It was argued that such practice should not be allowed to safeguard consumers from crony capitalism.

Allowing such post contractual changes would be unfair to other companies who had participated in the bidding process but were unsuccessful because the bid winners willingly waived off the risk involved in imported fuel cost.

- d) **Sustainability of Economy:** It was argued that the sustainability of economy should be considered above any other issue. This issue is much larger than the sustainability of business but comprised sustainability of economy and capital.

The decision taken by the Supreme Court might have an adverse impact on financial institutions. They contribute 70-80 percent in projects and if running a project becomes unviable for companies in the future, then NPAs of lenders will increase. Loans would be available at a high-interest rate resulting in high cost of capital for future projects. This will have a cascading effect on the cost of electricity for consumers. It was pointed out that whenever investment is made in public goods, it is meant for the consumption of economy, and if not priced or serviced properly, would adversely impact welfare.

- e) **Risk Sharing Mechanism:** Businesses are always under the cloud of unimaginable contingencies. It is immensely difficult for the companies to assess all the risk and chalks out risk mitigation measure in advance. There is need to develop an effective risk sharing mechanism to strike the balance between the welfare of consumers and sustainability of the business, to ensure the sustainability of the economy. However, to maintain the viability of the business, consumers alone should not pay the price. It was argued that this decision would push for better risk-allocation and mitigation measures built-in with dispute resolution mechanism.

Further, it was pointed out that business should bear the risk that is in their normal course of operations and functioning. In addition, an assessment on costs-benefit should be carried out regarding the efficiency of managing the risk by the businesses. Therefore, it was argued that more research is required in areas of dynamic risk sharing including risk shifting mechanisms.

f) **Need for Self-Adaptive System:** It was pointed out that trusting individual experts over processes might not be a sustainable solution and there is a need to adopt process based reform.

Often regulatory bodies become decision makers for the industry but decisions taken by them were not only time consuming but also questioned at various levels and multiple times.

Therefore, pointing towards transforming existing regulatory system into the self-adaptive system. Such transformations should be based on four principles: minimal and critical rules, creation and maintenance of permeable boundaries within the system and with the world around it, the involvement of all stakeholders in decision making, and aligned aspirations. Thus, the time has come to redesign organisations in such way that can maintain creative edge between a domineering hierarchy (and bureaucracy) on one side, and other stakeholders, such as industries and consumers on the other. Further, it was argued that this will ensure adequate participation and consultation of all stakeholders before carving out any policy. Also, this could result in enhancing transparency and accountability in the system.

g) **Need for Economic Assessment of Judicial Decisions:** The Supreme Court judgment viewed this case through the lens of Electricity Act 2003 under sections 63¹⁵ and 79¹⁶. Many industry stalwarts and other stakeholders have seen this decision as a blow to sustainability of business in the long run.

It was also pointed out that judicial decisions are based on technicalities of the contract and legal provisions but did not consider the economic efficacy of the issue. CERC took this into account but the decision was overruled Supreme Court. It was observed that Indian laws are grounded in the liberal capitalist framework, often ahead, and at odds with its social economic and social realities. As a result, market players are expected to be aware of implications of legal provisions, but such awareness does not necessarily exist. Hence, there is a need to review judicial decisions from economic perspectives. The economic assessment of the judicial decision would also bring more clarity on jurisprudence.

However, it was also pointed out that the court was seized with the question of interpretation of the contract, particularly, the force majeure clause, and ruled accordingly. Thus, the expectation from the Court to consider broader economic impact might have been misplaced.

In addition, other important issue rose in the debate was; political economy challenges in power sector. Vested interest of the politicians and officials in power distribution company's (discoms) create hurdles in the development of the sector. Free electricity and waiver in electricity bills by politicians to agriculture and rural consumers during elections alongside reluctance of officials in discoms to install electricity meters, result

¹⁵ Section 63 (Determination of tariff by bidding process): The Appropriate Commission shall adopt the tariff if such tariff has been determined through transparent process of bidding in accordance with the guidelines issued by the Central Government.

¹⁶ Section 79 (Functions of Central Commission) (1)(b): The Central Commission shall regulate the tariff of generating company's other than those owned or controlled by the Central Government specified in clause (a), if such generating companies enter into or otherwise have a composite scheme for generation and sale of electricity in more than one State;

in an increase of debts on discoms. It was argued that such issues hurt the overall economy of the sector.

Conclusion and the Way Forward

The discussion congregated many points of view to make sense of the complexity of the pressing issue of sustainability of business and sanctity of contract possess. Furthermore, in dynamically changing situations, there is a need to consider interests of risk taking entrepreneurs without running a welfare state for capitalists.

However, some of the issues brought forth during discussion needed further deliberations. These are mentioned below:

- *At what extent, should the economic efficacy of the system be considered in the judicial decision making? How can we bridge the interface between law and sustainability of economy?*
- *What should be the bidding mechanism? What should be done to check project viability to avoid a similar situation in the future?*
- *What should be the design of contract? Should it allow post contractual negotiation, if yes under what conditions? Further, what should be the risk sharing mechanism?*

5. Some Relevant Writings of Scholars and Commentators

Tata Power, Adani Power Case: Supreme Court Verdict is Worrying; here is why it matters

The Financial Express, October 31, 2017

While providing relief to Tata Power and Adani Power, the CERC had used its powers to regulate tariffs under the Electricity Act of 2003, and argued that while one part of its job was to look after the interests of consumers, another part was to look after the health of the industry.

While providing relief to Tata Power and Adani Power, CERC had used its powers to regulate tariffs under the Electricity Act of 2003, and argued that while one part of its job was to look after the interests of consumers, another part was to look after the health of the industry. So, in the Tata/Adani case, it argued the case for a compensatory tariff to take into account the new rules in Indonesia that jacked up coal prices. The case went back and forth between the APTEL and it finally ruled in favour of CERC's compensatory tariff. When the matter reached the Supreme Court (SC), however, SC ruled against APTEL and said that CERC could not interfere with a PPA that was sacrosanct.

Another ruling by SC, also restricts the power of regulators. In this case, *Gujarat Urja Vikas Nigam Limited vs Solar Semiconductor Power Company*, the issue was about the date of commissioning of the project — under the PPA, if the plant was commissioned before a certain date, one price would be paid for the electricity; but, if the commissioning was delayed, a different price would be paid. While the commissioning was delayed, the Gujarat regulator ruled it was for reasons beyond the company's control and so the first tariff would be the applicable one.

While the two judges gave separate judgments, they were concurring. They argued that while the "Commission is competent to adopt a procedure which is at variance with any of the other provisions of the Regulations ... in view of the special circumstances", there cannot "be a Regulation which is not in conformity with the provisions of the Act or Rules". In another place, the ruling is "under the guise of exercising its inherent power, as we have already noticed above, the Commission cannot take recourse to exercise of a power, procedure for which is otherwise specifically provided under the Act".

It is not clear if, in the future, the SC will also curtail state or central regulators from offering substantive relief to power suppliers/buyers on grounds the PPA is inviolate. Given the length of the PPA and how underlying conditions can change overnight, it is critical that the regulators have the power to order changes in the contract. If they do not, the only option will be for power suppliers/buyers to breach the contract by, shutting down in the case of suppliers and refusing to buy in the case of state electricity

boards/distribution companies. Since instability is not good for the industry, the SC rulings are unfortunate.

www.financialexpress.com/opinion/tata-power-adani-power-case-supreme-court-verdict-is-worrying-here-is-why-it-matters/912952/

Gujarat Government May Take Over Tata, Adani, Essar Power Plants

Dev Chatterjee*

The Wire, October 11, 2017

The three companies had earlier offered to sell a 51 percent stake in their plants for Re 1 to the Gujarat State Electricity Board.

The Gujarat government and lenders led by State Bank of India are working on a resolution plan for the electricity generation units of the Tatas, the Adanis, and the Essar group in Gujarat that are making huge losses due to an adverse Supreme Court judgment. The judgment has prohibited coal-based plants from passing on their increased cost to customers.

This resolution plan, now in an advanced stage, comes in the backdrop of the lenders agreeing to invoke the strategic debt restructuring (SDR) plan for Essar Power. Under the plan, all its interest and principal payments have been frozen for the next 18 months.

The three companies had earlier offered to sell a 51 percent stake in their plants for Re 1 to the Gujarat State Electricity Board (GSEB), but with the assembly elections scheduled to take place in a few months, the government has deferred any decision till the end of the polls. Once the elections were over, the GSEB would take 51 percent equity in the three units, industry sources said.

Tata Power, Adani Power and Essar Gujarat Power – with a combined capacity of more than 9,800 MW – were impacted by the Supreme Court judgment, under which the companies were denied permission to charge higher tariffs, the need for which arose because imported coal from Indonesia became more expensive.

Essar executives said the SDR was invoked by the Joint Lenders Forum of the banks in September and it had become effective from the end of July. Essar has debts of Rs 5,000 crore and Rs 2,600 crore of equity for its 1,200 MW plant.

“The company has decided to end the issue and not pump in more equity and approached lenders to take a majority stake,” said an Essar executive. Essar would continue to operate the power plant and the account had not become a non-performing asset, the official said.

The company had to go for SDR because the selling price of electricity to the state boards was far lower than its cost price, and it was unable to service its dues. After the lenders take control of the asset, they would invite bidders to buy their 51 percent stake in Essar unit. If the projects, including those of the Adanis and the Tatas, are bagged by a

government entity, it would become easier for the three units to buy coal from local sources.

The companies are hoping that with this resolution in play, the value of their residual 49 percent stake in these subsidiaries would rise and it would be able to exit at a profit. In a recent interview with this newspaper, A. M. Naik, chairman of L&T, said there were power projects of 20,000 MW that were up for sale in India with no takers.

**Author is associated with Business Standard*

<https://thewire.in/186461/gujarat-government-may-take-tata-adani-essar-power-plants>

India: Future of 'Compensatory Tariff' In Light of the Supreme Court Decision in Energy Watchdog vs. CERC

Saurav Jena*

Mondaq, September 14, 2017

In the judgment delivered on April 11, 2017, on the issue of validity of 'compensatory tariff', the Supreme Court has put an end to the unbalanced use of regulatory power, upheld the sanctity of contracts and significantly restricted the impact of power tariffs in light of consumer interest.

In view of upholding a healthy competition, Section 63 of the Electricity Act, 2003, allows regulatory commissions to adopt a tariff for generation through a transparent and competitive bidding process conducted as per the guidelines issued by the Central Government. The guidelines emphasise a fair and transparent process for bidding and give the bidders an option to pass on the fuel price variation and other related risks by quoting various escapable and non-escapable charges transparently at the time of bidding.

As per CERC, most of the tariffs discovered through bidding were more competitive than "cost-plus" tariffs determined for similar projects. As per a report of Prayas Energy Group, the tariffs discovered through bidding were indeed lower than those determined on a cost-plus basis. It also highlights several governance concerns regarding bidding processes in several states including potential danger of post-bidding changes to tariffs. Highlighting the potential fuel risks inherent in some of the fixed price bids, the report presciently questioned the feasibility and viability of these projects.

At the time of commercial operation, many companies started complaining about viability issues on account of increased fuel costs. In 2012, some of these projects such as Tata Power's Mundra UMPP and Adani Power's Mundra project filed cases before the CERC. They sought revision of the quoted tariff on grounds of –

- Increase in the price of Indonesian coal
- Shortfall in domestic coal supply and depreciation of the Indian rupee.

Similar cases were also filed before the Maharashtra Commission and a few other state commissions.

PPAs allow revision of tariff only on two pre-conditions i.e. change in law, whereby a legal action of a government body or a court imposes any cost (or results in benefit) and force majeure, which implies an unforeseen event which prevents or unavoidably delays the performance of obligations under the contract.

The companies contended that, change in price of coal by virtue of Indonesian regulation should be treated as either a force majeure event or a change in law event and that, they should be compensated for the hardship imposed on this account and making their projects viable. This claim was supported on the grounds of sectoral and consumer interest.

Decision of CERC

The Commission chose to use its overreaching regulatory powers to grant the projects what it termed as "compensatory tariff". The commission noted as follows:

"In our view, the parties should confer to find out a practicable solution and agree for compensation package to deal with the impact of subsequent event while maintaining the sanctity of the PPA and the tariff agreed therein. In other words, the compensation package agreed should be over and above the tariff agreed in the PPA and should be admissible for a limited period till the event which occasioned such compensation exist and should also be subject to periodic review by the parties to the PPA."

The Commission, going beyond the boundaries of the contract, imposed the entire burden of fuel price variation on to the consumers, directly or indirectly and allowed compensatory tariff to Tata Power and Adani Power, to the tune of Rs. 2,300 crore and Rs. 3,600 crore respectively till March 2016.

Following this order, regulatory commissions of several other states such as Maharashtra, Uttar Pradesh and Rajasthan adopted the same approach of modifying competitively set tariffs by granting compensatory tariffs. According to economic times, the total amount of compensatory tariff granted till date would have amounted to, around Rs. 11,000 crore.

Decision of APTEL

The order of CERC was challenged before the APTEL, which rejected the use of regulatory power to grant relief to the projects. It held that changes in the domestic coal distribution policy and promulgation of the Indonesian regulation couldn't be treated as "change in law" under the PPA. It stated that the change in the price of imported coal would rather fall under the purview of "force majeure". By holding this, it directed the commission to determine the exact scope of relief to be granted to such projects. Subsequently, CERC through another order lessened the amount of tariff.

Then appeals were made to Supreme Court by several companies and NGO's on account of this order.

Decision of the Apex Court

Composite scheme – The Adani Mundra project has different contracts with different state distribution companies. The Commission granted relief considering them to be under a composite scheme. The SC held that, "...*"composite scheme" does not mean anything more than a scheme for generation and sale of electricity in more than one State.*"

Regulatory Overreach – The Supreme Court has rejected the use of regulatory powers to alter tariffs or any provisions of the contract, inasmuch as the bidding guidelines and the contract specifically deal with such issues. Since the contract (PPA) and bidding guidelines clearly define the circumstances and the manner in which the quoted tariff can be changed, the commission cannot use its regulatory powers to overrule such provision(s).

It upheld the sanctity of contracts while not taking away the regulatory power, especially in a situation where the contract or other legal and policy provisions are silent or inadequate. This clarity will help in improving the quality of regulatory decision-making, as it has demarcated the boundaries for the use of such regulatory power.

Effect of Indonesian laws, thus validity of compensatory tariff – Promulgation of Indonesian regulations would neither qualify under "change in law" or "force majeure". As far as applicability of Force Majeure is concerned, the court cited that, "*This clause [Force Majeure Exclusions] makes it clear that changes in the cost of fuel, or the agreement becoming onerous to perform, are not treated as force majeure events under the PPA itself.*"

The judgment further notes that, "*It is clear that an unexpected rise in the price of coal will not absolve the generating companies from performing their part of the contract for the very good reason that when they submitted their bids, this was a risk they knowingly took.*"

It states that the term "law" cannot be construed to mean any law including both Indian and foreign laws, as "*The meaning will have to remain the same whether coal is sourced wholly in India, partly in India and partly from outside, or wholly from outside. This being the case, the meaning of the expression "any law" in clause 13 cannot possibly be interpreted in the manner suggested by the respondents.*" Hence no tariff increase can be allowed on account of the change in Indonesian regulations. Therefore, no relief is applicable to projects or PPAs based on imported coal (such as Tata Mundra UMPP or Adani Mundra PPA with GUVNL based on imported coal).

The judgment holds that this amendment to the New Coal Distribution Policy (NCDP) should be considered as a change in law event. It is to this limited extent that relief has been granted for period after July 2013 for projects that are impacted by such shortfall in the domestic coal supply. However, the exact quantum of the relief will have to be computed by the commission on a case to case basis after taking into account the given project's fuel supply agreements, actual coal supply and cost of alternate coal arrangement.

The Judgment not only protects the public interest in question, but also looks forward, considering a sector plagued with NPAs, as it discourages aggressive bidding by holding bidders and their lenders liable for the risks that are voluntarily assumed to excel in such contracts. In fact, from a competition point of view, it can serve as a landmark judgment as it not only upholds the sanctity of contracts, but also enforces the rule of law and thus creating a level-playing field.

The commission should indeed take decisions that are in the larger sector's interest, which should, in fact, be broader than the individual companies' interests or issues of viability thereof, by giving a wider interpretation of law. However, such decisions need to be guided by certain principles that would define the circumstances under which such actions are called for and the extent to which the commission can deviate. Coming from the apex court, such clarity has the force of law and hence it will not be limited to power purchase contracts and tariff issues, but will apply to broader sector issues while also setting a good precedence for other sectors to follow. Secondly, the judgment has undoubtedly strengthened competition by enforcing the rule of law and holding bidders and lenders accountable for the risks that had been willingly assumed to win the contracts. Such clear and accountable mechanisms will not only discourage aggressive bidding based on risky fuel arrangements, but will also lead to more realistic tariff discovery for future projects, which would also provide more realistic price signals for the sector at large. To conclude, the judgment indeed puts a bar to the 'bid low today, raise price later' strategy of bidding.

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<http://www.mondaq.com/india/x/628912/Oil+Gas+Electricity/Future+Of+Compensatory+Tariff+In+Light+Of+The+Supreme+Court+Decision+In+Energy+Watchdog+v+CERC>

Dilemma in Contractual Disputes Resolution

Arun Maira*

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Should contracts be enforced regardless of consequences or should public institutions consider the greater public good?

The Supreme Court of India's verdict requiring two private power companies to comply with the contracts they had signed has stirred a large public debate. The companies say that circumstances beyond their control — changes in Indonesian laws — have made the price of their coal input too expensive for them to sell power to their Indian customers at the prices they had contracted. The companies pleaded for force majeure relief. Their opponents had feared that if their plea was accepted, it would be another instance of unforeseen losses of private companies being borne by society whereas the companies would have retained unforeseen gains if there were any. Their plea was that there must be sanctity of contracts to avoid such 'moral hazards'. However, the other side's concern is that further investments will not be forthcoming unless a more practical view is taken even if it undoes a legal contract.

The moral hazards dilemma

India has made an ambitious push with PPPs to build infrastructure for power, roads, airports, and ports. Many of these projects have become unviable because the requisites of their long-term contracts did not allow for unforeseen difficulties. These stranded projects have created a huge overhang of NPAs with Indian banks. Moral hazard is complicating the resolution of these NPAs, where, also, the principle of sanctity of contracts is colliding with the sustainability of economic growth. A more poignant issue where the sanctity of contracts is colliding with the sustainability of businesses is waivers of farm loans by many state governments. With farmers unable to pay off their contracted loans, what is at stake here is the sustainability of farmers' lives. In this case, some of the same economists who plead for policy-makers and courts to be practical in the case of bank loans to large infrastructure companies invoke moral hazard to argue against writing off the loans of small farmers.

Reality must be faced, whether one is from the left or right of the political spectrum. The future cannot be predicted too far. In the case of businesses, technological changes and geo-political uncertainties – especially when businesses become connected to global supply chains, as the Indian power projects were – make it very difficult to foresee all contingencies beforehand and factor them into contracts. Farmers have a very hard time too, predicting the weather and prices for their produce. In such cases, what should be honoured for justice to be done?

The legal contracts that were signed – which in the case of the infrastructure projects – were clearly without coercion or, should considerations of the welfare of the farmers and investors, and the sustainability of their businesses and lives, over-ride legal contracts? What would make a better governed society? Enforcement of contracts, regardless of their consequences, as Shylock had insisted in Shakespeare's *Merchant of Venice*? Or, that public institutions should consider the welfare of all affected?

Citizens' trust in the ability of their state's institutions to deliver justice is a condition of good societies. In great societies, trust in institutions goes much deeper than expecting that legal contracts will be enforced regardless of their consequences. It comes from the confidence that, if something undesired happens, all points of view will be considered fairly and justice will be done.

The competence question

India's Supreme Court has been criticised by some people for its decisions in matters that it does not, according to them, have the competence for, such as the implementation of pollution standards for automobiles and the implications of power contracts. In these instances, the Supreme Court had not given any new decision. In the automobile industry case, it upheld a decision taken by the executive branch. In the power producers' case, it upheld the sanctity of contracts voluntarily entered into by the parties. Given the complexity of these issues, some economists have proposed adding an economist to India's Supreme Court.

But experts in no discipline, not even economists, can see all aspects of complex systems. Modern experts in social sciences, including economics, are becoming increasingly specialised. They know more than others do about a part of the whole, as

do specialists in modern medicine. Therefore, one cannot expect to find any expert with a solution that will do justice to the welfare of the whole system. Besides, economists (and other experts) also have their ideological preferences. Those on the right of the political spectrum evoke the concept of moral hazard to deny farmers relief, while those on the left evoke it against forgiveness to large investors.

A comprehensive view

Many points of view, like the many blind men around the elephant, must be brought together to make sense of complexity. Moreover, in dynamically changing situations, conditions on the ground must be considered to understand reality. Therefore, good and just solutions can only come from a good process of participation of affected stakeholders.

Competent executive and unbiased courts are only two legs of the stool. The third leg is required for societal stability. The third leg is a systematic process of democratic deliberations to supplement the formal institutions.

Prof. Mark Moore of the Kennedy School of Government writes in *Creating Public Value: Strategic Management in Government*: "We might think of this activity (of public deliberations) as helping to define rather than create public value. But this activity also creates value since it satisfies the desire of citizens for a well-ordered society in which fair, efficient, and accountable public institutions exist."

In other words, the quality of the process of resolving economic and social issues and making public policy is a public good of great value in itself. It increases citizens' trust in the institutions that govern their lives. Moreover, participative and well conducted multi-stakeholder processes increase social solidarity, which makes good societies.

This is an investment more in need today than anything else. In great societies, trust in institutions goes much deeper than expecting that legal contracts will be enforced regardless of their consequences. It comes from the confidence that, if the unexpected should happen, all points of view will be considered fairly and justice will be done. Not doing so is a risk to the India story.

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<http://www.thehindubusinessline.com/opinion/dilemma-in-contractual-disputes-resolution/article9768594.ece>

Raising the 'Bar' for India's Power Sector

Aditi Roy Ghatak* and Abir Das Gupta

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Two prominent infrastructure companies belonging to Adani Group and Tata Group had sought the assistance of electricity regulators to hike the rate at which they sold power to several state power utility and distribution companies. They claimed that compensatory tariffs to the tune of nearly Rs 8,000 crore were due to them as they had to absorb an

increase in the price of coal imported from Indonesia used to fuel their power plants. But this was denied to them by the Supreme Court.

India's high-flying industrialists are not used to having their pockets picked. Yet India's apex court appears to have done just that, in the most honourable manner, one might add. Justices Pinaki Chandra Ghose and Rohinton Nariman of the Supreme Court, in a recent order, have produced a sterling judgment with far reaching consequences for two major private corporate players in India's power sector — companies in the Adani Group and Tata Group — as well as for the future governance of the power sector. The judgment of the Supreme Court is expected to set a precedent for a number of similar cases currently being dealt with by various state-level electricity regulators across the country.

As the Court order affects the operations of two of India's three largest coal-fired thermal power plants, this moment offers an opportunity to re-evaluate the country's long-term strategy to build large electricity generating capacities in an efficient, sustainable and inexpensive manner. It also offers an opportunity to take a relook at the various regulatory conundrums that the sector currently faces.

The April 11, 2017 Supreme Court order, which relates to a clutch of cases involving power generating subsidiaries of the Adani and Tata Groups, along with a number of other players in the power sector, has relieved two particular companies — Adani Power Limited and a subsidiary of Tata Power Limited, Coastal Gujarat Power Limited (CGPL) — of an estimated Rs 4,300 crore and Rs 3,600 crore respectively (*Financial Express* 2017) that they had nearly managed to secure as compensation for what they claimed was an unexpected rise in the price of coal imported from Indonesia. Tata Power (through CGPL) owns and operates a 4,000 megawatt (MW) UMPP in the town of Mundra, Gujarat while Adani Power operates the 4,620 MW Mundra Power Plant, both located near the Mundra port in Gujarat. Both thermal power plants use Indonesian coal and both sell their power to several state power utility and distribution companies (discoms) in Maharashtra, Gujarat, Rajasthan, Punjab and Haryana. Both companies had argued that an increased cost in procuring high-quality coal from Indonesia merited an increase in the price charged by them; implying that the burden of this increased tariff would have fallen on the discoms, and finally, on the consumers.

The apex court's order was in response to a set of appeals that had been filed in the Supreme Court by the state discoms and the civil society NGOs Energy Watchdog and Prayas (Energy Group) — both authorised consumer representatives for the power sector who have been involved in these cases from their origin at various state regulators — against an April 2016 order of the APTEL based on which in December 2016 the CERC had awarded compensatory tariffs to the power producers.

The APTEL order had remanded the CERC to recalculate compensation due to the power producers, having changed the legal basis on which the compensation was permissible. Earlier, in 2014, the CERC had awarded compensatory tariffs to Adani Power and CGPL based on calculations done by a committee headed by Deepak Parekh, the chairman of HDFC (formerly the Housing Development Finance Corporation). (Disclosure: Parekh is a trustee of the Sameeksha Trust which publishes the EPW.) The

compensatory tariffs awarded then had amounted to Rs 0.52 per unit for CGPL and Rs 0.41 per unit for Adani Power. This award was to apply for five years till 2019.

The award was challenged before APTEL by the discoms and the NGOs. APTEL then ruled that while some compensation was due to Adani Power and CGPL, the legal basis on which the CERC had awarded this was invalid. Having established a different justification, APTEL ordered the CERC to recalculate the award.

The December 2016 recalculation by the CERC — based on sample calculations offered by CGPL and Adani Power in their respective cases and also taking into account caveats and objections raised by the discoms and the civil society representatives — had been “much more generous” to the power companies (*Financial Express* 2017). The order by the Supreme Court, by setting aside the APTEL ruling, has effectively also set aside the CERC award.

The Supreme Court’s order implies a huge earnings setback for CGPL and Adani Power, with the latter having already included a likely inflow of compensatory tariff to the tune of Rs. 8,800 crore (Vishwanath 2017) in its revenue calculations and projections (having assumed that the CERC award would hold). For the Tata Group company, the court order increases the risk of a future earnings downgrade for 2018. The annual negative impact on Tata Power could be Rs. 800–Rs. 1,000 crore, if the company continues running their power producing units at the minimum plant load factor, that is, at the minimum level needed for the plant to stay operational (Vishwanath 2017).

The fact that the Supreme Court set aside the CERC award also increases the probability of both power plants at Mundra becoming economically unviable. CGPL in its submissions to CERC and APTEL had said that if a compensatory tariff were not awarded the project would lose Rs. 1,873 crore a year, totalling Rs. 47,500 crore over its entire 25-year period of expected operation. After the court order, Tata Power stated, “CGPL would continue to work towards alternatives, including sourcing of competitive and alternative coals to best contain the onslaught of under recovery.” Analysts, however, expect that CGPL may now decide to forego their equity investment of Rs. 4,000 crore and may ask lenders to either restructure the company’s debt or sign new contracts to sell power to state discoms or find a new developer for the project (Vishwanath 2017). At the time of publication it was reported that CGPL has discontinued operating 800 MW of the 4,000 MW total capacity of its plant (*Economic Times* 2017).

More than CGPL, for Adani Power, which has been infusing nearly Rs 2,000 crore into its power project every year and which had a consolidated debt of Rs 49,547 crore at the end of September 2016, the Supreme Court order is a bigger shock (Vishwanath 2017). The company has a high net debt-to-equity ratio of 6:1 and the Rs. 8,800 crore of expected earnings in compensatory tariffs that it had booked in its accounts but which it will now not get, is higher than its estimated net worth of Rs 7,948 crore (Vishwanath 2017). In a statement to the Bombay Stock Exchange, Adani Power said,

A preliminary analysis [of the court order] showed that [the company] will get benefit in respect of its [contract] for 1,424 MW to Haryana discoms, the [contract] for 3,300 MW

with Maharashtra discoms and in [the contract] for 1,200 MW with Rajasthan discoms. (Vishwanath 2017)

The Supreme Court has stated that compensatory tariffs can be granted differently (due to changes in the country's coal allocation policy in 2013). Still, analysts suggest that the amounts that can be expected as benefits will be significantly lower than what was earlier awarded by APTEL and CERC. Meanwhile, the *Economic Times* reported on 11 May that Adani Power has already started to scale down its operations at its Mundra plant and cut power supplies to the Gujarat state discom by deactivating capacity of 1,250 MW (out of its total capacity of 4,620 MW) (*Economic Times* 2017).

As two members of Prayas point out in an article for the *Wire*, since the CERC's award of compensatory tariffs to Adani and Tata, regulatory commissions in several states such as Maharashtra, Uttar Pradesh, and Rajasthan started revising competitively-discovered tariffs under Section 63 of the Electricity Act, 2003, by granting additional compensatory tariffs for similar claims (Chitnis and Dixit 2017). "Thus, even in the absence of any possibility of relief under the contract, the commissions were using their regulatory powers to grant compensatory tariff without any public consultation," the Prayas members stated. Media reports suggest that the total compensatory tariff granted by various commissions aggregate Rs. 11,000 crore. It can be expected that the Supreme Court order will set a precedent for each of these awards as well, in case these are challenged.

Tariff Determination Process

Thermal power tariffs have two components: fixed costs and variable costs. Fixed costs include interest on loans, returns on equity, depreciation, operation and maintenance expenses, insurance, taxes and interest on working capital. Variable costs comprise fuel cost (coal and oil) in the case of coal-based thermal plants. The two-part tariff structure allows power producers to recover fixed costs such as capital investment even when the entire capacity is not utilised.

The Electricity Act allows for tariffs to be determined in two ways. Under Section 62 of the act it allows tariffs to be determined by the appropriate (state or central) regulatory commission for the "supply of electricity by a generating company to a distribution licensee." In the event of a shortage of fuel supply, the regulator may fix the upper and lower limits of the tariff in terms of the agreement signed between a generating company and the licencees for no more than a year to ensure that the price paid by the consumer of electricity is reasonable.

The second approach to determining tariffs defined under Section 63 of the act is discovering it through a competitive bidding process. Under this system, power producers are invited to submit their bids to supply power to state discoms whenever the need for fresh capacity arises or a new power project is to be set up. Section 63 allows regulatory commissions to "adopt" such competitively discovered tariffs, under procedures notified by the Central Government. The regulatory commissions are meant to monitor the bidding process and as per guidelines notified in 2005, the Central Government notifies the standard bidding documents such as the request for qualification (RfQ), request for proposal (RfP) and PPAs that are to be signed between

the power producers and the discoms. These documents were last notified in 2014 and were meant to be valid for five years.

The bidding guidelines constitute a fair and transparent process and give the bidders an option to pass through fuel price and other related risks by quoting various escapable and non-escapable charges. Escapable parameters allow bidders to transparently pass on potential price variations for each of their subcomponents. The escapable components play a crucial role in deciding the competitiveness of a given bid and hence, the ultimate tariff. The bids are evaluated based on the “levelised tariff” and the PPA is signed with the lowest bidder. The levelised tariff is the ratio of the net present value of total capital and operating costs of a plant to the net present value of the net cost of electricity generated by that plant over its operating life. The discount rate used for calculating the net present value is a crucial variable and is notified by the CERC every six months, for evaluating bids opened in that period.

The distribution company is required to publish all financial bids without the names of the bidder along with the winning bid on its website after the PPA has been signed. Besides, a notice with details of the signed PPA must be published in at least two national dailies and published on the company website. The final signed PPA along with the necessary certificates and reports are to be submitted to the regulatory commission for tariff adoption. The quoted tariff cannot be changed post-bidding (unless specifically allowed in the terms of the PPA). Under the standard model PPA, competitively determined tariffs can only be changed under the terms of Article 12 (“change in law”) or Article 13 (“force majeure”—or unforeseen circumstances outside the control of the contracting parties).

Increasingly, it is the process under Section 63 that has become important for most new power projects in the country. Large contracts for setting up new power plants using non-renewable fuel sources are up for grabs in India with the Twelfth Five Year Plan (2012–17) noting that capacity addition from conventional sources is estimated at 1,01,645 MW. Of the total capacity addition, 56 percent is expected to come from the private sector, according to the Central Electricity Authority (CEA 2016). Private corporate groups like the Adani Group and the Tata Group obviously want a big share of this cake and have been bidding successfully in many cases, though not necessarily wisely.

It goes without saying that any overvaluation of plant equipment or fuel leads to an increase in the base capital cost of the project. In the case of a project for which tariffs are determined under Section 62, such an overvaluation can have serious tariff implications because the fixed cost component is approved by the regulatory commission. When the overvaluation becomes part of the base cost, it is annually recoverable and will directly burden electricity consumers in terms of excess tariff. In competitively bid projects, bidders are expected to put their best foot forward, offering the most reasonable rates possible. However, as has been reported earlier in this journal, the Adani Group, among others, allegedly overvalued both equipment and coal imported from Indonesia which is currently being investigated by the Directorate of Revenue Intelligence in the Ministry of Finance (Guha Thakurta 2016; Guha Thakurta and Malik 2016).

The Adani Power Case

Adani Power's Mundra project in Gujarat has PPAs with state-owned discoms in Rajasthan, Gujarat, Haryana and Punjab (Vishwanath 2017). The project had initially not planned on using Indonesian coal. It assumed that coal would come from indigenous sources and from Germany and Japan. Indonesian coal entered the picture later. The Supreme Court judgment laid out the background of how Adani Power came to win these contracts:

On February 01, 2006, Gujarat Urja Vikas Nigam Limited (GUVNL) issued a public notice inviting proposals for supply of power on long term basis under three different competitive bid processes. The participating bidders were to decide on the tariff and quote such tariff after competing against each other. The bidders were entitled to quote scalable or non-scalable tariff or partly scalable and partly non-scalable tariff, as was considered appropriate by them to cover their respective risks so as to obtain whatever returns are available to them. The best levelised tariff as per certain pre-disclosed criteria was to be followed in order to arrive at the lowest tender.

In January 2007, a consortium led by Adani Power submitted its bid for generation and supply of 1,000 MW to GUVNL, quoting a levelised tariff of Rs. 2.3495/kWh (kilowatt hour) with Rs. 1/kWh as the capacity charge, and Rs. 1.3495/kWh as the non-scalable energy charge. The consortium won the GUVNL contract on January 11, 2007 with a letter of intent (LoI) issued in its favour. This was followed by a PPA between GUVNL and Adani Power signed on February 02, 2007 for the supply of power from a project being set up at Korba in Chhattisgarh. The agreed terms were changed on April 18, 2007 when the power source was changed to the Mundra project. This did not seem to be of any great consequence at that time and a supplementary PPA was signed to this effect on the same date.

During this period, Adani Power also bid successfully to supply power to the Haryana state discom. The Haryana discom initiated its competitive bidding process for the supply of 2,000 MW of power on a long-term basis on May 25, 2006, on similar lines to the GUVNL public notice. Adani Power's successful bid entailed the company supplying 1,424 MW power to the Haryana discom at a levelised tariff of Rs. 2.94/kWh from the Mundra plant non-scalable energy charges. Adani Power won the bid on July 17, 2008, received a LoI and executed two PPAs with two Haryana government entities for the supply of 712 MW of power to each entity from the MPP. The Haryana State Electricity Regulatory Commission adopted the tariff under Section 63 of the Electricity Act on July 31, 2008 while the Gujarat regulatory authority adopted the tariff for the supply of power to GUVNL on December 20, 2007.

At the time of these bids, the consortium had indicated that the Adani Group — through its flagship company Adani Enterprises Limited (AEL)—had an arrangement with the Gujarat Mineral Development Corporation for indigenous coal procurement for the project, because it had been allotted a certain coal block in Chhattisgarh. There was no talk of Indonesian coal at this stage. AEL said that it had signed a memorandum of understanding (MoU) with a German company named Coal Orbis Trading GMBH for the supply of 3–5 million tonnes of imported coal on a long-term basis till the year 2032. There was a similar MoU between AEL and a Japanese agent (Kowa Company Limited)

for supply of 3–5 million tonnes of coal on a long term basis. The two MoUs were attached to the bid proposal submitted to GUVNL. They also formed the basis of coal supply agreements (CSAs) that AEL signed with Adani Power on December 08, 2006 to supply coal for phases I and II of the Mundra power project.

However, after signing the first PPA for the Gujarat utility, AEL terminated its MoUs with the German and Japanese suppliers. Subsequently, AEL executed another two CSAs with Adani Power on March 24, 2008 (for phase III of the project) and on April 15, 2008 (for phase IV). It was at this stage that Indonesian coal entered the picture. AEL had floated a Singapore-based subsidiary, PT Adani Global Limited, in 2000 which had acquired mining rights for the Bunyu mines in Indonesia in 2008. According to a red herring prospectus (Adani Power Limited 2009) issued by Adani Power on July 14, 2009 (seeking to raise Rs. 3,000 crore through an initial public offering), the company stated that

The primary fuel for the [Mundra] power project will be coal, which we propose to source from AEL ... The expected consumption of coal for the Mundra Phase I and II Power Project is 3.68 MMTPA (million metric tonnes per annum) with an average GCV (gross calorific value, a measure of the quality of coal) of 6,000 kcal/kg at 85.0 percent plant load factor (PLF). PT Adani Global, a wholly owned subsidiary of AEL, has entered into agreements to exclusively mine coal in Bunyu Island, Indonesia. For [the MPP], AEL proposes to procure the coal from these mines in Indonesia.

On December 14, 2009, a CSA was executed between PT Adani Global and Indonesian mining company PT Dua Samudera Perkasa for the supply of 10 MMTPA of coal at the CIF (cost, insurance and freight) price of US\$30-US\$35 per metric tonne depending upon its GCV. On July 26, 2010, AEL entered into a consolidated CSA with Adani Power. The consolidated CSA provided for the supply of 10 MMTPA of coal at CIF price of US\$36 per tonne for 15 years from the scheduled commercial operation date of the last unit of phase IV of the project. This agreement replaced all previous CSAs between the companies and effectively, the entire quantum of coal required for the company's Mundra project was now to be sourced from Indonesia.

What is significant to note is that almost a year before the December 2009 agreement, on January 12, 2009, the Indonesian government passed the Law on Mineral and Coal Mining No 4 of 2009 (hereafter, the "mining law") designed to overhaul the mining industry to enhance its value for the Indonesian economy. This law replaced the previous Mining Law No 11/1967 which had governed all of Indonesia's pre-2009 mining concessions and applied to all existing arrangements. The new mining law eliminated several of those concessions, making it mandatory for Indonesian coal miners and suppliers to benchmark the price at which they sold their coal to the prevailing rates in the international market. While its implementation took another year, it was clear from January 2009 to all stakeholders that a rise in the price of Indonesian coal was imminent. On September 23, 2010, Indonesia's minister of energy and mineral resources promulgated the Regulation of Ministry of Energy and Mineral Resources No 17 of 2010; Article 2 required the holders of mining permits (and their affiliates) to sell the output at prices determined by the benchmark price either for domestic sales or exports. Existing CSAs were required to be updated to reflect the new

regime within a year's time. It was at this time that the actual escalation in the price of Indonesian coal took place.

This prompted Adani Power to petition the CERC seeking relief

On the score of the impact of the Indonesian Regulation to either discharge them from the performance of the PPA on account of frustration, or to evolve a mechanism to restore the petitioners to the same economic condition prior to occurrence of the change in law.

Adani Power argued that there were three possible routes by which they could receive relief: on account of the "change in law" clause in the PPAs — wherein it claimed that the clause must be read as including foreign laws as well — or via the "force majeure" clause of the PPAs. The company contended that the new law of the Indonesian government constituted a force majeure event (force majeure implies the action of forces outside the control of the parties to a contract and unforeseeable for them, which prevents or unavoidably delays the discharge of their duties under the contract). Failing both, it sought relief under Section 79 of the Electricity Act. Adani Power claimed that the CERC, in accordance with its functions as a regulator protecting the interests of both consumers and producers, could summarily revise the tariff laid out in the PPAs in order to compensate the company.

The Tata Power Case

In the case of the Tata Power-owned CGPL, the story began in 2005 when the Ministry of Power in association with the CEA and the Power Finance Corporation initiated the concept of UMPPs with the aim of meeting India's growing power demand. The idea was to commission several high capacity thermal power plants, each in the range of 4,000 MW. The private sector was expected to take over the construction, commissioning and operation of the power plants following a process of competitive bidding (Power Finance Corporation of India).

Special Purpose Vehicles (SPVs) were to be set up by the Central Government and state governments as shell companies for the purpose of acquiring land, providing water supply and fuel supply for those UMPPs which were to be attached to captive mines. The necessary regulatory clearances were required to be obtained before the projects were offered to private players to take over. The SPV mechanism was developed in order to "enhance the investor's confidence, reduce risk perception, and get a good response to the competitive bidding process" (Power Finance Corporation of India).

It was expected that this method would result in the discovery of competitive power tariffs. Of the 19 SPVs formed under this programme, only four have reached the stage of competitive bidding. Two UMPPs are currently operational — CGPL in Mundra and Reliance Power's Sasan UMPP in Madhya Pradesh (Ministry of Power). The establishment of two others, at Tilaiya in Jharkhand and at Krishnapatnam in Andhra Pradesh — both also owned by Reliance Power — have been delayed due to a variety of factors. Reliance Power backed out of the Tilaiya UMPP in April 2015 citing delays in land acquisition. Subsequently the SPV was taken over by a group of power procurers (Jai 2016). Reliance Power has requested the Andhra Pradesh government for a similar move for the Krishnapatnam UMPP which has apparently been stalled due to the

company not being able to supply electricity due to higher prices of Indonesian coal (*Business Standard* 2016).

CGPL's Mundra UMPP was set up to supply power to discoms in Gujarat, Maharashtra, Rajasthan, Punjab and Haryana. In accordance with the guidelines issued by the Power Ministry, CGPL was incorporated on February 10, 2006 to undertake the process of bidding on behalf of the procurers as an SPV wholly owned by the Power Finance Corporation. The RfQ was notified on March 31, 2006, and on November 07, 11 qualifying bidders, including Tata Power were issued with RfP documents. As per the RfP, the tariff to be quoted would consist of two main components: the energy charge and the capacity charge, with both split further into scalable and non-scalable components. After evaluating the bids that were submitted, Tata Power's was declared to be the winning bid, quoting a levelised tariff of Rs. 2.26367 per kWh. An LoI was issued to it on December 28, 2006 and Tata Power acquired 100 percent ownership of CGPL on April 22, 2007. CGPL entered into PPAs with the respective state discoms on April 22, for the supply of 3,800 MW of power. The CERC adopted the tariffs and notified them in an order dated September 19, 2007.

CGPL envisaged that it would run its plant using imported coal. It required a supply of approximately 12 MMTPA of coal. CGPL entered a CSA with Indonesia's IndoCoal Resources (Cayman) Limited for the supply of 5.85 MMTPA on October 31, 2008. Tata Power was to supply the remaining requirement to CGPL, and the two companies signed a CSA on September 09, 2008. Tata Power reassigned its existing agreement with IndoCoal Resources for supply of 3.51 MMTPA of coal (which earlier powered its coastal Maharashtra power plant) via an Assignment and Restatement Agreement dated March 28, 2011. Here too, it is necessary to note that this reassignment was taking place after the Indonesian price hike. While the CSA that it re-routed from the coastal Maharashtra plant to the Mundra UMPP was signed before the price hike, it is unclear why the issue of the escalated price had no effect on the reassignment agreement.

When the Indonesian mining law was passed in 2009 and consequent regulations notified in 2010, CGPL calculated that the change in coal price without an adjustment of the tariff would result in a loss of Rs. 1,873 crore per annum, adding up to Rs. 47,500 crore over the 25-year contract period (according to submissions it made to the CERC). It took up the issue with the lead procurer GUVNL and the Ministry of Power through a letter dated August 04, 2011. The Ministry responded stating that:

A PPA is a legally binding document exclusively between the procurers and the developer. Therefore, any issue arising therein is to be settled within the provisions of PPA by the contracting parties for which Gujarat being the Lead Procurer may take necessary action.

Following an unsuccessful attempt by CGPL to obtain an exemption from the Indonesian government for it to come under the purview of the new mining law, on March 09, 2012, it was called upon by IndoCoal to align the original CSAs with the new regulations. With the CSAs amended on March 23 and June 22, CGPL filed for relief at the CERC requesting compensatory tariffs along the same three possible routes as Adani Power did.

Trials and Tribulations

The issues then took an interesting turn at the CERC. On April 02, 2013 (in the Adani case) and April 15, 2013 (in the CGPL case), the commission passed similar orders on both cases. It held the claims by Adani Power and CGPL requesting relief to be permissible. It, however, rejected the claims of force majeure and/or change in law. Consequently, seeking to provide them relief by some other route, the CERC exercised its regulatory powers under Section 79 of the Act to “provide redressal of grievances to generating companies, considering the larger public interest and hence constituted [the Deepak Parekh] committee to look into the alleged difficulties faced by Adani and to find an acceptable solution thereto” in the words of the Supreme Court judgment. The committee submitted its report on the basis of which the CERC awarded compensatory tariffs to CGPL and Adani Power in 2014.

Expectedly, a flurry of appeals and cross-appeals resulted, including appeals before the APTEL and even the Supreme Court. The upshot was a combined order on both the cases by APTEL on April 07, 2016. The APTEL order held that the CERC’s exercise of its regulatory power under Section 79 of the act to award compensatory tariff was unwarranted since the PPAs had been the result of a competitive process of tariff discovery under Section 63. The APTEL order reviewed the questions of force majeure and change in law, and found that while the change in law provisions did not apply — because the relevant change in law was not a change in Indian law — a case of force majeure was made out. Having reached this conclusion, APTEL remanded the matter back to CERC to determine the impact of the force majeure event, in order to grant compensatory tariffs. On December 06, 2016, the CERC arrived at a certain determination, and granted compensatory tariffs on account of force majeure. At this stage, appeals against the APTEL order were pending at the Supreme Court and the CERC in its ruling noted that its award was subject to the outcome of the case in the apex court.

In the Supreme Court, the appellants represented by senior counsel Raju Ramachandran and Prashant Bhushan argued that force majeure, as defined in Section 56 of the Indian Contracts Act, 1872, read with the specific contractual definition in the relevant clauses of the respective PPAs could not apply, making it clear that “it must be an unforeseen event or circumstance that wholly or partly prevents the affected party in the performance of its obligations under the agreement.” Their main contentions were that Adani Power and CGPL had voluntarily decided to quote energy charges as non-escalable in order to make their bids competitive and, therefore, to win the contracts. The bids were not premised on the import of coal from Indonesia only and it was open to them to get coal from any source. They argued that

The price of coal is the price of raw material and if prices go up, a contract does not get frustrated merely because it becomes commercially onerous, as the PPA itself states in clause 12.4. In any event, the fundamental basis of the PPAs between the parties was not premised on the price of coal imported from Indonesia.

A battery of legal luminaries argued the case. Harish Salve and Abhishek Manu Singhvi appeared for Adani Power while Kapil Sibal and C S Vaidyanathan appeared for the Tata Group. They argued that the fundamental basis of the PPAs was the CSA that was

entered into and pointed out various clauses in the PPAs to substantiate their claim that the CSA and imported coal were both very important elements in the bids and the PPAs. According to them,

Non-escalable tariffs do not lead to the conclusion that if a source of coal becomes unavailable in a manner that completely undermines the basis of the bid, the tariff cannot be adjusted. If otherwise they fall within the change in law provision and/or force majeure provision, the mere fact that a non-escalable tariff has been quoted would make no difference.

They found support in the fact that neither GUVNL nor the Haryana discoms had filed appeals and emphasised that it was clear that “where there is grave unforeseen hardship on account of non-allocation of Indian coal, the rise in cost should be adequately compensated.” They argued further that, in any event, the CERC did not give them the entire benefit of the rise in the prices of coal. Thus, they contended that in the final analysis, the relief granted on the ground of force majeure by the CERC should not be disturbed and relief on the ground of change in law should, in addition, have been given to them.

Another interesting intervention in the matter was the appearance of the Attorney General of India Mukul Rohatgi who appeared on behalf of the Union of India to state how important private producers of power were, in the Indian scheme of things. To quote the judges

Rohatgi was only appearing in order to apprise us that the electricity sector, having been privatised, has largely fulfilled the object sought to be achieved by the 2003 Act, which is that electricity generation, being de-licensed, should result in production of far greater electricity than was earlier produced. He urged us not to disturb the delicate balance sought to [be] achieved by the Act, [that is] that producers or generators of electricity, in order that they set up power plants, be entitled to a reasonable margin of profit and a reasonable return on their capital, so that they are induced to set up more and more power plants.

Rohatgi strongly relied upon Section 3 of the Electricity Act which states that the Central Government shall from time to time, prepare a National Electricity Policy and a tariff policy in consultation with state governments, and the requisite authority for development of the entire power system, based on the optimal utilisation of natural resources, which will be binding on all concerned; something also indicated in Section 79(4). The attorney general also referred to a decision of the Cabinet Committee for Economic Affairs which recognised the overall shortfall in the supply of domestic coal and the subsequent new coal distribution policy of July 2013 which was formulated. The new policy, he said, had binding directions

Making it clear that as generators of electricity, who depend upon indigenous coal, have been given less coal than was anticipated, should be allowed either to import the coal themselves, or purchase imported coal from Coal India Limited with the difference in price being passed through to them.

He further referred to and relied upon the revised tariff policy of January 28, 2016 to bolster his arguments in favour of granting compensatory tariffs.

What was evident during the proceedings in the Supreme Court was that the Indian government represented by Rohatgi and the lawyers representing Adani Power and CGPL were all singing the same tune!

Supreme Court Slams the Door Shut

Having heard all the submissions, Justices Ghosh and Nariman delivered their verdict. On the question of force majeure, they explained that the claim by the power producers of "frustration" did not hold as the fundamental basis of the PPAs remained unaltered.

Nowhere do the PPAs state that coal is to be procured only from Indonesia at a particular price. In fact, it is clear on a reading of the PPA as a whole that the price payable for the supply of coal is entirely for the person who sets up the power plant to bear. The fact that the fuel supply agreement has to be appended to the PPA is only to indicate that the raw material for the working of the plant is there and is in order. It is clear that an unexpected rise in the price of coal will not absolve the generating companies from performing their part of the contract for the very good reason that when they submitted their bids, this was a risk they knowingly took ... (that) the bid may be non-escalable does not mean that the respondents are precluded from raising the plea of frustration, if otherwise, it is available in law and can be pleaded by them. But the fact that a non-escalable tariff has been paid for, for example, in the Adani case, is a factor which may be taken into account only to show that the risk of supplying electricity at the tariff indicated was upon the generating company.

Accordingly, the Supreme Court rejected the claim of force majeure.

On the exercise of regulatory power under Section 79 by the CERC, the Supreme Court upheld the appellants' contention that

Under Section 63 of the Act, the Commission does not "determine" but only "adopts" tariffs discovered through a transparent process of competitive bidding." Thus, "there is no residuary source of power contained in the Commission either in Section 79 or otherwise to fix compensatory tariffs once the tariff is adopted under Section 63. If at all, such tariff can be modified only in accordance with the guidelines issued by the Central Government and not otherwise ... "[i]t is clear that in a situation where the guidelines issued by the Central Government under Section 63 cover the situation, the Central Commission is bound by those guidelines and must exercise its regulatory functions, albeit under Section 79(1)(b), only in accordance with those guidelines ... it is only in a situation where there are no guidelines framed at all or where the guidelines do not deal with a given situation that the Commission's general regulatory powers under Section 79(1)(b) can then be used.

In this instance, given that the PPAs and the bidding guidelines clearly spell out the conditions under which tariffs can be revised, the Supreme Court held that the CERC could not overrule those provisions under its regulatory powers.

On the question of change in law, the Court clarified that the term "law" could not be construed to mean any law whether Indian or foreign.

The meaning will have to remain the same whether coal is sourced wholly in India, partly in India and partly from outside, or wholly from outside. This being the case, the meaning of the expression “any law” in clause 13 cannot possibly be interpreted in the manner suggested by the respondents.

With these arguments therefore, all three routes to compensation were shut off.

The Supreme Court did provide an alternate route to some relief though, albeit at a significantly smaller scale. In October 2007, the New Coal Distribution Policy had been notified by the Central Government, spelling out a framework for future coal allocations from Indian coal mines. This policy was amended in July 2013, with India staring at shortages in domestic coal supply. The 2013 amendment made it clear that only a certain percentage of domestic coal could be allocated via Fuel Supply Agreements (FSAs) and that any surplus requirement of a project would have to be covered through imported coal or spot auctions. The amendment stated that

taking into account the overall domestic availability and the likely actual requirements of these TPPs (thermal power plants), it has been decided that FSAs will be signed for the domestic coal quantity of 65 percent, 65 percent, 67 percent and 75 percent of ACQ (Annual Contracted Quantity) for the remaining four years of the 12th Plan for the power plants having normal coal linkages.

The apex court granted that this amendment constituted a “change in law” event and to this limited extent offered relief for the period after July 2013. The order directed that the CERC should calculate on a case-by-case basis what the quantum of relief would be under these considerations. Preliminary calculations by analysts at Prayas suggest that the total relief using this route is much lower. They wrote

as far as domestic coal is concerned, the last year has witnessed an impressive increase in production from CIL [Coal India Limited] and SCCL [Singareni Collieries Company Limited] of about 43 MT and in fact CIL has been advised to reduce production to avoid excessive stockpiling. The benchmark price for Indonesian coal peaked around March 2012, but ... it has been falling since then. So it seems that the worst of the Indonesian coal price increase was already passed by July 2013. Given the fall in power sector's demand for coal and increase in CIL's production, one can also assume that the worst of domestic coal shortage is past. Thus, the impact is likely to be only for the period of one or two years from August 2013. Considering all these factors, our preliminary macro analysis shows that the total relief as awarded by the Supreme Court would only be around 20-25 percent of the relief granted by various regulatory commissions. (Chitnis and Dixit 2017)

The sequence of events prior to the initial claim at the CERC though begs the question as to how force majeure was considered to be a valid argument at all when in fact the new Indonesian law — the factor that had actually resulted in the price rise — had already been promulgated when Adani Power signed its final consolidated CSA in 2010. As we have seen, a similar issue can be pointed out in the CGPL claim of force majeure as well. Curiously, the fact that the mining law preceded the final CSAs was not belaboured even by those arguing against the compensatory tariff hike. The focus of the case, instead, was on the fact that the Indonesian regulations followed the signing of the earlier CSAs,

which provided the power producers the ability to claim that a hike in coal prices had made their bid untenable. In any event, the Supreme Court brought all this chicanery to nought but the episode demonstrates the mind-set of some of India's top infrastructure companies and corporate conglomerates.

Conclusions

Following this order by the apex court, both projects at Mundra — originally intended to supply electricity for a 25-year period — now seem unviable. As mentioned above, both CGPL and Adani Power have already started to cut electricity supply from these power plants. Will the projects shut down?

The Supreme Court order has thrown into uncertainty the future of India's coal-based thermal power generation sector. Will no new large coal-fired power projects be sanctioned in the near future? Only two of the 19 proposed UMPPs are currently operational, as already stated. The remaining projects that were envisaged have found no takers in the private sector. The Gujarat government recently announced that it was dropping its proposal for setting up a second UMPP in the state and had no intentions of reviving the proposal (Jai and Dave 2017).

There is a pervasive regulatory ambiguity in this sector. No clarifications have come from government officials on how best to deal with changes in law and regulations in foreign countries where Indian corporations operate or have interests that are directly tied to the financial and operational viability of domestic power projects. There is still little clarity on who should bear the higher costs if compensation is due. The Supreme Court verdict merely patches an individual problem that requires more systemic policy action to deal with. Gajendra Haldea, a former member of the (erstwhile) Planning Commission and the author both of the Electricity Act, 2003, and the model PPAs that the sector currently uses, argues that

It is patently unsustainable to pass on the inflation risk or commodity price risk to an individual company on a long-term basis ... [and a contract which demands this] reflects poorly on all the contracting parties. (Haldea 2017)

Two other points are also pertinent to consider. The first is that the general issue of compensatory tariffs is not necessarily restricted to coal and conventional ways of generating electricity. Both the Draft National Electricity Plan of December 2016 and the Twelfth Five Year Plan envision India becoming energy secure through renewable energy sources rather than coal or other conventional fuels. This is in line with commitments made by India to the international community to reduce India's carbon dependence at the Paris Climate Change Conference in 2015.

With the solar energy sector booming worldwide and India lacking significant domestic capability to build capacity, equipment will continue to have to be imported. Prices will rise and fall depending on market forces and India requires a clear plan on how to deal with all eventualities. Regulators and the government cannot allow ambiguity to prevail and unconsciously encourage litigation. Government authorities at various levels cannot absolve themselves of the responsibility to mediate and regulate rather than rely on the judiciary.

The other point is the question of how seriously India takes deregulation of the electricity sector that was envisaged in 2003 when the Electricity Act was passed. At that time, the aim was to “unbundle the various segments of the electricity industry with a view to enabling competition and choice in the supply of electricity to consumers” (Haldea 2017). While the aim has been achieved to some extent in the case of power generation with several private players having demonstrated capability and competence, power distribution remains a government monopoly. As a result, with all suppliers having to sell their power to the government bodies which control distribution of electricity to consumers, the consequent lack of competition benefits entrenched interests.

Distribution companies have also piled up a huge Rs. 4, 00,000 crore in debt that is now being passed on to taxpayers through the Narendra Modi launched UDAY (Ujwal Discom Assurance Yojana) scheme, in a repeat of the grim scenario that the country had faced in 2002. A decade and a half later “the soul of the Electricity Act [has] remain[ed] caged” (Haldea 2017).

In the few limited cases where competition has been permitted in power distribution, such as in the city of Mumbai, it is becoming apparent that regulatory problems persist resulting in an inability to achieve the goal of making power more abundant and cheaper to consume. A detailed analysis by Prayas of the situation in Mumbai has shown how the use of the cost-plus regulatory regime has in fact proved counter-productive, providing little incentive for the private players to optimise operations (Prayas Energy Group 2017).

The Supreme Court order, aside from dealing with the specific issues in the Adani Power and Tata Power cases, has sent out a strong and unambiguous signal. It makes it clear that bidders must bid with honesty of intent and that they must do so in a bidding environment that is fair and which ensures sanctity of contracts. More importantly, the order makes it clear that it is always the consumer whose interests and rights must come first. The order may mark a watershed moment for India’s electricity sector.

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<http://www.epw.in/journal/2017/20/insight/raising %E2%80%98bar%E2%80%99-indias-power-sector.html#>

Supreme Court’s Verdict Denying Compensatory Tariff to Power Projects Opens a Pandora box!!

Radha Krishna Tripathy*

Modern Diplomacy, May 16, 2017

Adani power limited has set up a power plant at Mundra with a total capacity of 4620MW. It has a PPA with GUVNL and two other Haryana utilities (UHBVNL and DHBVNL) to provide power at levelised tariff of Rs. 2.3495 per unit (Rs 1 per unit

capacity charge and Rs. 1.3495 non-escalable energy charges). Similarly Tata power has bagged Mundra UMPP (4000MW) based on imported coal from Indonesia at a very competitive tariff of Rs. 2.26 per unit. Mundra UMPP has to supply power to five states.

In the year 2010, Indonesia promulgated “Regulation of Ministry of Energy and Mineral resources No 17 of 2010” which link the coal prices in Indonesia to international benchmark prices for any sale (domestic or export). Due to the change in law, the coal prices have invariably increased for Tata Power and Adani power for their power projects in Mundra and adversely affect their revenues. The companies have reported huge under recovery for these projects and knocked the door of CERC for a price revision under compensatory tariff. They have sought this revision under “force majeure” conditions. CERC after several rounds of discussions and hearing; saw merit in their appeal and approved compensatory tariff under a formula. This ruling was upheld in APTEL also. The aggravated parties (Distribution companies and several other CSOs and NGOs) took the matter to SC.

In a historical judgment in April 2017, SC (Supreme Court) set aside the order of CERC/APTEL to allow Adani power and Tata Power to charge compensatory tariff against the increased imported coal cost from Indonesia. While this is a great relief for the consumers and state distribution companies who are parties to the agreement, it raises several other concerns starting from the financial ramifications for the affected generators to business viability of the sector as a whole. Although Adani Power and Tata Power, the parties that were affected badly by the SC would find ways and means to lower down the risk or work out to avoid the adverse consequences, questions are raised against SC intervention on an issue that can be dealt with by the sector regulator under its jurisdiction.

My Assessments

The SC verdict on denying compensatory tariff raises several other concerns which require immediate attention such as its long term consequence on contractual arrangements between parties and flexibility in distribution of risks over a long term period, project promoters' acceptance of force majeure conditions and its definitions under certain conditions, impact on competitive bidding for other renewable energy project particularly on solar, and its overall impact on competition and market development for the energy sector in India. Any interventions from the Supreme Court on the quasi-judicial bodies like CERC may undermine its authority on the sector.

The Supreme Court Judgment and its repercussions on the stakeholders

The SC took a stand on the “Force Majeure” clause in the contract and declared it null and void for any changes in law and regulation outside the host country of the contract; in this case Indonesia. While bidding companies were well aware that they were bidding under a fixed price contract for a long term and would have to absorb any risks arising in the future, they should not have been come forward for a re-negotiation for a price adjustment for the increase fuel cost whatever the reasons. But in India, it is often a common practice that the project promoters first bid unreasonably to win the contract at first stage and then come back to renegotiate at the later stage citing taking advantage of weak regulations and badly designed contracts.

The recent SC judgment affects every stakeholder in the power sector value chain. For Adani Power and Tata power, it is hard to believe that they did not have any alternative plans for these kinds of eventualities. While the last option is to forego their equity and sell the assets to the investors for further restructuring, they may also go for other coal sourcing options to run the plants.

For distribution companies having PPA with Adani power and Tata power, this comes as a big relief. While they have saved themselves from any additional burden in terms of fuel price pass through, this might trigger another set of troubles for the power sector. Distribution utilities may refrain from signing fresh PPAs and may stick to price discovered without any flexibility in the contracts. This will make project promoters to be very cautious while bidding aggressively for the projects.

While any adverse judgement against the project promoters dents their revenue and overall profitability prospective, there is a fear of power assets going bad. In this situation, servicing debt would be under severe pressure and it directly impacts the funding agencies. Generally 70-80 percent of the project cost is debt financed and any default will result in huge NPA for the banks. As a consequence, they will refrain from any further loans to the sector as is clearly evident for many projects in the power sector now. While the flow of fresh investments dry down owing to bad assets, the whole sector may become unviable.

As far as CERC is concerned, they need to have a balanced approach. A balanced approach would require understanding of the complete scenario and the intention of taking such steps as deemed necessary to run the sector. They have seen merits in this case and due to perceived threat of generators defaulting on PPA contract and overall repercussions to the entire sector. The question still remains whether CERC has taken this stand due to fear perceptions for the generator getting out of the contract as a defaulter or simply favour the generators because of any hidden interest

Consumers are the least consulted but most affected party. They have little voices in any regulatory hearings due to lack of knowledge and interest. They completely depend on the government to represent their case through the utilities. However, organisations like Prayas and CUTS are representing the consumer voices and put forth the consumer's perspective in several forums. In general, public perception is positive for reverse auction bidding procedure where discovered tariff is on a downward trend owing to intense competition. If such renegotiations occur mid-way or any regulator interventions favoring the project developers, it dents their confidence. The tax payers in such cases make the government responsible which might affect the political economy of the ruling parties in terms of disgruntled consumers not opting to vote them in elections

No doubt, SC ruling in this case affects the economy at large and have long term repercussions for the entire sector. Questions are raised in its intervention on the quasi-judicial bodies like regulators and APTEL. But SC is the last resort for any justice and its views and opinions are important. The economic consideration arising out of shutting down the power units citing financial concerns and the resultant job losses should have been taken into consideration while pronouncing judgements and a balanced approach

could have been worked out for this case by the SC. When assets get stressed, power companies stand to lose credit rating and combined with less equity and higher interest, cost of capital, the chance of defaulting increases.

SC does not always consider the entirety of the case or the business and it restricts itself to the contract provisions under which it has to pass judgements. So in this case while passing judgments, it clearly defines that "force majeure" cannot be evoked for any changes in law in any foreign countries (in this case Indonesia) and the contract clearly defines that any risk arising in future will have to be borne by the developer. So, even if the case merits for a compensatory tariff on other various grounds, the contracts do not have such a provision and going by the book, it should be disallowed.

The Way Forward

The argument is not that who is right and who is wrong. In this case, there is a clear indication on risk assessment by the bidder and risk distribution which is not set through the bidding contract. Can it be reallocated through regulatory or judiciary interventions? Consequently, the consumer interest cannot be overlooked. SC in its judgement has not commented on the power of regulator under section 79 to fill in the gaps if any; in the bidding process but it has only highlighted that any foreign change in laws and regulations cannot be accepted as force majeure for Indian contracts.

The SC in its judgment clearly highlighted the followings which lays down clear indications for any bids in future in terms of creating informed bidding procedures with specific guidelines for procurement of input materials. The bidders need to be well aware of pricing risks in competitive bidding for long term contracts with imported components if any and SC is in for creating better risk allocation and built in mitigation measures in long term contractual projects.

This is a clear case of responsibilities and priorities set. While government should be allowed to decide on how to allocate resources and projects and what is best for country, regulatory and other institutes should perform their duty strictly on guidelines and procedures set. While government should decide on how to utilise an idle asset and recovery of dues so that NPAs could decline, the institutions should rather function independently to take decisions under its judicial provisions and mandate.

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An Evolving Risk Paradigm in the Power Sector

Anjali Viswamohan and Manu Aggarwal*

Live Mint, May 16, 2017

The growing risk profile for thermal power plants is likely to result in increasing cost of capital for them

Two recent events have displayed the financial viability and competitive advantage of investment in renewable energy, as compared to investments in coal-based power. On April 11, 2017, the Supreme Court disallowed Tata Power and Adani Power from charging compensatory tariff to neutralise the price hike of imported coal due to a change in Indonesian regulations. On May 09, Indian solar tariffs fell to yet another record low of Rs 2.44 for Solar Energy Corporation of India's 500MW project at Bhadla in Rajasthan. What are the implications of these events for India's rapidly transforming electricity market? They range from balance of payments, capacity utilisation, and construction delays to financial risks.

The Supreme Court judgement highlights the risks prevalent in the thermal power market, seeded in fuel sourcing, availability, and import dependency. Volatility in imported coal prices and the uncertainty around cost-efficiency of domestic coal production add more concern. Non-availability of coal could swiftly turn the once lucrative and viable coal power plants into stranded assets. Further, the Ministry of Coal's latest discussion paper on auction of mines for commercial mining examines free pricing of domestic coal. The paper suggests pegging the minimum revenue to be generated at 1.2 times of Coal India's run of mine price, which is likely to increase operating costs for thermal operators. While India's renewables sector does not have to battle risks associated with fuel sourcing, the current reliance on imported solar panels and balance of system products exposes the renewable energy sector to balance of payment implications, as in the case of coal imports. This makes it imperative for India to rapidly ramp up domestic renewables manufacturing capacity.

Thermal power plants are increasingly facing lower capacity utilisation. More than one-third of India's total thermal power capacity is currently stranded and the rest is running at 55 percent utilisation. This spells trouble for the lenders to these thermal projects, mainly state-owned banks, since lower capacity utilisation translates to falling recoveries. In recent times, renewable energy capacity is also increasingly seeing curtailment despite being granted a must-run status. In renewables, curtailment risk arises due to unavailability of transmission infrastructure, grid congestion, and grid instability. However, utilities are attempting to address this risk by introducing minimum offtake guarantees and deemed generation clauses in the renewable energy power purchase agreements.

Longer construction periods for thermal plants (three-four years), compared to renewable sources of power (12-14 months), is another important aspect for risk evaluation. Delays in obtaining environmental clearances, affecting 89 percent of the projects, according to a recent Comptroller and Auditor General of India report, could additionally prolong the construction of thermal plants. Renewable energy projects, in most cases are exempt from environmental clearances, and significant advances have

been made in recent years in streamlining the procurement of other clearances for renewable energy projects. The longer commissioning cycles, combined with higher likelihood of delays, makes investment in thermal power significantly riskier than that in renewables.

The Ministry of Environment's 2015 notification mandating stricter emission and water usage standards to minimise environmental impacts of running coal-based plants has also been troubling the sector.

Leaving aside the zero comparison on emissions, a coal-based thermal power plant takes around 3.8 cubic metre/MW of water as compared to 0.1 cubic metres/MW for solar, and almost nil for wind. Going forward, water usage could lead to conflict between thermal power producers and local communities, especially in water-scarce regions of the country. Thermal power producers have been cantankerous about upgrading technology to meet these standards due to high costs and complicated procedures. Stricter standards are also likely to increase the cost of power for ordinary consumers. Hence, the government may not come down hard on defaulters who fail to take adequate measures to curb particulate matter, sulphur dioxide and nitrogen oxide emissions by the December 2017 deadline. Thermal power producers should, however, be prepared for stricter enforcement of emission standards in the near future.

The growing risk profile for thermal power plants is likely to result in increasing cost of capital for thermal projects. At the same time, with the tariffs for both wind and solar power dropping to unprecedented levels, power sector investors may shift focus to renewables. In the same breath, it is important to note that the renewable energy sector is also plagued by several risks, such as delays in executing offtake agreements, delays in payments from the utilities, curtailment, etc.

However, as the cost of renewable electricity declines, the financial burden posed by it on the utilities also declines, causing the most dominant risks in the sector to shrink. The redirection of investments to renewables and allied sectors such as energy storage, energy analytics services, etc., could drive the price of electricity from renewable energy sources down further, improving their technical grid integration feasibility and shrinking associated risks for investors.

Making strategic policy and financing decisions has become imperative in the new world of growing competitiveness of renewable energy. The traditional electricity utility models are being upended and it will augur well for financiers and policymakers to heed the risks that have unfolded in the thermal sector. If the government continues to actively revamp and reimagine India's power sector, along with making simultaneous efforts to ensure a quick expansion in transmission infrastructure and a pickup in demand, India could find a sweet spot for itself in the new low-carbon world.

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http://www.livemint.com/Opinion/SZAi8vdmvddKR3N2NMANQJ/An-evolving-risk-paradigm-in-the-power-sector.html?utm_source=newsletter&utm_medium=email&utm_campaign=newsletter

Supreme Court's Compensatory Tariff Order: Game-Changer or Myopic?

Payaswini Upadhyay

Bloomberg Quint, May 02, 2017

After successfully jumping through several hoops, power companies – Tata Power Ltd. and Adani Power Ltd. – lost the last lap in the Supreme Court.

Use of regulatory powers by the CERC and merit in force majeure argument at the Appellate Tribunal for Electricity meant that the power companies could claim compensatory tariff from state electricity commissions. The Supreme Court has put an end to this euphoria by denying compensatory tariff.

While the judgment may end up making the bidding process competitive, it might have killed the regulatory jurisprudence, lawyers told Bloomberg Quint.

CERC: Use of Regulatory Powers

In 2013, the CERC had permitted Tata Power and Adani Power to revise tariffs in their power supply contracts as a result of increase in the cost of imported coal due to a change in Indonesian law. However, the PPA signed by the electricity producers with the distributors permitted increase in tariff only in case of a force majeure situation.

Though the CERC had denied that a change in Indonesian law amounted to force majeure, it held that there are certain events which are beyond the contemplation of the parties and, if the impact of such events is not taken into account, it would render the contract unworkable.

If the price escalation is on account of some event which was beyond the contemplation of the parties, then the impact of price variation needs to be duly considered and addressed in order to enable the parties to continue to perform their obligations under the contract.

CERC Order, 2013

In saying so, the CERC had upheld the arguments of the power companies that if price escalation is not addressed, it would lead to frustration of contract.

Frustration of contract, by definition, means impossibility of performance; it does not mean difficulty, Mohit Saraf, senior partner at law firm Luthra & Luthra, pointed out.

If the government of India makes a law that you cannot import coal into India – then the contract is impossible to perform. The frustration doctrine clearly provides that financial difficulty does not imply frustration.

Mohit Saraf, Senior Partner, Luthra & Luthra

APTEL: Merit in Force Majeure Argument

The CERC decision was challenged before the APTEL, which also ruled in favour of power companies but for different reasons. The APTEL upheld the force majeure argument of power companies but held that the CERC had no regulatory power to grant

compensatory tariff. It sent the case back to the CERC to determine the extent of impact of force majeure event and grant relief to power companies under their respective PPAs.

Accordingly, in 2016, the CERC granted compensatory tariff based on the force majeure provision.

SC: No Force Majeure; Yes Regulatory Powers

Aggrieved by APTEL's order, distribution companies and a consumer interest group knocked the doors of the apex court. The Supreme Court noted the language of the PPA and rejected the argument that increase in price of imported coal is a force majeure event.

This clause (12.4) makes it clear that changes in the cost of fuel, or the agreement becoming onerous to perform, are not treated as force majeure events under the PPA itself.

Supreme Court Order, 2017

Senior Advocate Gopal Jain told Bloomberg Quint that the apex court's order does very little to the cause of regulatory jurisprudence which is more dynamic compared to the static nature of the law.

Regulatory jurisprudence has to be looked at in the context of a particular sector and each sector has its own story. It is different from laying down a straight-jacket law and has to address the challenges of a particular sector. We are witnessing the problem of non-performing assets in the infrastructure sector – that is also not in public interest.

Gopal Jain, Senior Advocate

The court could have interpreted the PPA but could have also acknowledged the existing problem with long-term contracts in India and given certain directions, he added. "Sometimes courts have to take a more solution-oriented, holistic, forward-looking approach which is what regulatory jurisprudence, unlike law, is all about – constantly evolving, changing to meet the varying circumstances," Jain said.

Saraf, however, lauded the apex court's judgment and said it is important that people get a bitter lesson so that they are responsible in their corporate behaviour.

When we are expecting trillions of dollars in the infrastructure specie, the bidding rules have to be fair so that international players can participate. I was representing an international utility company which pulled out at the end from Sasan and Mundra projects bidding because they couldn't understand how you can underwrite coal prices. Similarly, there has been a lack of participation in road and airport projects except recently where they have started bidding for the solar projects because now the bidding conditions are becoming crystal clear.

Mohit Saraf, Senior Partner, Luthra & Luthra

This Supreme Court order sends a message to corporates that if they bid irresponsibly, they will incur losses, Saraf said. "Companies will stop bidding aggressively with the belief that they will be able to change the terms and conditions later on. It will lead to a transparent and fair bidding process across sectors," he added.

Besides striking down the force majeure argument, the apex court partially upheld CERC's regulatory powers to alter tariffs. It held that CERC can exercise this power only in the absence of Central Government guidelines or where the guidelines do not deal with a given situation.

*Deputy Editor in Bloomberg Quint

<https://www.bloombergquint.com/law-and-policy/2017/05/02/supreme-courts-compensatory-tariff-order-game-changer-or-myopic>

Economically Responsible Justice

Pradeep S Mehta*

Live Mint, April 27, 2017

Judges need to understand the complex linkages between various areas of governance and economic and legal activity today.

The Supreme Court collegium has recently cleared a record 51 names for high court judge posts. Of these, 20 are judicial officers and 31 are advocates. Other than this, not much information is available in the public domain about the expertise of the selected individuals. In the rush to fill judicial vacancies, there should be no compromise in the quality of judicial decisions and ensure judges are capable of dealing with increasingly complex issues interlinking law, economics, technology, intellectual property, competition and allied fields.

An inability or unwillingness to take into account economic considerations in judicial decisions is putting a significant number of jobs at risk, and a substantial amount of investment in peril. Therefore, it is time to enable delivery of economically responsible justice by addressing the issue squarely.

Knowledge about the interfaces between law, economics, technology, cybersecurity, intellectual property and allied fields — and their overlaps — is increasingly becoming relevant for the higher judiciary in order for them to adjudicate fairly. A quick review of recent decisions reveals that it is unfortunately not up for the challenge.

The higher judiciary is increasingly dealing with issues which have large-scale economic and commercial impact. These include allocation of natural resources such as spectrum, coal blocks, allowing mining of sand and sandstone, use of the Aadhaar card to access essential services, data privacy and security and waiver of farm loans.

A lack of economic analysis while passing judgement has the potential to create an adverse impact on employment, growth of infrastructure, hospitality, tourism, real estate and other economically relevant sectors, revenue of Central and state governments, and balance sheets of banks and financial institutions, without having the desired positive impact on social behaviour. For instance, the Supreme Court's recent order banning the sale of liquor near highways could adversely affect the tourism sector

and result in the loss of a great many jobs. Alcohol consumption is not a social ill but irresponsible drinking is.

Perhaps the neglect of economic considerations is baggage from the past. Historically, the Indian judiciary has dealt with socially significant issues such as health, education, reservations in education and employment, priority sector lending, bank nationalisation, bank branch licensing in remote locations, etc. While such issues have direct and indirect economic impact, the need for conducting economic analysis of judicial decisions was not felt, perhaps owing to our limited understanding of the linkages between judicial decisions and economic governance.

It would be foolish to repeat the mistakes made in the past. We are increasingly looking to the judiciary to balance apparently conflicting interests: the rights and obligations of sovereign and private parties; the right to privacy and economic inclusion; environmental considerations and economic equity; innovation/intellectual property and public interest. Such matters have significant economic impact. Ascertaining the correct balance even for granting interim injunctions could become complex at times.

Efforts in the past to undertake economic analysis of judicial decisions have remained half-baked. For instance, in *M.L. Sharma v. Principal Secretary and Ors*, the Supreme Court heard parties on the potential economic impact of cancellation of coal blocks, but was persuaded by Central Government submissions that it was fully prepared to deal with the impact of cancellation and levy of additional penalty on coal block allottees. It did not provide any rationale for accepting the Central Government's contentions; nor did it take into account the economic impact of cancellation and levy of penalty on several stakeholders.

Thus, while the economic impact of decisions may often be recognised, the depth of economic analysis and the significance given to it while decision making seem to be inadequate. A comprehensive economic analysis not only aids in sound decision making, but also promotes transparency and improves the quality of decision making.

It is thus important for the judiciary to conduct sound economic analysis before arriving at decisions and efficiently communicate the rationale of its decisions. Such analysis should not be a one-off or depend on the judgement or the judge, but must follow a well laid out process, which considers different interests, and facilitates disclosure of the rationale for the decision in simple language.

It needs to be recognised that the economic impact of judicial orders could be direct, indirect, patent or latent, and different stakeholder groups could be differently affected. Accordingly, capacity building within the judiciary to balance different competing interests will be needed. With the arrival of commercial courts and benches, this becomes more necessary than ever.

The economic impact assessment of judicial decisions will aid in upholding the credibility of the judiciary and the quality of judicial decision making, which is increasingly coming under scrutiny. Judges need to understand the complex linkages

between various areas of governance and economic and legal activity today to ensure delivery of economically responsible justice.

**Secretary General of CUTS International*

<http://www.livemint.com/Opinion/euUWgC152BPeaONeAzH7m0/Economically-responsible-justice.html>

SC is Right in Denying Power Tariff Hike to Tata Power & Adani Power

V Ranganathan

The Economic Times, April 25, 2017

The Economic Times editorial, ‘Another Legal Blow to Commercial Logic’ (April 13, 2017), arguing against the sanctity of contract and against the Supreme Court judgement in the compensatory power tariff case is curiously out of line with both justice and sustainable business principles.

The case relates to competitive bids made by Tata Power and Adani Power, where they were asked to quote a single levelised tariff for supplying a specific quantity of power to specific discoms. This was part of the scheme of ultra-mega power projects where the Power Ministry combined economies of scale (bid for 4,000 MW) with competitive bidding to extract the best bids.

The bids were of two types: one, where the source of coal supply was identified, and two, where it was left to the supplier. The case relates to the second type: in which identifying the source of coal, its price, etc. are the bidder’s responsibility. In the case of the purchase of coal, the coal price risk devolved on to the bidder.

The two firms knew this very well. They tried to manage this risk by buying off coal mines in countries like Indonesia, and had a back-to-back long-term contract for coal supply at a fixed contract price. What they failed to do was to analyse the robustness of this price, in view of its nexus to the profit of the Indonesian joint venture, and, thus, tax and foreign exchange implications to the Indonesian government.

Having got the right to supply through competitive bidding — after finding that the Indonesian government’s announcement would make their project unviable or less viable — Tata and Adani went to the CERC and stated that the CERC is the right body to determine tariff as according to the Electricity Act 2003, and that the PPA be torn up. The CERC accepted this and awarded a higher cost. This was found insufficient and it appealed. The APTEL asked CERC to redo the sums.

In December 2016, it did this and gave further enhancement. This was appealed by the discoms and NGO Prayas, and the result is the present Supreme Court judgement.

Did CERC have jurisdiction to set generator prices? Section 79(1) (b) of the Electricity Act 2003 said that the CERC should regulate generator prices that supplied to more than one state. But Section 63 (Determination of Tariff by Bidding Process) states, “The appropriate commission shall adopt the tariff if such tariff has been determined through

transparent process of bidding in accordance with the guidelines issued by the Central Government.”

The primary job of the CERC is to ensure competition. Or if competition is not possible if it is a natural monopoly, it has to regulate the price that will be similar to what would have prevailed under competition. So, the CERC had no jurisdiction to set prices, which are set through a competitive process, unless it suspects that it is a competition only in name and not in substance.

APTEL, comprising a judicial member and two technical members, does not understand the designing of markets (competition) in electricity and can't be expected to give the correct interpretation of the Act, beyond going by the letter of the Act. The apex court arrived at the correct decision, without going through the competition route, by looking at whether the sanctity of contract was violated.

The court rightly asserted that the deemed coal price increase caused by the Indonesian government is not a force majeure. This is a risk consciously borne by the supplier. Otherwise, it would have insisted to write in the PPA a clause allowing the pass-through of fuel price, as is normally done. Change in law has also not been accepted. That would apply only to change in Indian law.

As for the argument that Indonesian law makes the project unviable, ‘sanctity of contract’ is not just rhetoric. All business has an element of gamble: you win some, you lose some. And the losses, in this case, are transient.

With international coal prices falling, the project can still make up for losses. If the international price had fallen below the contract price, would the Independent Power Producers (IPPs) have given a discount to the power price? This is a time one has to be firm. And one would say about the Supreme Court regarding this case, a Daniel has come to judgement.

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<http://blogs.economictimes.indiatimes.com/et-commentary/sc-is-right-in-denying-power-tariff-hike-to-tata-power-adani-power/>

Supreme Court's Order on 'Compensatory Tariff' Powers Accountability and Strengthens Competition

Ashwini Chitnis and Shantanu Dixit*

The Wire, April 20, 2017

The judgement puts a much-welcome end to the '*bid low today, raise price later*' bidding strategy employed by power sector players.

In landmark judgement delivered on April 11, 2017, on the issue of 'compensatory tariff', the Supreme Court has put an end to arbitrary use of regulatory power, upheld the sanctity of contracts and significantly restricted the impact of power tariffs on consumers.

The judgement also holds implications for vital issues such as distribution utility finances, contract enforcement, regulatory governance, public policy, and consumer interest.

How did we get to this stage? Let's take a look.

The beginning

The Electricity Act of 2003 de-licensed generation (except large hydro and nuclear), making it possible for anyone with the necessary statutory clearances to set up generating stations. Underlining the need for competition, Section 63 of the Act allows regulatory commissions to adopt a tariff for generation that has been discovered through a transparent bidding process conducted as per the guidelines issued by the Central Government. The guidelines emphasise a fair and transparent process for bidding and give the bidders an option to pass on the fuel price variation and other related risks by quoting various scalable and non-scalable charges transparently at the time of bidding. The bidding framework seemed like a promising start and more than 40 GW of capacity has been added under this regime.

However, soon enough there were indications of potential problems.

Early warnings

In 2010, the CERC published a study which pointed out that most of the tariffs discovered through bidding were more competitive than 'cost-plus' tariffs determined for similar projects. In an analysis report published in 2011 Prayas (Energy Group) highlighted that the tariffs discovered through bidding were indeed lower than those determined on a cost-plus basis. However, the report also highlighted several governance concerns regarding bidding processes in several states including potential danger of post-bidding changes to tariffs. It noted that despite having the option of transparently passing on the fuel price variation related risks, many projects had won the contracts by willingly assuming such risks by quoting a fixed value for that part of the tariff.

Highlighting the potential fuel risks inherent in some of the fixed price bids, the report presciently questioned the feasibility and viability of these projects. Curiously, lenders and financers did not seem to be bothered by such bidding strategies although the general outlook regarding domestic coal sector was never too bright.

Too good to be true

As the projects approached commercial operation, many started complaining about viability issues on account of increased fuel costs. In 2012, some of these projects such as Tata Power's Mundra UMPP and Adani Power's Mundra project filed cases before the CERC. They sought revision of the quoted tariff on grounds of increase in the price of Indonesian coal along with other issues such as shortfall in domestic coal supply and depreciation of the Indian rupee. Similar cases were also filed before the Maharashtra Commission and a few other state commissions.

The contracts – known as PPAs – signed by these projects allowed revision of tariff only under two circumstances: change in law, whereby a legal action of a government body

or a court imposes any cost (or results in benefit) and *force majeure*, which implies an unforeseen event that prevents or unavoidably delays the performance of obligations under the contract.

The companies approached the CERC claiming that the promulgation of the Indonesian regulation which aligned the Indonesia coal price with a market-determined benchmark price, should be treated as either a force majeure event or a change in law event and that they should be compensated for the hardship imposed on this account. Further, the projects also argued that if it is not possible to grant them relief under these provisions of the contract, then the CERC should use its broader regulatory powers under the Electricity Act, 2003, and provide relief to make the projects viable. This claim was supported on the grounds that such action of the CERC is necessary to protect not just the projects but also the investments (banks and lenders), which in turn would be in sectoral and consumer interest.

Regulatory overreach

While concluding that no relief is possible under their respective contracts, the CERC through its interim order in 2013, chose to use its overarching regulatory powers to grant the projects what it termed as 'compensatory tariff'.

The commission noted its decision as follows:

"In our view, the parties should confer to find out a practicable solution and agree for compensation package to deal with the impact of subsequent event while maintaining the sanctity of the PPA and the tariff agreed therein. In other words, the compensation package agreed should be over and above the tariff agreed in the PPA and should be admissible for a limited period till the event which occasioned such compensation exist and should also be subject to periodic review by the parties to the PPA."

This decision of the CERC fundamentally altered the risk allocation enshrined in the contract and imposed the entire burden of fuel price variation on to the consumers. Following this interim order, the CERC set-up a committee to evaluate the extent of compensation needed. Through its final order in 2014, the CERC allowed compensatory tariff to both Tata Power and Adani Power, which was to the tune of Rs. 2,300 crore and Rs. 3,600 crore respectively till March 2016.

Following CERC's footsteps, regulatory commissions in several states such as Maharashtra, Uttar Pradesh and Rajasthan adopted the same approach of revising competitively discovered tariffs by granting additional compensatory tariffs. Thus, even in the absence of any possibility of relief under the contract, the commissions were using their regulatory powers to grant compensatory tariff without any public consultation. According to press reports, the overall quantum of compensatory tariff granted by various commissions would have amounted to around Rs. 11,000 crore.

Lopsided nature of the Commission's approach

In spite of repeated submissions, the CERC did not undertake any public process to grant such additional relief, though its decision would have affected electricity tariffs for consumers across five different states. While the commission took two years to decide the matter, it ruled out a public process on the grounds that "If the public process at this

stage is adopted as sought by Prayas, it would result in further delay and spell doomsday for the petitioner."

Since the commission was extending relief beyond the PPA terms and conditions, it was argued that an asset supported and sustained in this manner should ultimately belong to the consumers and hence should be returned to them at the end of the contract term at an appropriate transfer price. The commission rejected such suggestion stating that "As regards the suggestion of Prayas for return of the generation assets at the end of the useful life, we are of the view that this aspect will be governed as per the terms and conditions of the PPA and is beyond the scope of the present proceedings which is confined to compensating the petitioner for the hardship suffered by it on account of Indonesian Regulations."

Such decisions highlight the lop-sidedness of the commission's approach in balancing interests of consumers. While granting the compensatory tariff, the CERC felt it important to go beyond the contract terms and conditions, but to provide similar considerations to consumers; it chose a strict and narrow interpretation of the law and contracts.

The APTEL ruling

The compensatory tariff order of the CERC was challenged before the APTEL, which through its April 2016 judgement, rejected the use of regulatory power to grant relief to the projects. It also ruled that changes in the domestic coal distribution policy and promulgation of the Indonesian regulation couldn't be treated as change in law events under the PPA.

It however ruled that the change in the price of imported coal on account of the Indonesian regulation should be considered as a force majeure event and hence granted relief under the force majeure provisions of the PPA. After deciding that the projects can be granted relief under force majeure, the APTEL however remanded the matters back to CERC without defining the exact quantum and extent of relief. The APTEL also directed the CERC to decide the matters within three months of its April 2016 judgment. This meant that the entire responsibility of defining the scope and applicability of force majeure, as well as deciding the computation methodology fell on the CERC.

Meanwhile, appeals were filed against the APTEL judgement before the Supreme Court by all parties – distribution companies, consumer representatives and also the generators. The Supreme Court did not stay the matters before the CERC, but it directed that "The order passed by the CERC shall be produced before this court on the next date of hearing. It is made clear that the order passed by the CERC shall not be given effect to, without getting permission from this court."

The CERC, in December 2016 granted relief to the projects under force majeure provisions, which was substantially lower compensatory tariff than what it had allowed in 2014.

The verdict and its implications

Given the series of developments mentioned above, the Supreme Court judgment is crucial in providing clarity on the following key issues:

- *Composite scheme:* The Adani Mundra project has different contracts with different state distribution companies. The tariff for the respective contracts had been approved by the concerned state commissions and hence the CERC's jurisdiction in granting relief to Adani Mundra project by considering it to be a composite scheme was contested right from the beginning. In absence of a clear definition of composite scheme under the Electricity Act, 2003, the Supreme Court has cleared this ambiguity by ruling that "composite scheme does not mean anything more than a scheme for generation and sale of electricity in more than one State." This is a significant development and will have far reaching implications on what has been hitherto interpreted in terms of the number of projects and schemes that fall under the CERC's jurisdiction.
- *Use of regulatory powers:* The Supreme Court has rejected the use of regulatory powers to alter tariffs or any provisions of the contract, so long as the bidding guidelines and the contract specifically deal with such issues. The judgement notes that "It is clear that in a situation where the guidelines issued by the Central Government under Section 63 cover the situation, the Central Commission is bound by those guidelines and must exercise its regulatory functions, albeit under Section 79(1)(b), only in accordance with those guidelines. As has been stated above, it is only in a situation where there are no guidelines framed at all or where the guidelines do not deal with a given situation that the Commission's general regulatory powers under Section 79(1)(b) can then be used." Since the PPA and bidding guidelines clearly define the circumstances and the manner in which the quoted tariff can be changed, the commission cannot use its regulatory powers to overrule such provisions.

This is very crucial as it upholds the sanctity of contracts while not taking away the regulatory power if it is needed in a situation where the contract or other legal and policy provisions are silent or inadequate. This clarity is very significant in improving the quality of regulatory decision-making, as it clearly defines the boundaries for the use of regulatory power. Given the broad and wide nature of regulatory power, the implications of this will be much beyond power purchase contracts and compensatory tariff matters.

- *Impact of Indonesian Regulations:* The Supreme Court has rejected the idea that the promulgation of the Indonesian regulation and the resultant price rise should be treated as a force majeure or a change in law event. With regard to its finding on applicability of force majeure, the court has said that: "This clause [Force Majeure Exclusions] makes it clear that changes in the cost of fuel, or the agreement becoming onerous to perform, are not treated as force majeure events under the PPA itself." The judgement further notes that "It is clear that an unexpected rise in the price of coal will not absolve the generating companies from performing their part of the contract for the very good reason that when they submitted their bids, this was a risk they knowingly took."

Further, the judgement notes that the term 'law' cannot be construed to mean any law including both Indian and foreign laws, as "The meaning will have to remain the same whether coal is sourced wholly in India, partly in India and partly from outside, or wholly from outside. This being the case, the meaning of the expression 'any law' in clause 13 cannot possibly be interpreted in the manner suggested by the respondents." Hence no tariff increase can be allowed on account of the change in Indonesian regulations. Therefore, no relief is applicable to projects/PPAs based on imported coal (such as Tata Mundra UMPP or Adani Mundra PPA with GUVNL based on imported coal).

- *Impact of change in domestic coal policy:* In October 2007, the government had notified what is called the New Coal Distribution Policy (NCDP), which spelt out the broad framework for future coal allocation. Subsequently, the government amended the NCDP in July 2013 to bring in consistency in the fuel supply agreements that were to be signed under the NCDP. While the 2007 NCDP was ambiguous regarding the extent of coal to be imported in case of any shortfall in domestic coal production, the 2013 amendment clearly laid out the percentage of domestic coal that would be supplied under the fuel supply agreements and hence the extent to which sourcing coal from other sources such as import or spot auctions may be needed. The amendment states as follows: "Taking into account the overall domestic availability and the likely actual requirements of these TPPs, it has been decided that FSAs will be signed for the domestic coal quantity of 65 percent, 65 percent, 67 percent and 75 percent of ACQ for the remaining four years of the 12th Plan for the power plants having normal coal linkages."

The judgement holds that this amendment to the NCDP should be considered as a change in law event. It is to this limited extent that relief has been granted for period after July 2013 for projects that are impacted by such shortfall in the domestic coal supply. However, the exact quantum of the relief will have to be computed by the commission on a case to case basis after taking into account the given project's fuel supply agreements, actual coal supply and cost of alternate coal arrangement.

Table 1 captures the decisions given by the various forums on the key issues concerning these matters.

Figure 2: Variation in Indonesian coal price from January 2012-August 2016

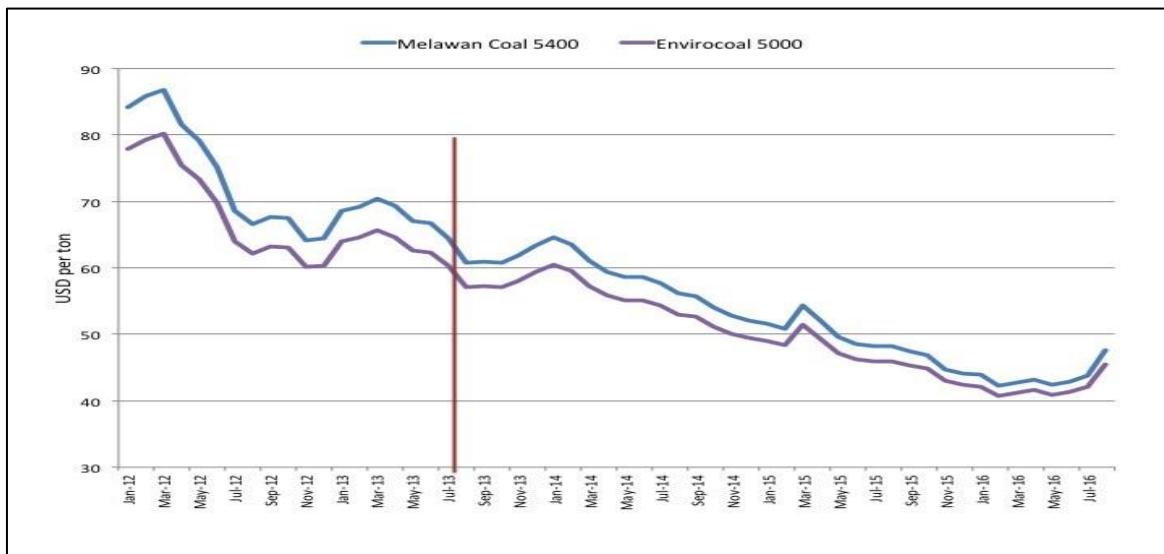


Table 1: The twists and turns in rulings on compensatory tariff

Issue	Forum		
	CERC 2013	APTEL 2016	Supreme Court 2017
Does a project with different PPAs with different state distribution companies for same project fall under the category of composite scheme?	Yes	Yes	Yes
Does the promulgation of the Indonesian regulation and the consequent changes in the fuel price constitute a “change in law” event?	No	No	No
Does the promulgation of the Indonesian regulation and the consequent changes in the fuel price constitute a “force majeure” event?	No	Yes	No
Does the amendment of the New Coal Distribution Policy constitute a “change in law” event?	–	No	Yes
Can a commission use its regulatory power to modify tariff discovered through bidding beyond the provisions of the guidelines and the PPA?	Yes	No	No

In order to appreciate the potential impact of the relief granted by the Supreme Court one needs to consider various factors such as actual shortfall in domestic coal supply, extent of imports and the price of imports.

As far as domestic coal is concerned, the last year has witnessed an impressive increase in production from CIL and SCCL of about 43 MT and in fact CIL has been advised to reduce production to avoid excessive stockpiling. The benchmark price for Indonesian coal peaked around March 2012, but as Figure 1 shows it has been falling since then. So it seems that the worst of the Indonesian coal price increase was already passed by July 2013. Given the fall in power sector's demand for coal and increase in CIL's production,

one can also assume that the worst of domestic coal shortage is past. Thus, the impact is likely to be only for the period of one or two years from August 2013. Considering all these factors, our preliminary macro analysis shows that the total relief as awarded by the Supreme Court would only be around 20-25 percent of the relief granted by various regulatory commissions.

Some sections in the media have criticised the judgement saying that 'mere' legal interpretation is a narrow way of looking at things and the Court should have been more concerned about project (un)viability. Some have questioned the role and need of quasi-judicial bodies like the regulatory commissions, if such decisions are going to be based on strict legal interpretations.

There are two issues with such arguments. One, they belie the fact that the judgement is not only legally sound, but also forward looking for a sector plagued with NPAs, as it discourages aggressive bidding by holding bidders and their lenders accountable for the risks that were willingly assumed to win the contracts. In fact from a competition point of view, it is a landmark judgement as it not only upholds sanctity of contracts, but also enforces the rule of law and creates a level-playing field. Two, it brings out the dichotomy of the utilities in calling for the use of regulatory powers to balance individual party's interest against the broader sector interest only when it suits them. Mumbai's parallel distribution license is a good case in point. In 2003 the Maharashtra Commission had taken a 'balanced' view by ruling that though Tata Power Company has a parallel license to distribute electricity in Mumbai, it should be allowed to function as a parallel licensee only after few other preconditions are fulfilled. At that time, Tata Power Company challenged the said interpretation of the commission in all forums up to the Supreme Court, till it got a strictly legal interpretation on the issue that allowed Tata Power to undertake retail supply in Mumbai.

In general, the commissions should indeed take decisions that are in the larger sector's interest, which may be broader than specific companies' interests or issues of viability but beyond the strict and narrow interpretation of law. However, such decisions need to be guided by certain principles that would define the circumstances under which such actions are called for and the extent to which the commissions can deviate. In this regard, the Supreme Court's judgement is a big step forward. Coming from the apex court, such clarity has the force of law and hence it will not be limited to power purchase contracts and tariff issues, but will apply to broader sector issues while also setting a good precedence for other sectors to follow.

Secondly, the judgement has undoubtedly strengthened competition by enforcing the rule of law and holding bidders and lenders accountable for the risks that had been willingly assumed to win the contracts. Such clear and accountable mechanisms will not only discourage aggressive bidding based on risky fuel arrangements, but will also lead to more realistic tariff discovery for future projects, which would also provide more realistic price signals for the sector at large. To conclude, the judgement indeed puts an end to the 'bid low today, raise price later' strategy of bidding.

**Authors are associated with Prayas Energy Group*

<https://thewire.in/126016/supreme-courts-order-compensatory-tariffs-accountability/>

Yet Another Commandment

Gajendra Haldea*

Business Standard, April 18, 2017

Though fair, the SC verdict denying compensatory tariffs for two mega power projects will add to the instability in the power, banking sectors

Thou shalt respect the sanctity of contracts' seems the commandment emerging from the recent Supreme Court judgment that denies compensatory tariffs for meeting the increased costs of coal imported by Tata and Adani power projects. This casts an ominous shadow on the future of these two mega projects of about 4,000 Mw each — among the largest in the world. It will also have a significant bearing on the way we treat infrastructure projects in India.

I happen to be one of those not surprised by the judgment. After all, the tariffs were determined through open competitive bidding where all risks and rewards were specified upfront. If the two companies knowingly agreed to bear the risk of fuel price as part of their respective bids, the buyers of their power can legitimately refuse to pay any additional costs of imported coal.

Consider a situation where the coal prices decline. Would these companies share the profits with their buyers? No way. By its very nature, a commercial risk is not shared with any other party, unless the contract says so. If this rule is not respected, an orderly conduct of trade and commerce would be impossible.

The format of PPAs for these projects was mandated by the Power Ministry under Section 63 of the Electricity Act, which requires the regulator to adopt the tariff determined by competitive bidding based on this format. As such, the regulator had no jurisdiction to set or amend the tariff in these cases. Hence its award of compensatory tariffs was fundamentally flawed, being contrary to law. Little wonder it was set aside.

India has an elaborate regulatory structure for the power sector comprising a regulatory commission in each state and one at the Centre. There is a dedicated Appellate Tribunal too. The principal role of these regulators is to oversee the implementation of the Electricity Act, which primarily unbundles the various segments of the electricity industry with a view to enabling competition and choice in the supply of electricity to consumers. That is the way power sector functions in the developed world. For example, if you are living in a flat in London, you can choose from among a dozen competing suppliers of electricity who would use a common network for transmitting the power — very much the way it works in telecom.

India's power regulators have steadfastly prevented any competition in the supply of power to consumers. As a result, virtually all bulk power must be sold to the government-owned entities, who in turn supply to consumers through a chain of inter-connected monopolies. In international literature, this arrangement is referred to as a 'single-buyer model' which some experts describe as an evil practice.

The lack of competition essentially benefits the entrenched interests, never mind the enormous losses that distribution companies make year after year. These losses have accumulated in the form of debt exceeding a whopping Rs. 4,00,000 crore and are now being passed on to taxpayers through UDAY, much the same way it was done in 2002. The main beneficiaries would be the public sector banks who kept lending to bankrupt discoms. This can hardly be viewed as reform.

Successive governments — be it United Progressive Alliance (UPA)-I, UPA-II and now National Democratic Alliance (NDA) — have failed to bring about the much-needed structural reform in the power sector, as contemplated by the Electricity Act. On the contrary, they have willingly allowed the soul of Electricity Act to remain caged. The regulatory commissions have also abandoned the interests of consumers for whose benefit they were created. The consequences are predictable.

So far as PPAs are concerned, they are very complex contracts that require a high degree of skills and an honest intent to serve public interest. These elements are often deficient in the governance of our power sector where the dominant sentiment is to somehow fix a deal and move on. In the process, unsustainable and unjustified benefits are cornered by influential companies. Public sector buyers also demand some unreasonable clauses, one such example being the allocation of fuel price risk to private sector companies.

Any student of commercial contracts will testify that it is patently unsustainable to pass on the inflation risk or commodity price risk to an individual company on a long-term basis because such prices are determined by market forces over which an individual company has no control. In essence, no person should agree to bear a risk over which he has no control, unless he is in the business of speculation. Such provisions reflect poorly on all the contracting parties.

The standard bidding documents issued by the Power Ministry of UPA-I actually allocated the fuel price risk to private companies. Several other flawed provisions were also included in an environment of crony capitalism that has ultimately destabilised the power and banking sectors as we are currently witnessing. Objections raised by the author were often ring-fenced by the powers that were.

When these projects came under increasing stress, the Power Ministry approached me in the erstwhile Planning Commission to write the model PPAs afresh, which I did. These new model documents were notified by the Power Ministry in 2013 and have not faced any problems so far. In fact, several states (including Bihar and Kerala) have used them to their advantage in a fair, transparent and sustainable manner.

The tragedy of governance in India is that we often brush aside knowledge, past experience and lessons learnt. A lack of accountability enables successive decision-makers to engage in experimentation, which I call governance by trial and error. It imposes huge costs on the economy and the citizens. Professionalism and evidence-based policy making is often missing.

The power sector in India continues to be in a deep mess. Some window dressing has indeed given the impression of progress, but the initiatives taken so far will only lead to marginal improvements. One can only hope that the Supreme Court judgment would ignite an in-depth introspection for reform of this mother of all industries, which impacts the growth and welfare of all.

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www.pressreader.com/india/business-standard/20170419/281964607594402

No Such Thing as a Perfect Renewable Energy Contract

Rahul Tongia*

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The ultimate need for a renewable energy project is low-interest-rate funding seeking modest yields over time.

India's 175 GW renewable energy (RE) targets by 2022 are ambitious, to say the least. Compared to RE targets in Europe, China, or California that require 4-5 percent growth in RE capacity annually, Indian targets require 25 percent growth. This translates to enormous capital investment (well over US\$100bn), including from global investors.

RE investors used to complain that dealing with India was like dealing with 30 countries; each state had its own norms. The model bidding document across states took care of that complaint. This is now being supplemented by model PPAs, drafts of which have been circulated to stakeholders. While this is a positive step, it ignores a fundamental challenge: A 'perfect' contract is only on paper. What happens when things do not go as planned?

RE is overwhelmingly in the hands of the private sector. Even the Solar Energy Corporation of India Ltd (SECI), NTPC Ltd, and other quasi-governmental RE programmes involve private developers. While all power producers face counter-party (off-taker) risk, i.e., risks from struggling state utilities (discoms), this challenge is particularly acute for RE, which is volatile and expensive for discoms in the short term, at least on a cash basis.

What happens when utilities do not buy the power as they promised, despite a PPA? Or, worse, take the power but do not pay? If states do not offtake power, can developers easily sell this power to third parties? Due to scheduling and grid reasons, this is neither automatic nor easy. Worse, the prices available may be lower than contracted in the PPA, especially considering the low power exchange (spot) prices in the last few years.

Yet, one does not often hear of developers declaring defaulters, because doing so effectively severs the relationship, leaving few alternatives for the power projects. It also has a negative impact on investor sentiment. Instead, projects muddle along, else risk becoming political or murky, potentially attracting palm-greasing.

What violates a contract?

RE contracts, like most contracts, have fine print. Even the upcoming model contracts have conditions under which a utility may refuse to offtake power, ostensibly under grid security norms. Even if required, all such backing down must be transparent, and ideally declared by an independent system operator (ISO). The affected party should not be the one unilaterally determining when a force majeure (unexpected events that prevent the fulfilment of a contract) equivalent clause applies. Otherwise, we risk a charade similar to how airlines get to absolve themselves of any delays under the guise of 'weather'.

The risks of not buying will only increase as RE grows from today's approximately 6 percent of power consumed to over 10 percent in just a few years. Even if the price premium comes down, the operational impacts are non-trivial — RE often helps with energy requirements but not power capacity requirements, since India's peak power demand is mostly in the evening. Just like Open Access (retail choice) was mandated under the Electricity Act, 2003 but overtly and covertly resisted by utilities (also often under grid security claims), who feared losing their paying customers and disliked the operational and planning headaches, such a 'go slow' mentality towards RE by states represents one of the largest risks for scaling up RE.

Transparency is the first requirement

When one does not trust the buyer (or seller), a common mechanism has been the use of escrow accounts. For RE projects, pooled mechanisms such as the Payment Security Mechanism envisaged by SECI — the special purpose vehicle for buying and bundling RE across projects — have limits on the power capacity they can cover. Any amount could, in theory, be covered, but at a cost, which today is being borne by the Central Government. Even with an escrow, if drawn down, how is this to be replenished or prevented from becoming a moral hazard?

Instead of focusing on risk management, why not improve risk avoidance? The Clean Energy Finance Forum has suggested improved transparency for utilities as a key need, especially related to RE purchases. In fact, we do not even have consistent, granular and timely data on RE production. For starters, stakeholders, especially developers, need to know quanta of backing down, along with a reason (if declared). Importantly, we need to have transparent data on payments made to RE (and all) power projects. Delays cannot be swept under the rug, masking under-performing assets that will also never be declared non-performing.

The ultimate need for RE and other infrastructure is 'patient capital', which is low-interest-rate funding seeking modest yields over time, like a home rental, instead of capital willing to take on higher risks but expecting higher returns, like an equity developer interested in asset appreciation or resale. Patient capital is held by sovereign, pension and insurance funds, which seek governance, predictability, and then returns.

The sooner we recognise that improved contracts are necessary but not sufficient, the sooner we can tackle risks not addressed by the contracts, either because they are outside the scope of the contract, or because the contracts only cover the risks in theory but not in practice.

**Fellow, Brookings India*

www.livemint.com/Opinion/JkEdX92CpjzrfO0lnTAO4M/No-such-thing-as-a-perfect-RE-contract.html

Supreme Court Judgement Analysis on Compensatory Tariff granted by CERC to Tata Power and Adani Power

Amit Kapur*

A brief outline of the Supreme Court's judgement with passages extracted placed in the analysis:¹⁷

1. The judgement delivered by Hon'ble Supreme Court in the coal price impact on bid out PPAs batch of appeals [*Energy Watchdog vs. CERC & Others : 2017(4) SCALE 580*] must be understood in terms of the factual foundation of the case and how the law is applied to the set of facts in deciding the questions considered. To facilitate the same, I have extracted below language used by Supreme Court under 7 heads - each of which is bound to inform future public procurement processes and risk-pricing of bids, particularly in context of the governing legal, regulatory and bid framework.

2. ***To begin with, the judgement is organised in the following sections/parts:***

- (a) Basic facts and submissions of the contesting parties ... paras 1 to 14
- (b) Stand of the Attorney General of India qua Govt's policy ... para 15
- (c) Interpretation of the Electricity Act
 - i. Sections 61, 62, 63 and 79 : role of regulators in bids ... paras 16 to 19
 - ii. Sections 79 vs. 86 and 64(5) : CERC vs SERC jurisdiction ... paras 20 to 27
- (d) ***Findings in the facts of the case***
 - i. Scope of Force Majeure under bidding guidelines and PPA and whether the Generators have a case for relief under this ... paras 28 to 45
 - ii. Scope of Change in Law under bidding guidelines and PPA and whether the Generators have a case for relief under this ... paras 46 to 53
- (e) Consequential directions ... paras 54 to 55

3. ***The factual premise of the judgement is recorded as follows:-***

- a) "The facts necessary to appreciate the issues which arise in the present case, which will cover all the cases before us¹⁸ will be taken only from Civil Appeal

¹⁷ http://cuts-ccier.org/pdf/2017/Judgement-Analysis_Amit_Kapur.pdf

¹⁸ The judgement is premised on generators having chosen the source of fuel (domestic vs foreign, and hence has assumed the related risk). Evidently the foundational facts of CGPL's case were not considered as reflected in facts recorded in Para 2 to 9 of the Judgment. Supreme Court did not notice the findings of the facts by Ld. CERC's Order dated 15.04.2013 (Para 36 to 48 and 79-80) and Ld. Tribunal's Judgment dated 07.04.2016 (para 300 and 301) that port based Mundra UMPP was conceived, bid-out, awarded and implemented based on imported coal as required by the Procurers + once CGPL complied with the conditions subsequent re fuel supply Indonesian coal became the substratum of the PPA + promulgation of Indonesian Regulations impacted CGPL/ Tata Power's FSA from Indonesia + grant of relief to CGPL is in the interest of consumers et al.

No.5348 of 2016, namely Prayas (Energy) Group vs. Central Electricity Regulatory Commission¹⁹." [Para 1]

- b) ".... In any event, the fundamental basis of the PPAs between the parties was not premised on the price of coal imported from Indonesia²⁰." [Para 10]

In this context, I am extracting below the exact language used by the Court on each of the 4 issues answered by it were also the consequential directions issued.

4. ***Re. Regulatory Power in context of competitively bid PPAs.***

"It is important to note that the regulatory powers of the Central Commission, so far as tariff is concerned, are specifically mentioned in Section 79(1). This regulatory power is a general one, and it is very difficult to state that when the Commission adopts tariff under Section 63, it functions de-hors its general regulatory power under Section 79(1)(b). For one thing, such ***regulation takes place under the Central Government's guidelines***. For another, ***in a situation where there are no guidelines or in a situation which is not covered by the guidelines, can it be said that the Commission's power to 'regulate' tariff is completely done away with?*** According to us, this is not a correct way of reading the aforesaid statutory provisions determination of tariff can take place in one of two ways - either under Section 62, where the Commission itself determines the tariff in accordance with the provisions of the Act, (after laying down the terms and conditions for determination of tariff mentioned in Section 61) or under Section 63 where the Commission adopts tariff that is already determined by a transparent process of bidding. ***In either case, the general regulatory power of the Commission under Section 79(1)(b) is the source of the power to regulate, which includes the power to determine or adopt tariff. In fact, Sections 62 and 63 deal with 'determination' of tariff, which is part of 'regulating' tariff.*** Whereas 'determining' tariff for inter-State transmission of electricity is dealt with by Section 79(1)(d), Section 79(1)(b) is a wider source of power to 'regulate' tariff. ***It is clear that in a situation where the guidelines issued by the Central Government under Section 63 cover the situation, the Central Commission is bound by those guidelines and must exercise its regulatory functions, albeit under Section 79(1)(b), only in accordance with those guidelines. As has been stated above, it is only in a situation where there are no guidelines framed at all or where the guidelines do not deal with a given situation that the Commission's general regulatory powers under Section 79(1)(b) can then be used.***" [Para 19]

5. ***Re. Jurisdiction : CERC vs. SERC***

The scheme that emerges from these sections is that whenever there is inter-State generation or supply of electricity, it is the Central Government that is involved, and whenever there is intra-State generation or supply of electricity, the State Government or the State Commission is involved. This is the precise scheme of the entire Act, including Sections 79 and 86. It will be seen that Section 79(1) itself in

¹⁹ C.A. No. 5348 of 2016 was filed by Prayas primarily challenging Ld. Tribunal's findings in Adani Power's case re: (a) Force Majeure and; (b) Liberty granted to Adani Power to argue Force Majeure and Change in Law.

²⁰ This statement was made while focussing on the facts of Adani Power's case.

sub-sections (c), (d) and (e) speaks of inter-State transmission and inter-State operations. This is to be contrasted with Section 86 which deals with functions of the State Commission which uses the expression 'within the State' in sub-clauses (a), (b), and (d), and 'intra-state' in sub-clause (c). This being the case, it is clear that the PPA, which deals with generation and supply of electricity, will either have to be governed by the State Commission or the Central Commission. The State Commission's jurisdiction is only where generation and supply takes place within the State. On the other hand, the moment generation and sale takes place in more than one State, the Central Commission becomes the appropriate Commission under the Act.....

.... the expression 'composite scheme' does not have some special meaning - it is enough that generating companies have, in any manner, a scheme for generation and sale of electricity which must be in more than one State.

We must also hasten to add that the appellant's argument that there must be commonality and uniformity in tariff for a 'composite scheme' does not follow from the Section." [Paras 23, 26, 27]

6. *Re. Force Majeure and the claim for relief*

"... The doctrine of frustration cannot apply to these cases as the fundamental basis of the PPAs remains unaltered. Nowhere do the PPAs state that coal is to be procured only from Indonesia at a particular price. In fact, it is clear on a reading of the PPA as a whole that the price payable for the supply of coal is entirely for the person who sets up the power plant to bear. The fact that the fuel supply agreement has to be appended to the PPA is only to indicate that the raw material for the working of the plant is there and is in order. It is clear that an unexpected rise in the price of coal will not absolve the generating companies from performing their part of the contract for the very good reason that when they submitted their bids, this was a risk they knowingly took.....

As a matter of fact, clause 12.4 which deals with force majeure exclusions ... makes it clear that changes in the cost of fuel, or the agreement becoming onerous to perform, are not treated as force majeure events under the PPA itself.

... Neither was the fundamental basis of the contract dislodged nor was any frustrating event, except for a rise in the price of coal, excluded by clause 12.4, pointed out. Alternative modes of performance were available, albeit at a higher price. This does not lead to the contract, as a whole, being frustrated. [Paras 40, 44 and 45]

7. *Re. Change in Law and the claim for relief*

"Both the guidelines and the model PPA, of which clause 13 is a part, have been drafted by the Central Government itself. ***It is, therefore, clear that the PPA only fleshes out what is mentioned in clause 4.7 of the guidelines, and goes on to explain what the expression 'any change in law' means.*** This being the case, it is clear that the definition of 'law' speaks of all laws including electricity laws in force in India. Electricity laws, as has been seen from the definition, means the Electricity

Act, rules and regulations made thereunder from time to time, and any other law pertaining to electricity. This being so, it is clear that the expression 'in force in India' in the definition of 'law' goes with 'all laws'. This is for the reason that otherwise the said expression would become tautologous, as electricity laws that are in force in India are already referred to in the definition of 'electricity laws' as contained in the PPA. ***Once this is clear, at least textually it is clear that 'all laws' would have to be read with 'in force in India' and would, therefore, refer only to Indian laws ...***

...it is clear that if otherwise the expression 'any law' in clause 13 when read with the definition of 'law' and 'Electricity Laws' leads unequivocally to the conclusion that it refers only to the law of India, it would be unsafe to rely upon the other clauses of the agreement where Indian law is specifically mentioned to negate this conclusion.

..., in so far as the applicability of clause 13 to a change in Indian law is concerned, the respondents are on firm ground.... Both the letter dated July 31, 2013 and the revised tariff policies are statutory documents being issued under Section 3 of the Act and have the force of law. This being so, it is clear that so far as the procurement of Indian coal is concerned, to the extent that the supply from Coal India and other Indian sources is cut down, the PPA read with these documents provides in clause 13.2 that while determining the consequences of change in law, parties shall have due regard to the principle that the purpose of compensating the party affected by such change in law is to restore, through monthly tariff payments, the affected party to the economic position as if such change in law has not occurred. Further, for the operation period of the PPA, compensation for any increase/decrease in cost to the seller shall be determined and be effective from such date as decided by the Central Electricity Regulation Commission. This being the case, we are of the view that though change in Indonesian law would not qualify as a change in law under the guidelines read with the PPA, change in Indian law certainly would." [Paras 48, 51 & 53]

8. *Re. Consequential Directions:*

..... The Central Electricity Regulatory Commission will, as a result of this judgment, go into the matter afresh and determine what relief should be granted to those power generators who fall within clause 13 of the PPA as has been held by us in this judgment" [Paras 48, 51, 53, 54]

*Senior Partner, J Sagar Associates

Annexure 1: List of Participants in the Roundtable Discussion

Attendee List		
S. No	Name	Organisation
1	Abhay Kumar	Tata Power
2	Amit Kapur	J Sagar Associates
3	Amol Kulkarni	CUTS International
4	Anand P Gupta	Economic Management Institute (EMI)
5	Anjali Viswamohanan	Council on Energy, Environment, and Water (CEEW)
6	Anusha Shrivastava	CUTS Institute for Regulation & Competition (CIRC)
7	Arpit Tiwari	CUTS International
8	Arun Maira	CUTS International
9	Arvind Mayaram	CUTS Institute for Regulation & Competition (CIRC)
10	Chandan Saha	-
11	Daljit Singh	Centre for Energy, Environment & Resources
12	Geeta Gouri	-
13	HL Bajaj	Appellate Tribunal for Electricity (APTEL)
14	Jignesh Langalia	Adani Power
15	Kanika Balani	CUTS International
16	Kirit Parikh	Integrated Research and Action for Development
17	Krishnadev CS	Federation of Indian Chambers of Commerce & Industry (FICCI)
18	Malav Deliwala	Adani Power
19	Manu Aggarwal	Council on Energy, Environment, and Water (CEEW)
20	N Chandra Mohan	Journalist
21	Nitaja Singh	Jamia Millia Islamia University
22	Nitin Desai	CUTS Institute for Regulation & Competition (CIRC)
23	Parminder Jassal	Tata Power
24	Pradeep S Mehta	CUTS International
25	Pramod Deo	-
26	Radha Krishna Tripathy	CUTS Institute for Regulation & Competition (CIRC)
27	Rajiv Malhotra	PTC India Ltd
28	Rakesh Kacker	India Habitat Centre
29	Ramji Srinivasan	Supreme Court of India

30	Ravi Shekhar	Enincon Consulting LLP
31	Saket Sharma	CUTS Institute for Regulation & Competition (CIRC)
32	Shakti Sinha	Nehru Memorial Museum and Library
33	Shaktiki Sharma	CUTS Institute for Regulation & Competition (CIRC)
34	Shantanu Dixit	Prayas Energy Group
35	Subharth Saha	CESC Ltd
36	V S Ailawadi	TATA Teleservices Limited

