IMPACT OF COMPENSATORY TARIFF POLICY UNDER ELECTRICITY ACT, 2003

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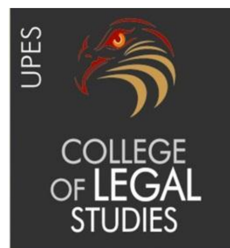
This dissertation is submitted in partial fulfillment of the degree of B.A.LL.B. (Hons.)



College of Legal Studies
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CERTIFICATE

This is to certify that the research work entitled **"Impact of Compensatory Tariff Policy under Electricity Act, 2003"** is the work done by Nitya Rao, under my guidance and supervision for the partial fulfillment of the requirement of B.A.LL.B. (Hons) degree at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

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DECLARATION

I declare that the dissertation entitled **"Impact of Compensatory Tariff Policy in the Electricity Act, 2003"** is the outcome of my own work conducted under the supervision of Mr. Rajkumar, at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

I declare that the dissertation comprises only of my original work and due acknowledgement has been made in the text to all other material used.

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07th April, 2014

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List of Abbreviations

¶	Paragraph
§	Section
APL	Adani Power Limited
ACQ	Actual Contracted Quantity
API4	Benchmark Reference for Coal exported out of South Africa's Richard Bay Terminal
BU	Billion Units
CCEA	Cabinet Committee on Economic Affairs
CEA	Central Electricity Authority
CERC	Central Electricity Regulatory Commission
CGPL	Coastal Gujarat Power Limited
CIL	Coal India Limited
CSA	Coal Supply Agreement
DGMCA	Diretor General of Minierals and Coal of Indonesia
EA	Electricity Act
EIA	Environmental Impact Assesment
FOB	Free on Board
FSA	Fuel Supply Agreement
FY	Financial Year
GCT	Gross Compensatory Tariff
GCV	Gross Compensatory Value
GUVNL	Gujarat UrjaVikas Nigam Limited
HBA	Harga Batubara Acuan
HPGCL	Haryana Power Generation Company Limited
Kcal	Kilo Calories
KWh	Kilo Watt Hour
LC	Letter of Credit

LOI	Letter of Intent
MEMR	Ministry of Energy and Mineral Resources, Indonesia
MERC	Maharashtra Electricity Regulatory Commission
MT	Metric Tonne
MTPA	Metric Tonnes per annum
MW	Mega Watt
NCDP	New Coal Distribution Policy
O&M	Operation and Maintenance
PLF	Plant Load Factor
PPA	Power Purchasing Agreement
PSPCL	Punjab State Power Corporation Limited
QEFEC	Quoted Escalable Fuel Energy Charges
QNEFEC	Quoted Non-Escalable Fuel Energy Charges
RBI	Reserve Bank of India
RFP	Request for Proposal
SBD	Standard Bidding Document
SCOD	Scheduled Commercial Operation Date
SEB	State Electricity Board
SERC	State Electricity Regulatory Commission
SPV	Special Purpose Vehicle
T&D	Transmission and Distribution Losses
TPCL	Tata Power Company Limited
TPP	Thermal Power Plant
UHBVNL	Uttar Haryana BijliVidyut Nigam Limited
UMPP	Ultra Mega Power Plant
UPPCL	Uttar Pradesh Power Corporation Limited
UDS	United States Dollar

Table of Cases

1. *Adani Power Limited vs. Uttar Haryana Bijli Vidyut Nigam Ltd. & Ors*., Petition No.155/MP/2012
2. *Adani Power Maharashtra Limited vs. Maharashtra State Electricity Distribution Company Limited* Case No.131 of 2014
3. *Coastal Gujarat Power Limited vs. Gujarat Urja Vikas Nigam Limited, Vadodara &Ors., Petition* No. 159/MP/2012
4. *Uttar Haryana Bijli Vitaran Limited & Dakshin Haryana Bijli Nigam Limited vs. Central Electricity Regulatory Commission &Ors*., I.A. No. 343 of 2014 In Appeal No.98 of 2014
5. *LancoAmarkantak Power Limted vs. Haryana Electricity Regulatory Commission &Ors.*, Appeal No.65 of 2013
6. S*asan Power Limited vs. MP Power Management Company Ltd. &Ors.,* Petition No.14/MP/2013
7. *M/S Adani Power Rajasthan Ltd. vs. M/s Jaipur Vidyut Vitran Nigam Ltd &Ors*, Petition No.RERC-392/13
8. *JSW Energy Limited vs. Maharashtra Electricity Distribution Company Limited (MSEDCL),* Case No.145 of 2014

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IMPACT OF COMPENSATORY TARIFF POLICY ON ELECTRICITY ACT, 2003

1. Introduction

'Energy security' is defined in terms of reasonable assurance effectively rendered to have access to energy and relevant technologies in all times when it is required with an accuracy to cope with sudden shocks. Energy security does not mean complete energy independence, it only means an ability to meet reasonable requirements with reasonable assurance of stable supply or an ability to pay for import needs.[1]

It is necessary to ensure supply of clean energy to nurture inclusive growth, meeting the millennium development goals and raising India's human development index (HDI), which are comparable with other poor countries, categorized under 'developing countries' that are currently placed below India's level of development. The broad vision of India's integrated energy policy is to reliably meet, both the demand and supply for energy services of all sectors including the lifeline energy needs of far reaching households in all parts of the country with safe, clean and convenient energy at the least-cost- which has to be commissioned by effective use of technically proficient and environmentally viable solutions.

Presently, India is one of the three fastest developing economies of the World; as a characteristic culmination, it is irreplaceable that the vitality grows with speedier increment of capacity in power generation, which heavily and abundantly relies on 'Coal', as a primary source of energy. As per the latest National Inventory on Indian Coal Resources published by Geological Survey of India, the total coal resources assessed in the country stand at 301.56 Billion Tonnes as on 1st April, 2014.[2]

Coal is India's primary source of energy (equaling to almost 44% of total energy consumption), and the country presently is ranked as the third-largest global coal producer, consumer, and importer of coal in 2012.[3]Though production in terms of quantity of coal produced per unit has

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[1] Power & Energy (Planning Commission), http://planningcommission.nic.in/sectors/index.php?sectors=energy

[2] Press Information Bureau – Ministry of Coal and Coal Reserves, http://pib.nic.in/newsite/PrintRelease.aspx?relid=116572

[3] Energy Information Administration, *Today in Energy: India is Increasingly Dependent on Imported Fossil Fuels as the Demand Continues to Rise,* http://www.eia.gov/todayinenergy/detail.cfm?id=17551

increased by about 4% per year since 2007, the power producers or the companies engaged in generation and transmission have consistently failed to achieve government's production targets. Meanwhile, demand of coal grew more than 7% annually from the past five years with an enhanced growth of electricity demand and lower power generation from natural gas and hydroelectricity as a result of recent supply disruptions.[4]

Since power plants rely heavily on coal, which eventually results in theft of electricity and other unavoidable or unforeseeable consequences of use of thermal coal;these are certain inevitable outcomes which consequentially become a major contributor to shortfalls in electricity generation resulting in unregulated and unrestricted blackouts throughout the country. Despite significant coal reserves, India has experienced increasing supply shortages as a result of a lack of competition among producers, insufficient investment, and systemic problems with its mining industry.

Due to the wide gap between the demand and supply of coal; India has met more of its coal needs with its imports from various nations. Net coal import dependency has risen from practically nothing in 1990 to nearly 23% in 2012. India imports thermal coal for power generation from Indonesia and South Africa.[5]India's coal demand is expected to increase multifold within the next five to ten years, due to the completion of ongoing power projects, and demand from metallurgical and other associated industries, whilst Coal India Limited (CIL) dominates the domestic coal supply market with an 80 percent market share, although some industrial consumers, typically in the power and steel sectors, have access to captive mines.

The steel and cement industries are equally significant coal consumers. India has limited reserves of coking coal, used for steel production, and imports large quantities of coking coal from Australia.

The market forces development shall be an important determinant of the future market dynamics for the prices of thermal coal. The market has been substantially volatile in terms of import requirements, that have beenexacerbated by the fact that India is largely self-sufficient in thermal coal, while India's domestic demand in 2014 equalled around 80% of the global market, which implies that small changes in supply and demand can have a relatively large impact on total import requirements. Even if domestic coal production was to increase, there would still be

[4] *Id.*
[5] *Id.* at 4

issues getting the coal to market due to variouslogistical bottlenecks. A statistical analysis of the potential forecast changes to India's imports suggests a wide range of outcomes, affecting the viability of the Ultra Mega Power Plants (UMPP's)and its impact felt by the seaborne market, influencing the demand and supply needs of the product market.

The Indian power Sector is currently under severe stress, while eagerly waiting for one of the recent developments for the treatment of increased costs of imported coal for two of the largest marquee investments in power generation - the 4,620-Mw power project being developed by the Adani Group and the 4,000-Mw Ultra-Mega Power Project being developed by the Tata Group, both at Mundra; while the Budget of 2015-16 has announced Clean energy cess increase from 100 to 200 per metric tonne of coal, etc. to finance clean environment initiatives[6], implicating that the increase in cess shall lead to an unprecedented hike in thermal power tariff to the detriment of the Distributors, leaving the consumers to pay Rupees five paisa per unit more electricity, while nearly 75% of the electricity is generated through Coal Fired Plants, affecting the pre-dominant market share of Coal India in ahumongous manner.

Both, Adani and Tata Power had undergone the transparent competitive bidding procedure under Section 63[7] of the Electricity Act, 2003 and the post win '*compensatory tariff dispensation*' methodology has been keenly analyzed by the Power Sector Market in place, setting a conducive stage for the other Independent Power Producers (IPP's) to follow the same route for gaining monetary incentive in the name of '*Compensatory Tariff Package*'.

An effective bailout, amounting to a couple of thousand crores of power plants owned by the Tatas and Adanis by the Central Electricity Regulatory Commission (CERC) sets many deeply worrying precedents for the power sector. Perhaps the biggest one is that it questions the basic principle underlying electricity reforms since the '90s — the competitive procurement of electricity under the current regime enshrined under Electricity Act, 2003.

Compensatory tariff in the most ordinary sense means some kind of a monetary, fiscal benefit or cost recovery incentive given by the appropriate commission by increasing the tariff rate for aninterim period which is higher than the rate of tariff quoted during the competitive bid,

[6] Ministry of Finance – Union Budget of India, http://indiabudget.nic.in/budget.asp?pageid=2

[7] Notwithstanding anything contained in Section 62, 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

followed by a number of unavoidable, unprecedented circumstances encountered by the Power Producers.

Compensatory Tariff is often termed as a '*cost recovery model*' for power producers to increase their return on equity, wherein the company will be allowed to temporarily increase tariff tocompensate for additional fuel costs incurred on account of coal imports becoming expensive due to sudden change in the regulatory policy changes in the Indonesian Government in 2012, which started levying higher royalty affecting the financial viability of the project.

For an elaborate description of the import transaction, If Adani purchased coal for 1,980 Mega watt to supply power at 2.26 Rs tariff ; but since they depend on importing coal from Indonesia, which establishes the base price of coal of the '*landed energy product*'that is almost four times higher due to change in circumstances in Indonesian Coal Regulations, Adani group was unable to meet their fuel cost at this tariff rate for the 1,980 Mega watt and the change in price of import coal was considered to fall within the ambit of *force majeure* (exceptions) which under the Power Purchasing Agreement (PPA) does not make the purchaser of coal ,to supply coal at the same rate, hence for them to meet the cost, the Central Electricity Regulatory Commission (CERC) agreed to give them a *compensatory package*which means that they are allowed to recover their cost,through a revised tariff rate, which can be Rupees three or four, though with prior approval of the appropriate authority, and in accordance with the provisions of the Electricity Act, 2003.

The conceptual understanding of the phrase "Compensatory Tariff" is reflected in various orders passed by the Central Electricity Regulatory Commission and the Appellate Tribunal for Electricity (APTEL), whereinthe *legal issues* surrounding the "*compensatory package*" substantiated by the relevant provisions of the Electricity Act, 2003 shall be thoroughly examined.

The present need is to promote thermal power projects, as the dependence on coal requirement has been augmenting, evidenced in the quantum of imports from Indonesia. It is expected that India will continue to be dependent on coal to meet its power requirements because of the limited availability and high prices of gas, hydro and other renewable sources, hence the need is to promote lower greenhouse gas emission.

Tata Power, Adani and Coastal Gujarat had securitised itself with the investment in Indonesia. However, the change in the pricing formula also extended to the old contracts, i.e. the change in pricing formula impacted the old contracts which were in existence at the time of import of coal.

The concept of compensatory tariff was employed to represent the components of the gross or actual tariff on goods based on consumption cost in the final goods sector; a similar view was taken by the European Economic Community where the tariff is imposed on final goods.[8]Compensatory Tariff has been adjusted for Net profit earned in mines, excess revenue earned by third party sale if the project achieves PAF>80%, 100bps haircut on ROE and saving in fuel with lower cost with lower GCV coal without sacrificing operational efficiency.[9]

Economic benefit derived by the independent power producers (IPPs) from the recent Central Electricity Regulatory Commission (CERC) order on tariff by setting up ultra mega power projects, shall rest on distribution companies' (discoms) willingness to provide such compensatory relief; as they would be aggrieved by the order for supplying power less than the estimated cost generated per unit in comparison to the imported price of coal. It will also depend upon the quantum of benefit agreed to and the timeliness of the tariff. Alternatively, discoms have the option to appeal against the CERC leading them to an *ad infinitum* process for speedier recovery.

The present relief granted to Adani Power Limited has negatively encouraged other Independent Power Producers (IPP's) to approach CERC for frustration of power purchase agreements (PPAs) on grounds of '*force majeure*' due to the change in Indonesian coal regulations in the name of '*Change in law*'. It is hereby suggested that CERCshould not augment this practice of granting compensatory tariff orders in the name of '*change in law*' or '*force majeure*' leading to frustration of PPAs since the Indonesian regulations have changed unfavourably to the Indian Power sector. However, the proposal for a compensatory tariff is based on a pragmatic approach to keep the industry viable and protect the interest of consumers. In case IPPs are forced to supply power at the contracted tariff, they will become unviable ultimately leading to stoppage of supply.

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[8]US Department of Power, *Technical Bulletin Issues on Compensatory Tariff: US Power Deptt.,* 1379-84

[9]Committee Report for CERC For Determination of Compensatory Tariff- In the matter of Coastal Gujarat Power Limited,http://www.cercind.gov.in/2013/Reports/COMREP_CGPL.pdf:Moneylife; *Also see* CERC, *Compensatory Tariff Orders are a Fine Balancing Act*, http://www.moneylife.in/article/cerc-compensatory-tariff-orders/36686.html

2. Compensatory Tariff-Analysis and A Fine Balancing Act

The term '*compensatory tariff* ' or '*compensatory package*', is a recent evolution by the Courts of law to adjudicate on matters pertaining to energy economics, and decisions affecting market dynamics; by granting a monetary incentiveto the aggrieved, governed by the principles of the existing contract.

The tariff orders[10] rendered by the Central Electricity Regulatory Commission (CERC) or Appellate Tribunal for Electricity (APTEL) have built a consensus among the stakeholders for providing relief to developers against a sharp rise in Indonesian coal prices (due to change in Indonesian regulations) through a mechanism of '*Compensatory Tariff* ', which is currently outside the purview of PPA.

Under the auspices of the existing Power Purchasing Agreement (PPA), the study provides sufficient guidelines and determinants for renegotiation of all long-term contracts in the light of international practice; although the Court was not inclined to favour any re-negotiation of the tariff discovered through the process of competitive bidding, since the contractual sanctity of the bids should be maintained. The parties shall not renegotiate or re-determine the tariff discovered through the competitive bidding, as that shall bring uncertainty to the power sector and is prone to misuse. The Court opined that the parties should confer to find out and agree for a *compensation package* to deal with the impact of subsequent event resulting from the operation of Indonesian Regulations which has adversely affected performance under the PPAs while maintaining the sanctity of the PPAs and the tariff agreed therein.[11] In other words, the compensation package agreed should be over and above the tariff agreed in the PPA and should be admissible only for a limited or a temporary period till the event which occasioned such compensation continues to exist and should also be subject to periodic review by the parties to the PPA.

In the matter of Coastal Gujarat Power Limited[12], a subsidiary of Tata Power Company Limited, engaged in developing and implementing a 4000 MW Ultra Mega Power Plant at Mundra,

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[10] CERC, *Adani Power Ltd. v. Uttar Haryana BijliVitaran Nigam Ltd.*, Petition No. 155/MP/2012; CERC, *Coastal Gujarat Power Limited v. Gujarat UrjaVikas Nigam Limited*, Petition No. 159/MP/2012, MERC, *Adani Power Maharashtra Limited v.* MSEDC, Case No. 131 of 2014, APTEL, *Uttar Haryana BijliVitran Nigam Ltd.* v. *CERC,*IA NO.343 of 2014 IN APPEAL No.98 of 2014, APTEL, *LancoAmarkantak Power Ltd. v. HERC,* Appeal No.65 of 2013, CERC, *Sasan Power Ltd. v. MP Power Management Company Ltd.*, Petition No. 21/MP/2013

[11] *Id.* at ¶87, Petition No. 155/MP/2012, (21st February, 2014)

[12] *Id.* at Petition No. 159/MP/2012

Gujarat based on imported coal, the Commission was of the view that the escalation in price of imported coal on account of Indonesian Regulation is a temporary phenomenon and will be stabilized after some time. Therefore, the petitioner needs to be compensated for the intervening period with a compensation package over and above the tariff discovered through the competitive bidding. The compensation package could be variable in nature commensurate with the hardship that the petitioner is suffering on account of the unforeseen events leading to increase in international coal price affecting the import of coal.[13] As and when the hardship is removed or lessened, the compensatory tariff should be revised or withdrawn.

Whereas the Discoms appealed to the Appellate Tribunal of Electricity (APTEL), challenging the decision of the Commission[14]

In case of Adani Power Limited and Coastal Gujarat Power Limited, the Commission, vide orders dated 21.2.2014 in Petitions No. 155/MP/2012 and 159/MP/2012 has granted the compensatory tariff from the Scheduled Commissioning (SCOD) of respective units of the generating stations to offset the impact of the escalated coal price on account of the promulgation of the Indonesian Regulations which required the coal prices in the long term contracts to be aligned with international price. The Compensatory tariff is variable in nature and linked to the hardship being faced by the generating companies on account of Indonesian Regulations.[15]In the present case, the escalation in price of imported coal on account of Indonesian regulation and non-availability of adequate fuel linkage from state-run Coal India limited (CIL) for the project of the petitioner (Adani Power) is a temporary phenomenon, and is likely to be stabilised after some time;[16]M/s. Adani Power Rajasthan Limited has unequivocally filed a petition under sections, .61[17], 63[18]& 86[19] of The Electricity Act, 2003 for adjudication of dispute and for grant of suitable compensation and remedies to offset the commercial impracticability and other adverse consequences arising out of non-allotment of Coal block or Coal Linkage by Ministry of

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[13]*Id.* at ¶ 85
[14]*Id.*
[15]Rajya Sabha Starred Question No.469, *Demand for Higher Tariffs by Private Power Producers*, http://powermin.nic.in/upload/loksabhatable/pdf/Raj_11082014_enlish.pdf
[16] PTC India Limited, April 2013, p.27 'CERC Orders Compensatory Tariff for Adani Power', http://www.ptcindia.com/common/ptchronicle-april2013.pdf
[17] Appropriate Commission shall, subject to the provisions of this Act, specify the terms and the conditions for determination of tariff, and in doing so, shall be guided by the following [62(a)]
[18]*supra* n.7
[19] Functions to be discharged by the State Commission

Coal or Coal India Ltd. and enactment of new coal pricing Regulation by Indonesia government leading to occurrence of force majeure and change in law situation.[20]

As per the petition made to the CERC, for evolving a mechanism to compensate the adverse impact of unforeseen, uncontrollable and unprecedented escalation in the imported coal price and the change in the Indonesian Law; while the CERC had after considering the recommendations of the Committee appointed for the aforesaid purpose (comprising of experts from various disciplines like Legal, Banking, Finance, Technical and Procurers), decided that the Company or the Dev elopers are entitled to Compensatory Tariff from the date in effect as per the Order, over and above the tariff stipulated under the agreement with the procurers till the hardship on account of Indonesian Regulations persist.[21]

Tata Power, in its statement, said, "The company finds the order balanced perhaps keeping in view the beneficiaries and consumer interests. The decision of CERC was awaited to make Mundra viable, which had got impacted due to no fault of itself, but due to change of law at Indonesia as also other coal exporting countries and an unprecedented rise which could not have been perceived. The order provides partial relief to Mundra UMPP."[22] "The tariffs will go up. We had raised a lot of objections. Nothing stops us. We can very much go for an appeal.", said a senior Maharashtra Government Official requestinganonymity.[23]This will go towards resolving a major impasse affecting imported coal based power projects in the country that got impacted due to uncontrollable extraneous factors. The order provides partial relief to Mundra UMPP, which has been contributing to the nation by way of about 2-3% of the gross generation."[24]The Appeal filed by Uttar Haryana Bijli Vatran Nigam and Dakshin Haryana Bijli Vitran Nigam Limited (Haryana Utitlies) or the Discoms, against Adani Power Limited and Ors[25], the Appellate Tribunal for Electricity (APTEL), held that, since the Haryana Utilities are not able to supply the

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[20]RERC, *Adani Power Rajasthan Limited v. Jaipur Vidhyut Nigam Limited,* Petition No. RERC-392/13, Rajasthan Electricity Regulatory Commission, Jaipur, http://www.rerc.rajasthan.gov.in/Orders/Order237.pdf

[21] Coastal Gujarat Power Limited, *Director's Report to the Members, Statement of Accounts for the Year ended 31st March, 2014*, http://www.tatapower.com/investor-relations/pdf/CGPL-2013-14.pdf

[22] The Economic Times, State's may challenge power regulator's Order to Compensate Tatas, Adanis for costly Coal, http://articles.economictimes.indiatimes.com/2014-02-24/news/47635985_1_central-electricity-regulatory-commission-adani-power-power-tariff-cut; '5 States to appeal ATE against CERC incentive for Adani and Tata Power, KSEB Officer's Association, http://www.kseboa.org/news/5-states-to-appeal-ate-against-cerc-incentive-for-adani-and-tata-power-19033216.html

[23] CERC, *CERC Bails out Tata Power, States may challenge the Order*', http://www.livemint.com/Industry/CERC-bails-out-Tata-Power-states-may-challenge-order.html

[24]*Id.*

[25]*supra* n. 10

power to the consumers at large in the State as a result of which the consumers are said to be suffering; due to the sudden stoppage of supply, Adani is directed to comply with the Interim Order forthwith without any delay.[26]

Following APTEL's order, as far the current status of compensatory tariff awards are concerned, in August, responding to a petition by the power distribution utilities of Haryana, the apex court stayed the interim order of the Appellate Tribunal of Electricity (APTEL) to charge compensatory tariff, and asked the tribunal to finalize the matter expeditiously. While the hearing was being held every day by APTEL, the apex court, responding to an appeal filed byAdani Power on Monday, decided to put a stay on the proceedings at APTEL on Tuesday and start a fresh hearing.[27]

Creating further uncertainty for power producers, which are eager to make use of the regulator or Commission-allowed facility of actual cost escalation based compensatory tariffs to save their projects, troubled by unforeseen circumstances increasing the fuel costs or Rupee volatility; the Supreme Court has questioned the rationale of the relevant regulatory decision.

Both Tata Power and Adani Power had to take haircut of 1% each on their return on equity in the respective projects. Further, profits from their coal mining operations in Indonesia were also deducted to the extent of coal supplies to their Mundra plants for calculation of compensatory tariff. March 2013 was taken as the cut-off date by the CERC for fixation of compensatory tariff for the two plants as petitions were filed by Tata Power and Adani Power with the regulator in April 2013.[28] According to the Apex Court the Orders passed by the apex regulator shall have a direct bearing on the market structure dynamism of the country, setting an uncalled and unfettered precedent for other Power Producers to gain indirect and unauthorized access to re-determine their tariff, after undergoing the transparent bidding procedure, conducted under the

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[26] *Id.* at 54

[27] S. Gopalan, *SC Stays APTEL's Hearing on Compensatory Tariff of UMPP's Will Start a Fresh Hearing*,BUSINESS STANDARD, http://www.business-standard.com/article/companies/sc-stays-aptel-s-hearing-on-compensatory-tariff-of-umpps-will-start-fresh-hearing.html; Guneet, *SC Stays APTEL's Hearing on Compensatory Tariff*, INDIAN POWER SECTOR.COM, Nov. 12, 2014,http://indianpowersector.com/2014/11/sc-stays-aptels-hearing-on-compensatory-tariff-of-umpps-will-start-fresh-hearing

[28] *supra* n. 10, D. Ragini, *Supreme Court Nullifies APTEL's Interim Order on Compensatory Tariff*, INDIAN EXPRESS, Aug.26, 2014, http://indianexpress.com/article/business/economy/sc-nullifies-aptels-interim-order-on-compensatory-tariff

auspices of CERC. Also, Reliance Power had filed petitions with CERC for compensatory tariff on various accounts for its three UMPPs — Sasan, Tilaiya and Krishnapatnam.[29]

Tata Power and Adani Power simultaneously announced shutdown of some of their units citing technical snags and default in payment by some power utilities. This followed Supreme Court staying the order of Appellate Tribunal for Electricity (APTEL) allowing Tata power and Adani power to charge extra prices for electricity generated from their power plants due to use of imported coal. Supreme Court had asked the APTEL to dispose of the matter quickly.[30]

Steps taken on fuel price pooling which is a short term solution only, would provide some respite to new capacity, which otherwise has the risk of being stranded. Also the Central Electricity Regulatory Commission (CERC)'s order in April 2013, which called for a variable "compensatory tariff" till the fuel situationstabilizes for an imported coal based plant, is a progressive step for the sector.[31]

The current power sector has undergone a turbulent change in the recent years, besidesthere have clear instances of the troubled sector, struggling with an array of issues−shortage of fuel supply, unprecedented hike in coal prices in the international coal market, leading to worst blackouts in the nation, which highlighted the need for an integrated energy planning for India, and despite grappling with challenges, the level of determination exhibited by the private sector continued to contribute to the growth of the sector.

This decision of the regulator was welcomed by the industry and other Power Producers who are associated with this burning issue, as many imported coal based projects were either stalled or were running losses due to high imported fuel costs. Similar policy framework is needed to address various issues plaguing the sector for quick resolution of such ongoing tariff disputes.

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[29] *Id*. at 23, Petition No. 21/MP/2013, *supra* n. 10

[30] V.K. Gupta, *Power Ministry to intervene in Tariff Disputes between Adani or Tata & States,* INDIAN POWER SECTOR.COM,http://indianpowersector.com/2014/09/power-ministry-to-intervene-in-tariff-dispute-between-adanitata-states; AnirudhSethi, *Supreme Court Pulls up Tata Power and Adani Power, Says Firms Can't Seek Higher Tariff*, http://www.anirudhsethireport.com/supreme-court-pulls-up-tata-power-adani-power-says-firms-cant-seek-higher-tariff

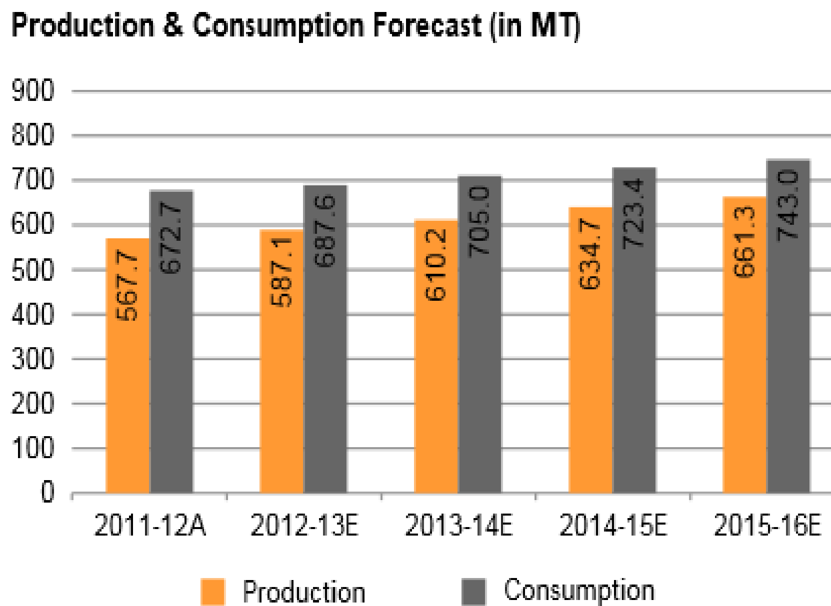
[31] *Mundra UMPP reflects Tata Power's commitment to the Nation*, http://www.tatapower.com/media-corner/pressreports/press-report-01-july-13.pdf

2.1. Market Dynamism surrounding Compensatory Tariff Mechanism

Coal has eventually emerged as the "black diamond" for power industries in India due to its precarious situation of its availability and subsequent linkage issues.[32] Almost all industrial activities where energy remains a key component to determine product price and thereby growth, have been badly affected due to non availability of coal.

The following graph projects the consumption and the production pattern of coal in India, affecting the market structure dynamics of the country[33]

Table 1



As projected in the above figure, the estimated production of Coal is in deficit with the growing demand or consumption standards of coal as a source of fuel in power generation as well as cement and steel plants in India would forcing the country to enhance its current level of production standards in an efficient manner.

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[32]Rajesh Kumar Shukla et.al., *Significance of Mining Sector as Engine for Economic Growth and Social Development: Relevance to Indian Coal Industry*,4 INDIAN STREAMS RESEARCH JOURNAL (2015); Ashok Yakkaldevi, *Coal Becomes Crucial Growth for Industrial Growth*, 4 INDIAN STREAMS RESEARCH JOURNAL (2012)

[33] LSI Financial Servics Pvt. Ltd., *The Black Diamond Coal Report*, http://www.lsifinance.com/img/quarterlyindustryreports/12.pdf

The slewing production of coal, led to the increased import−resulting in a wide gap between demand and supply of the essential energy product in the country.

Following data depicts the constant burgeoning increment in the quantum of imports in the country.[34]

Table 2

Import of Coal from 2005-06 to 2012-13 is as under: **(in Million Tonnes)**

	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Coking Coal	16.89	17.88	22.03	21.08	24.69	19.48	31.80	32.56
Non Coking Coal	21.7	25.2	27.76	37.92	48.57	49.43	71.05	105.00
Coke	2.62	4.69	4.25	1.88	2.36	1.49	2.36	3.01
Total Import	**41.21**	**47.77**	**54.04**	**60.88**	**75.62**	**70.4**	**105.21**	**140.57**

(Source: Provisional Coal Statistics:

Source: Provisional Coal Statistics(2013-14), Government of India, Ministry of Coal

Whereas, coal production all over India during the period 01st January, 2013 to 31st March, 2013 was 173.225 MT. During the period of 01st April, 2013 to 31st March, 2014,the production has substantially increased to 564.76 MT against the target of 604.55 MT.[35]

At present in India, more than 70 percent of base load power supply comes from coal-fired power plants. Coal India Limited (CIL) has not been able to increase the production to meet the demands. During 11th Five Year Plan Period (2007-12), the coal-based power capacity increased by 9.5 percent annually, from 68 gigawatts to 112 gigawatts, whereas in 2012, the installed coal capacity increased by 20 percent, whereas the domestic coal production increased only by 1.4 percent; consequently 38 gigawatts of capacity was stranded in 2012, leading to subsequent constraints in long term supply contracts or agreements − resulting in shortage of fuel or coal supply to the Independent Power Producers (IPP's) by the majority stakeholder, Coal India Limited (CIL), contributing to the sharp increase in imported coal.[36]

[34] Ministry of Coal, *Coal Production, Marketing & Distribution: Import of Coal from 2005-06 to 2012-13*, http://www.coal.nic.in/content/provisional-coal-statistics

[35] *Id.*

[36] Mani Khurana & Sudeshna Ghosh Banerjee, *Beyond Crisis: The Financial Performance of India's Power Sector,* DETERIORATING FINANCES 35

2.2. The Coal Crisis Impact

This persistent growth in imports is primarily driven by the demand from various industries, which accounts for around 75% of the total thermal coal imports.However, thermal coal imports could have increased substantially, had the 'tariff determination' by the recognized commissions or the authorities been proportional to the change in coal market dynamics.

The impact of shortage of adequate coal linkages or fuel supply agreements have been humongous in India, with respect to the allocation of the coal − leading to overall increase in price due to growing gap between demand and supply of coal; the unequivocal dependency on other fuels for the generation of electricity, surpassing United States.[37] In a developing nation like India, the same would imply relying on other renewable sources, which in turn would drive up the subsidy burden of the government.[38] On the other hand, many established power generation capacities would face the threat of the idle Plant Load Factor (PLF) being underutilized in the absence of coal.

Companies in turn would have to struggle with increasing power cuts or blackouts, leading to shut downs which in turn would impact their production and margins−and that would have been the darkest hour in the history of Indian Electricity Sector; however,there was an increase of 49.24% in gross import and 56.29% in net imports of coal in 2011-12over the previous year.[39]

Additionally, as observed in the previous sections, the change in the base policy of exporting laws by Indonesia and Australia may increase the cost of fuel for domestic players, besideswhat makes matters worse is the government's action and the authority of the Commission, deriving unfettered power of re-determining the tariff from the Statute[40] for the grant of '*compensatory tariff*' by way of hike in the power tariff to the detriment of the prospective consumers and the Discoms. As power producers are unable to entirely pass on the costs to the consumers, they face increased pressures on their margins, by way of additional fuel costs, low Return on Equity (ROE) for the price paid for the *landed energy price*.

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[37] International Energy Agency, *Coal's Share of Global Energy Mix to Continue Rising with Coal Closing in on Oil as World's Top Energy Source by 2017*, Dec. 17th, 2012 http://www.iea.org/newsroomandevents/pressreleases/2012/december/name,34441,en.html

[38] Siemens, *Coal Crisis*, http://www.siemens.co.in/pool/about_us/our_business_segments/sisl_industry/article-1_coal-crisis.pdf

[39] Import and Export of Coal, Foreign Trade in Conventional Sources of Energy, Central Statistics Office, National Statistical Organization,http://mospi.nic.in/mospi_new/upload/Energy_Statistics_2013.pdf

[40] *See* The Electricity Act, 2003 [No.36 OF 2003]

Power Tariff Regulation and Determination rests within the bounds of the Central Electricity Regulatory Commission (CERC) and the State Electricity Regulatory Commission (SERC), considering a Government-specified return on equity, and alternatively the these Companies bid for a certain amount which shall last till the life of the project or the till the existence of the contract or the agreement in force.

Tariff Policy was issued in January, 2006 to facilitate procurement of power on tariff based bidding. Power projects can be developed by States under Case I and Case II bidding.[41]

Guidelines for procurement of Power by Distribution licensees and Standard Bidding Documents have been issued by the Ministry of Power[42]. Many projects in Haryana, UP, Gujarat, Maharashtra etc,are being implemented through tariff based competitive bidding (Case 1/Case 2). The Draft guidelines prepared by the CERC prescribe a broad transparent framework for competitive bidding under regulatory supervision in order to achieve the main objective of the Electricity Act, which is to promote competition and investment in order to improve the availability and quality of electricity at reasonable prices.[43]

Once the requisite compliances are furnished by the prospective bidder, the project site shall be transferred to the successful bidder at a price to be intimated at least 15 days before the due date for submission of RFP bids, which is inclusive of Site Identification or the Land Acquisition, Environmental Clearance, Forest Clearance, Fuel Arrangements required for the total installed capacity of the plant.[44]

A typical tariff bid contains tariff components and escalation rates for the entire contract period, which is typically 25 years. The tariff bid shall comprise of Capacity charges,Energy (fuel and non-fuel) and Transportation and fuel handling charges respectfully.[45]

Further, the guidelines demonstrate the necessary components of Capacity Charge and Energy Charge − Fixed Operation and Maintenance Cost, Financing Cost, treated under the broad head

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[41] Ministry of Power, *Development of Power Projects on Tariff Based Bidding*, "In fulfillment of CEA's obligation under Section 3(4) of the Electricity Act, 2003" (2012)

[42] *Id.*

[43] Press Release, *CERC Advice on Tariff Based Competitive Bidding*, Central Electricity Regulatory Commission, (Oct. 3, 2004), http://www.cercind.gov.in/04102004/Press%20Release%20draft%20Guidelines%20for%20Competitive%20Bidding.pdf

[44] Ministry of Power, *Guidelines for Determination of Tariff by Bidding Process for Procurement of Power by Distribution Licensees*, Res. No. 23/11/2004-R&R (Jan. 9th, 2005) published by ministry of power, http://powermin.nic.in/upload/pdf/Guideline_for_determination_of_tariff_and_SBD_for_case_1.pdf

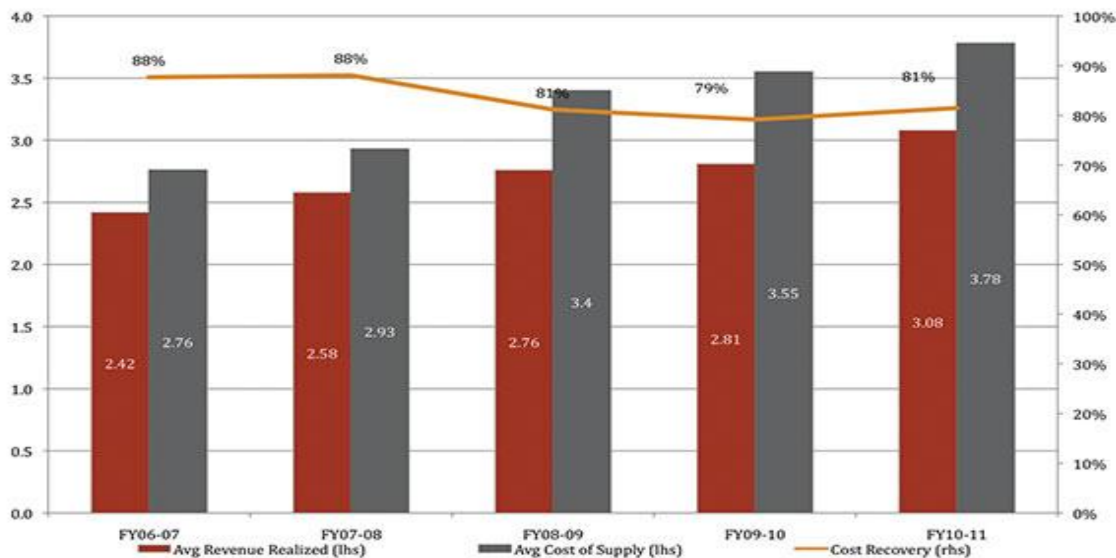
[45] *Id.* at 11

of ‘Capacity Charges’, whereas Variable Operation and Maintenance Costs, Fuel Costs, Fuel Transportation Costs and Fuel Handling Costs; these are scalable and the non-scalable components to be treated under the Case1 Bidding procedure.[46]

These scalable and non-scalable components are subject to variation and certain escalation rates which have to be determined by the CERC, hence any bidder quoting 100% of the increase in fuel costs as scalable, shall be able to pass through complete fuel cost in the tariff, a monetary or a procedural benefit earnable only by the Producers and not the Discoms, since it is difficult for them to pass on the increased cost of fuel for power procurement. Poor finance of distribution companies can lead to the risk of defaulting on or delaying payments to generators.

The following graph depicts the lopsided nature of tariff and recovery costs, restraining the Power Producers to import more coal, which are particularly of high gross calorific value.[47]

Table 3



Source:www.energyglobal.com

The main implications of this huge deficit has been projected through various instances, where the Government’s response to the unraveling shortage has been very ineffective and inadequate. Issuing presidential directives to Coal India Limited (CIL) and forcing it to sign Fuel Supply

[46] *Id*.

[47] Energy Global, *Indian Thermal Coal Imports*, www.energyglobal.com/upstream_news/special_reports

Agreements (FSAs) did not help as CIL could not possibly supply domestic coal in the quantities expected and consumers were unwilling to take high price of imported coal.[48]

While the bidding rounds are completed, the scalable and the non-scalable components are primarily determined in order to place any plea for increase in tariff by the aggrieved Power Producer, by applying the escalation rates and the percentage of scalable components; and subsequently if the Producer intends to win the bid, the most lowest tariff should be quoted including the fuel costs, although the Power Producers importing coal, for coal-fired projects, have faced many challenges due to the change in the policy of the Indonesian Government, since they changed the base price for export and adopted a new policy jeopardizing the interests of the domestic users, and increasing the landed energy costs, to the detriment of the Producers, Discoms and the over consumer segment in India.

As discussed earlier due to sourcing problems in India, power generators such as Adani, Tata and Reliance bought coal mines in Indonesia, although the expectation here was cheap source of coal; however, when Indonesia benchmarked its coal prices to international indices for all new and existing contracts, the cost of fuel procurement increased tremendously as compared to the time when these companies won the bids. Consequently this impaired the feasibility of long-term power supply contracts in terms of import of coal.

Many policy changes and implications followed the bold decision of the CERC, upheld by the APTEL, placing the Discoms and associated consumers in an disadvantageous situation, one of which is '*Financial Structuring*'[49] of ailing Distribution Companies, apart from a '*Compensatory Tariff package*' in an unprecedented move by the Commission, subsequently challenged by the Distribution Companies.

Earlier, the Policy[50] said the Coal India (CIL) would supply 100 per cent of the committed quantity to power plants at prices to be notified by the coal PSU.[51] It also said that in order to meet the domestic requirement, CIL would import coal as required from time to time, if feasible and adjust the overall price accordingly.

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[48] Sunita Nandan, *Largesse that Wasn't: Story of Coal Shortages in India*, Prayas (Energy Group – 2014)

[49] Ministry of Power, *State Distribution Utilities: First Integrated Annual Rating for State Power Distribution Utilities* 34(2013), http://www.ficci.com/sector/report/20065/fullnfinalsetratingbooklet.pdf

[50] The Coal Distribution Policy,2007

[51] PTI, *Government Modifies New Coal Distribution Policy*, http://www.thehindu.com/business/Industry/govt-modifies-new-coal-distribution-policy/article4963444.ece

Coal India Ltd. (CIL) to sign Fuel Supply Agreements (FSA) for a total capacity of 78000 MW including cases of tapering linkage, which are likely to be commissioned by 31.03.2015. However, the actual coal supplies would however commence when long term Power Purchase Agreements (PPA's) are tied up.[52] The new Coal policy has changed its earlier stand on the minimum supply agreement from 100% to 80% as per the commitment of coal requirement by power plants while signing fresh fuel supply agreements for 78,000 MW capacity that may be commissioned during April 2009- March 2015.[53]This indeed has created reliance on increasing number of imports in the country, by providing leverage to Coal India Limited (CIL) to form a monopoly or cartel, as prior to the Coal Distribution Policy, 2013, as the coal rates were determined under the auspices of the Public Limited Company alone.

The demand-supply gap of domestic coal production has led to incessant and frivolous litigations, claiming a 'liquidated damages' on account of commercial hardship faced due to the financial transactions deliberated or stipulated in the contract signed prior to the unprecedented or unavoidable circumstances which led to the claim of a hiked tariff, in the name of 'Compensatory Tariff', or 'Cost recovery benefit'.

2.3. Key Observations of the Ad-Hoc Committee

The Honorable Commission, vide its order dated 15th April 2013[54], opined that there was a prima facie case of Coastal Gujarat Power Ltd. (CGPL) being affected by incorporation of significant and abundant changes in the Regulatory mechanism, thereby effecting changes in the 'pricing regime or the pricing indexation' in the Indonesian Regulations and escalation in coal prices, which however did not qualify for relief under the provisions of the Power Purchasing Agreement(PPA) viz. Force majeure and Change in law. The order stated that the Honorable Commission had the jurisdiction to regulate tariff of CGPL determined by a competitive bidding process, and accordingly directed CGPL and the Procurers to constitute a committee consisting of the representatives of the Principal Secretary (Power) of the procurer states, Managing Directors of the Distribution Companies of the Procurers, Chairman of Tata Power Limited or his nominee, an independent financial analyst of and an eminent banker, conversant with the

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[52] Ministry of Power, *The Cabinet Committee on Economic Affairs (CCEA) Approves the Mechanism for Coal Supply to Power Producers*, PRESS INFORMATION BUREAU, http://pib.nic.in/newsite/erelease.aspx?relid=96683
[53] *Id.* at Features of the Policy
[54] *Coastal Gujarat Power Limited vs. Gujarat Urja Vikas Nigam Limited, Vadodara &Ors.*, Petition No. 159/MP/2012, http://www.cercind.gov.in/2013/orders/159_mp_2012.pdf

infrastructure sector. The Committee was mandated to find out an acceptable solution in the form of 'compensatory tariff' over and above the tariff decided under the PPA's to mitigate the hardship caused to CGPL.[55]

The stringent process of tariff determination under the Power Purchasing Agreements(PPAs) require strict analysis of various operating, financial and maintenance parameters; given the evolution of the Sector structure and the gradual introduction of the concept of 'competitive bidding' envisaged under various provisions of the Electricity Act, 2003 it is possible that the issues involved in tariff setting or determination would become increasingly complex in the coming years. The Determination of Tariff Policy, 2006 recognizes that application of uniform operating norms and revisions that could pose difficulties in the context of long-term agreements amongst sector entities.[56] Any modification in the costs of the utility or the Discoms vis-à-vis the costs (Variable and Fixed) approved under Aggregate Revenue Requirement, that are placed beyond its control and cannot be accurately predicted at the time of tariff determination, include the following:

- Change in Variable cost of power purchase from any source.
- Change in Fixed cost of power purchase from any source.
- Change in Variable cost of Own Generation of any plant (if any).
- Change in any other costs that satisfy the tests of being 'beyond the control of the utility' and are 'not predictable'.[57]

The indispensible ingredients referred herein to determine the tariff shall apply for procurement of base-load, peak-load and seasonal power requirements through competitive bidding, through the following mechanisms:

1. Where the location, technology or fuel is not specified by the procurer **(CASE-I)**
2. For Hydro-Projects, Load Centre Projects or other location specific projects with fuel allocation such as captive mines available, which the procurer intends to set up under tariff based bidding process**(CASE-II)[58]**

[55] *supra* n.9
[56] CRISIL, *Preliminary Discussion Paper on Tariff Policy: Long Term Agreements*, ¶4.2.1
[57] *Id.* at ¶7.2.6
[58] *supra* n.44 at ¶2.2.

The committee constituted by the Commission had worked out for various options to ascertain the methodology to determine 'compensatory tariff' and concluded that the compensation package to CGPL may be calculated based on the 'Under recovery of Fuel Energy Tariff Component, i.e. the Normative Fuel Energy charges incurred by the Producer'.

Accordingly, the Committee recommended the following formula for deriving at the compensation package to CGPL"

Gross Compensatory Tariff (GCT) Normative Fuel Energy charges – Tariff recovered from Fuel Energy components of PPA

The committee examined pros and cons of this method of arriving at the compensatory tariff:

- Avoiding re-negotiation of tariff components discovered through the process of competitive bidding, although the term is inclusive to mean and include 'redetermination of tariff under Section 62 of the Electricity Act, 2003
- Addressing the 'hardship' caused by both, Indonesian Regulations and the unprecedented hike of coal prices, causing unrelenting burden on the Distribution Companies, compelling them to comply with the payment mechanism
- Ensuring that the compensation derived and ascertained by the Committee members is to commensurate to the rigorness and harshness incurred on passing on the benefits accruing to the generator during lower coal price regime, at the time of bidding to the procurers, thereby protecting interests of the consumers, and allowing passing of the benefits of operational efficiency to the Procurers or the Distribution Companies.

Based on above recommended mechanism, using the coal prices, non escalable for the month of July 2013, certain normative and technical parameters and estimations made by the technical consultant of the Committee, KPMG the compensatory tariff for FY 2013-14 is calculated as Rs .59/kWh (based on July 2013 prices).[59]

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[59] MERC, *JSW Energy Limited vs. Maharashtra Electricity Distribution Company Limited (MSEDCL),* Case No.145 of 2014

The Committee has also deliberated on the other issues raised by the Honble Commission and procurers to reduce the burden of compensatory tariff and the recommendations of the Committee to the Honble Commission for compensatory package to CGPL are as below:

A. The provisional compensatory tariff for each period may be calculated using the following formula

Gross Compensatory Tariff (GCT) = Normative Fuel Energy charges – Tariff recovered from Fuel Energy components of PPA[60]

B. Provisional compensatory tariff shall be ascertained at the end of each financial year based on the audited financial statements in a time constrained manner with profitable adjustments made for, calculation of the Actual Normative Fuel Energy expenses.(See **APPENDIX**)

Tata Power's share of dividend which it receives from the current shareholding in the Indonesian mining companies is prominently proportionate to the coal supplied to the Ultra Mega Power Project. The Company's equitable share of profits and dividends, in *moratorium* shall be the summation of the dividends available to Company in India and the profits kept reserved at the Indonesia mining level, which is reduced to the extent of dividends declared in the Company in proportion to its shares. The capping limit of the compensatory tariff may be determined and locked, post the consultative sessions between the generator and procurers or as per the due approval of the Central Electricity Regulatory Commission, as a predetermined percentile of the power procurement cost of the procurers in that particular year as per the approved power purchase plan.[61]

The Power producer is currently incurring colossal losses not only on account of energy charges but also on account of capacity charges over and above the tariff quoted, both during the bidding rounds as well as in the post bidding session of the Competitive Bidding Procedure, enshrined within the provisions of the Electricity Act, 2003.

However, the point of serious observation is that, the scope of Committee is limited to evaluating, analyzing, and evolving a mechanism to mitigate the hardship on account of energy charges and shift the burden of payment to other stakeholders. Therefore, with respect to hardship on account of capacity charges, the Committee suggests that the sufferance inflicted upon the

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[60] *supra* n.9
[61] *Id.*

Discoms, may be mitigated by way of sharing such hardship with other stakeholders i.e. lenders by interest rate reduction, sacrifice of ROE, sharing of profit beyond normative availability on merchant basis.

The committee had analysed the petition of CGPL, claiming that, as per the Indonesian Regulations of the Ministry of Minerals and Resources, the holders of mining permits for production and operation of mineral and coal mines are required to sell mineral and coal in domestic and international markets including to their affiliates, or third parties by way of entering into Power Purchasing Agreements (PPA's), by referring to the benchmark price and the spot price of coal in the international markets.

According to the Indonesian Regulation No.17, which was freshly promulgated in the year 2010, all long term commercial or business contracts for supply of coal from Indonesia were mandatorily required to be aligned, and not in derogation with the Indonesian Regulations, strictly (within a time gap of 12 months) from the effective date of promulgation of the Regulation (23rd September, 2010).

This Committee was constituted and commissioned to analyse the outcomes, the effect and implications of the tariff order passed by the CERC, only for CGPL, when this power producer had entered into fuel supply contracts at a price less than the then prevailing benchmark price. CGPL had to face brutal consequences due to this prescribed Regulation N.17, promulgated under the Law No.4 of 2009.

The aftermath of such promulgation have been harsh on many such corollary Power Companies who import coal from Indonesia and have a substantive shareholding in their mining companies; This has resulted in rendering these fuel supply contracts as null and void.

Accordingly CGPL had amended the Coal Supply Agreements in March and May, 2012 in alignment with the Regulations prescribed therein. Committee is of the view that, since the CGPL was forced under unavoidable and unprecedented situations to adopt the Indonesian Regulations, CGPL is supplying power to the procurers by purchasing coal at a price higher than the price envisaged at the time of bid.

In a petition filed before the Maharashtra Electricity Regulatory Commission (MERC)[62], the auditing analyst, KPMG was appointed to determine the methodology and provide the

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[62] , MERC,*M/S JSW Energy Ltd vs. Maharashtra Electricity Distribution Company Limited (MEDCL* Case No.145 of 2014)

suggestions for a calculative approach towards tariff determination in this case, on same terms and situation. KPMG suggested that:

Compensatory Tariff= Incremental Cost of Current Coal Source/ Contracted Capacity

Comensatory Tariff =Quantity Imported x (P Quantity Imported new)- (P Quantity imported old / Contracted Capacity, wherein the P Imported Old is the Reference FOB based on verified FSA, whereas the P imported old is the Reference price based on relevant indexes for imported coal FOB price.[63]

A Committee was constituted to analyse the determination of tariff in the Adani Power Limited, as per the MERC Order dated 21st August 2013, which directed the parties to constitute a committee within 10 days from the issuance of the order, which outlined and analysed the problem in the following ways:

1. The Committee analysed the impact of non-availability of coal from Lohara Blocks on Unit 2 and 3 of Tiroda Plant, if the Company is adamant on supplying power at the tariff rate quoted in the PPA
2. Availability of Coal from an alternative block for a long term coal linkage in lieu of the non-availability of coal from Lohara
3. APML accessing the import of coal at discounted market prices, and its further implications on the Indian Power Market
4. Separate Coal Accounting and auditing for Unit 2 and 3, which has to be mandatorily submitted by the Company.[64]

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[63] *Id*. at ¶ 3.5

[64] Ministry of Power, *Committee Report for MERC: For the Determination of Compensatory Tariff in the matter of Adani Power Maharashtra Limited* (Feb. 2014)

3. Implications of 'Compensatory Tariff Awards'

The tariff orders are famously known as the *'Compensatory Tariffs Cases'*[65]; amidst the reality as the private investors, could magically ensure that utility prices could increase tremendously while thequality of service decreased and theprofitsflowed back to theparent company, was doomed to failure.In most cases, the political involvement in tariff process resulted in grant of compensatory tariffs. It is important to analyse the evolution of 'Compensatory Tariff', not as a term, but as a conceptual understanding, rendered in a plethora of Orders by Appropriate Regulatory Commissions, ranging from 2010 to 2014.

In a move that could pivot the fortunes of two transported in coal-based influence plants in Gujarat, the Central Electricity Regulatory Commission (CERC) has permitted pay of Rs 830 crore to Adani Power and Rs 329 crore to Tata Power from state-possessed appropriation Discoms in five states. The help has been allowed to adjust for higher expenses of transports of Indonesian coal.

The effect of compensatory duty has been brought down by CERC allowing the procurers an offer in benefit from Tata Power's and Adani Power's coal mining operations in Indonesia. This would be in extent to the coal utilized for contracted force. Moreover, they would get 60 percent partake in acknowledgment from outsider deals in the event of Tata plant and 50 percent on account of Adani.

While, the CERC's choice was anticipated to make Mundra feasible, which had got affected because of no deficiency of itself, yet because of a change of law in Indonesia as additionally in other coal trading nations and an exceptional ascent, which couldn't be forseen during the bidding rounds prior to the PPA in effect.

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[65] Avinash Celestine, *Compensatory Tariffs Case: Should Power Producers be Compensated for Rock-Bottom Bids Made Earlier?*, http://articles.economictimes.indiatimes.com/2014-10-12/news/54928953_1_adani-power-power-sector-aptel; *Compensatory Tariffs Case: Should Power Producers be Compensated for Rock-Bottom Bids Made Earlier?*, KSEB Officer's Association, http://www.kseboa.org/news/compensatory-tariffs-case-should-power-producers-be-compensated-for-rock-bottom-bids-made-earlier-11103451.html

3.1. Untangling the knot–Profitable for the Power Producing Companies

After Adani and Tata Power Company hadsigned the Power Purchasing Agreements (PPA's), Indonesia had introduced new set of rules and regulations[66], which set a 'minimum export price' for coal, linked to international benchmarks. Effectively, this however pushed the price of coal for any entity or Company importing the 'commodity' from Indonesia, though for the two companies in question, the impact was lower, since they owned 40% equity stakes in the mines they bought coal from.

This change in the Indonesian rules and regulations, compelled the existing direct sales contractors and the term contractors (long term) to comply with the Indonesian Regulations; resulting in Adani's expression of inability to comply with the same, while the Regulations also aimed at changing the coal supply norms as per the directions of the Indonesian Government, while any derogation from the rules shall lead to suspension of the license of the long term contractors.[67]Accordingly, the Indonesian Regulations were to come into force in respect of term sale contract (long term) with effect from 23.9.2011[68],coupled with the sharp rise in international coal prices for an interim period, while the weak supplies of domestic coal or lack of adequate coal linkage streams developing a vaccum between Coal India Limited (CIL) and the prospective power producers, made the companies lift their hands and tell their customers that the power tariffs they had bid were unviable, and that these should be re-negotiated or re-determined and the current Power Purchasing Agreement(PPA) should be renewed in order to increase the tariff pre-existing or earlier determined under the contract.

Compounding to the 'lost energy costs expenses'or to reimburse the fuel efficiency costs or to attain a higher Return on equity (ROE)or Return on Interest (ROI), the companies asked for a hiked compensation for the power they had supplied at the existing tariffs under the existing agreement citing major losses.

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[66]Government of Indonesia, *Regulation of Ministry of Energy and Mineral Resources: No.17 of 2010* [hereinafter referred to as 'Indonesian Regulations']
[67]APTEL, *Adani Power Limited vs. Uttar Haryana Bijli Vidyut Nigam Ltd. &Ors.*, Petition No. 155/MP/2012, ¶3
[68]*Id.*

The increasing cost of coal, and other associated fuels were considered to be far greater than what was anticipated under the stipulated agreement by the concerned parties to the agreement, giving rise to many such frivolous petitions, voluntarily filed by many power producers to earn higher tariff in the name of '*compensatory package*', as Indiabulls Power is now being allowed a Rs 1.55 a unit 'compensatory tariff' for using imported coal as pass through for its plant at Amravati in Maharashtra.[69] On 16th February, 2013 the Maharashtra Electricity Regulatory Commission (MERC) passed an order granting IndiaBulls Power the pricing flexibility by way of 'compensatory tariff'[70], though not using the term 'compensatory energy fuel'.

The Maharashtra State Electricity Regulatory Commission (MERC) had granted the award, by calculating the Baseline Quantity, Baseline Gross Calorific Value, the quantity which is in shortage, and devised a formula (amended), as proposed was:

Quantity of Alternate Coal in MTPA## = Shortfall Quantity in MTPA x Baseline Gross Calorific Value in kcal/kg divided by Revised Gross Calorific Value in kcal/kg[71]

The Commission considered the aspect of devising a replacement cost of shortfall in the domestic coal on account of imported coal, for which the Commission may consider the escalable and the non-escalable components.

The only respite the Distribution Companies and the consumers are left with is to approach the appropriate Commission to get adequate relief; where appropriate benchmarks and other checks and balances have been considered in the methodology adopted by the Commission so as to ensure that there is no profiteering on this account. Further, the Procurer or other stakeholders have the equal liberty to approach the Commission intermittently for review of any aspect of the compensatory fuel charges with changing market demand structure.

Though the decision of the Commission was welcomed by the Generators, yet the stay on the proceedings by the Supreme Court, directing the Appellate Tribunal for Electricity (APTEL) to dispose off the cases; created a sordid state of affairs for the Generators, and many others which created a stepping stone for them make such claims to the regulator.

The Commission (CERC) had granted Reliance Power's Sasan ultra mega power project, asking for compensatory tariffs following what it called '*unprecedented*' depreciation in the exchange

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[69] Agency, *Rajiv Rattan Takes Control of IndiaBulls Power, Amravati Power Plants Get Nod for Compensatory Tariff*, BUSINESS STANDARD, (Sept. 23rd, 2014), http://www.rattanindia.com/power-news/news6.pdf

[70] MERC, *IndiaBulls Power Limited. Vs. Maharashtra State Electricity Distribution Co. Limited &Ors.*, Case No.154 of 2013, http://www.mercindia.org.in/pdf/Order.pdf

[71] *Id*. at ¶ 33.1.1.

rate of the rupee versus the dollar after it signed PPAs with states such as Haryana, Gujarat and Madhya Pradesh in 2007.[72]Since the depreciation in the rupee, against the sharp rise in the Dollar was considered to be an 'force majeure', leading to a lump sum amount of Compensation for the same.

Similarly, in other cases ruled by Maharashtra Electricity Regulatory Commission (MERC) on a set of three petitions, concerning the supply of power by Adani, Indiabulls Power and JSW Energy to Maharashtra, which allowed compensatory tariffs to these companies on the grounds of a decline in supplies of domestic coal, and higher prices of imported coal.[73] The companies submitted the reason for filing the claims that the Union Cabinet's decision in 2013 to amend the Coal Distribution Policy, 2007 allowing for lesser coal to be supplied by Coal India to each power plant, having the Letter of Assuarance (LOA) or the Fuel Supply Agreement(FSA) with the balance to be made up by imported coal, qualified for being considered as a 'change in law', thus allowing them to claim compensation; further restricting them to qualify for any fuel supply agreement with any power company with capacity less than 78000 MW.[74]

For many such Generators who are standing in queue to attain a profitable position by way of an increment in the fuel costs, the Appropriate Commission has been given territorial jurisdictionary powers to adjudicate on matters and grant 'compensatory package', as a relief to them, and hence if the Commission allows such companies to hike the tariff, even with compensatory adjustment,, which sounds more economical, than similar upcoming situations.

3.2. Broader Issues miring 'Compensatory Tariff'

The Ministry of Coal shall amend the New Coal Distribution Policy (NCDP), while the Ministry of Power shall empower the Central Electricity Regulatory Commission (CERC) and State Electricity Regulatory Commissions (SERC) to permit the pass-through of imported coal costs.[75]The CERC is required to specify a detailed mechanism to allow such costs. It was further

[72]SASAN POWER*supra* n. 10; Supra n.59

[73]MERC, *Adani Power Maharashtra Limited &Ors.Vs. Maharashtra Electricity Distribution Company Limited*, Case No.140 of 2014, http://www.mercindia.org.in/pdf/Order%2058%2042/Order_Case%20140%20of%202014.pdf; MERC, *JSW Energy Limitedvs. Maharashtra Electricity Distribution Company Limited (MSEDCL)*,Case No.145 of 2014, http://www.mercindia.org.in/pdf/Order%2058%2042/Order_2014.pdf

[74]*Id*. at ¶3.2.

[75] PRS Legislative Research, *CCEA Permits Pass-Through of Imported Coal Cost by Power Plants*, MONTHLY POLICY REVIEW (2013), http://www.prsindia.org/administrator/uploads/general/1372826755~~June%202013%20-%20MPR.pdf

determined that the said policy will also apply for coal imports through Coal India as well as imports undertaken by power plants themselves.[76]

The pass-through mechanism would allow the generators to raise tariffs exponentially higher for power plants set-up post March 31, 2009[77]. The government aims to supply coal to power projects which currently lack coal linkages in order to compensate for the loss suffered on account of importation of fuel costs.

According to Central Electricity Regulatory Commission (CERC), the rising costs of coal from Indonesia (the biggest exporter of coal to India), acts as a 'force majeure' event allowing compensatory tariff to be provided. The Committee appointed by the Commission, to analyse and adopt a methodology in order to compensate the Companies, had highlighted various key points and recommendations to be accepted by both, the Generators and the Procurers. The Committee examined the financial status of the Petitoner Company (Adani Power Limited), also analysed the financial condition separately for Phase-III and IV of the Company with reference to the Capital cost, where the Committee has followed a consultative approach, wherein the Compensatory Tariff, determined should be variable in nature and commensurate with the hardship caused to the Procurers.[78]

3.3. Grant of Compensatory Tariff 'Harsh' on Distribution Companies

The oft mundane practice by the Commission of granting partial reliefs to Generators in the form of '*compensatory tariffs*', as previously observed in a platoon of petitions filed by various power companies, has off late caused tremendous financial losses to the Distribution sector, affecting the financial viability of the power project, by the '*unprecedented*' hike in the tariff pre-determined by the generator and the procurer in accordance with the clauses of the Power Purchasing Agreement(PPA). For the distribution utilities in various States, getting affected by the grant of compensatory tariff would lead to rise in retail tariffs.

As per Icra estimates, average increase in tariff on account of supplies from Coastal Gujarat Power alone to utilities in the five states of Gujarat, Haryana, Maharashtra, Punjab and Rajasthan is estimated in the range of 0.4% to 1.8% (3 to 10 paise/unit) while in the case of supply by

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[76] *Id.*

[77] Ministry of Power, *Impact on Tariff in the Concluded PPA's Due to Shortage in Domestic Coal Availability and Consequent Charges in NCDP(New Coal Development Policy)*, http://powermin.nic.in/upload/pdf/Impact_on_tariff_in_the_conclude_PPAs.pdf

[78] *supra* at n.10

Adani Power alone, the average tariff for the utilities is estimated to increase by average 1.7% (7-10 paise/unit) in Gujarat and Haryana.[79]

Both Tata and Adani operate power plants in Mundra, Gujarat had entered into PPAs with the State Discoms(Gujarat, Maharasthra, Punjab, Haryana and Rajasthan). The CERC had set up a panel or Committee comprising of various experts to finalise details for the compensatory tariffs. The panel, with representation from State Discoms, had examined the impact of price escalation in Indonesia before deciding an appropriate hike.[80] However, the report submitted, suggested that the state governments are going to challenge the ruling, allowing the power companies a lump sum amount of compensation in the form of a hiked tariff.

Income from operations for the quarter and nine months ended on 31stDecember, 2014, included a compensatory tariff of Rs.259.27 Crores and Rs. 670.43 Crores, respectively and Rs. 1843.12 Crores for the year ended 31st March, 2014 with respect to 1000MW Power Purchase Agreement with Gujarat UrjaVikas Nigam Limited.[81]

The Appellate Tribunal for Electricity (APTEL), in response to the appeals[82] filed by Gujarat UrjaVikas Nigam Limited (GUVNL) and the Haryana Discoms against the orders passed by the Central Electricity Regulatory Commission(CERC), dated 21st February, 2014[83] granting compensatory tariff (‘CT’) with effect from Scheduled Commercial Operational Dates (‘SCOD’) with respect to the Power Purchasing Agreements entered in force between the parties, passed an interim order dated 21st July, 2014 allowing the Compensatory Tariff to be paid in effect from March, 2014 and staying payment of the Compensatory Tariff of earlier periods, pending disposal of the appeal. Subsequently, in response to an appeal in the Honorable Supreme Court, by the Haryana Discoms seeking stay for payments of compensatory tariffs pursuant to the aforesaid interim order, the Court vide order dated 25th August, 2014, has in view of a statement made by Company’s counsel that the Company would accept the payment in terms of the PPA’s

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[79]Dhwani Pandya, *Tata Power’s Mundra Project to Partially Benefit from CERC Tariff Hike*, (Feb. 26th, 2014), DNA TIMES, http://www.dnaindia.com/money/report-tata-power-s-mundra-project-to-partially-benefit-from-cerc-tariff-hike-1965117

[80] PRS Legislative Research, *The CERC Permits the Power Tariff Hike*, MONTHLY POLICY REVIEW, (April, 2013), http://www.prsindia.org/administrator/uploads/general/1372827833_April%202013-%20Monthly%20Policy%20Review.pdf

[81] Adani Power, *Unaudited Financial Results for the Quarter*,http://www.adanipower.com/Common/Uploads/FinanceTemplate/2_FFReport_APL%20Results%20Q3.pdf

[82]*supra* n. 10 at I.A. No.343 of 2014 IN APPEAL NO.98 OF 2014, http://aptel.gov.in/judgements/IA%20No.343%20of%202014%20IN%20APPEAL%20No.98%20of%202014.pdf

[83]*supra* at Petition No. 155/MP/2012, http://www.cercind.gov.in/2014/orders/SO155N.pdf

without prejudice to its claim since the compensatory tariff related issue is already being heard by the APTEL, would render the previous orders of CERC and the APTEL inoperative and directed the APTEL to dispose the appeals expeditiously.[84]

One of the contentions made by the Distribution Companies was that 'Merely because, the performance of a contract resultsin losses or become onerous, it cannot be the ground to ignore the contractual obligation', that the financial difficulties or the contract becomes onerous is no ground to avoid the contractual obligations, stipulated under the Power Purchasing Agreement (PPA).[85]

It is however considered deliberately by the Forum of Regulators (FOR) which does not agree with the proposition that a one time "blanket" shift from Section 63 to Section 62 should be allowed to all competitively bid power projects.[86] The Appropriate Commission takes a considered view based on the facts of each case and after duly considering provisions of the Act, PPAs, etc; which is a glaring example of forced hardship on the shoulders of the Distributors and related power sector consumers, with special reference to the Steel Industry.

The Central Electricity Regulatory Commission (CERC) had commissioned a committee, comprising of various Distribution Companies who redressed their grievances, wherein a few companies agreed to the grant of 'compensatory tariff order' to the Generators (Companies), although Punjab State Power Corporation Limited (PSPCL) was identified a little dissatisfied with the order per se. The Company has submitted that if the recommendations made in the Committee Report[87] are accepted, it would result in reopening of all the executed PPAs signed by other generators and would be against the basic principle that the sanctity of the bidding process needs to be maintained.[88]

An official from Business Standard analyzed that the'States are approaching the Appellate Tribunal on a major issue regarding obstructing sanctity of the power purchase agreement signed by them for a period of 25 years (the usual validity of any ordinary Power Purchasing Agreement). The CERC had come out with a concept of 'compensatory tariff' to provide relief to

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[84]*supra* n.76 at ¶6(a)
[85]*supra* n. 10
[86] Business Session III, *Agenda Item No.6: Reference from Ministry of Power (MOP) − Regulated Tariff vs. Competitive Tariff− Presentation Made by the Association of Power Producers (APP) to Forum of Regulators (FOR)*, http://www.forumofregulators.gov.in/Data/Meetings/Minutes/45.pdf
[87]*supra* n.9
[88] APTEL, *Coastal Gujarat Power Limited vs. Gujarat UrjaVikas Nigam Limited &Ors.*, Petition No.159/MP/2012, ¶14

Tata Power, although the order shall provide relief to Tata Power, but the financial condition of utilities will further deteriorate.[89]

It is observed in many such orders and petitions filed by many Distribution Companies, expressing their dissatisfaction towards the coerced payment in lump sum to the generators, just as it was witnessed and incinerated

Punjab State Power Corporation Ltd (PSPCL) has petitioned in Appellate Tribunal for Electricity (APTEL) challenging Electricity regulator (CERC's) order, granting 'compensatory tariff' to two Mundra projects of Tata Power and Adani Power. Punjab in its petition, with the APTEL, said that the Central Electricity Regulatory Commission (CERC) 'erred' on various grounds while deciding on the compensatory tariff for the two power companies.[90]

3.4. Compensation in '*Moratorium*'

Prior to decisions rendered by the Appellate Tribunal and the Commission that allowed Tata Power Limited and Adani Power to charge compensatory tariff from various procurers with whom they have signed Power Purchasing Agreements. The Appellate Tribunal on July 21st, 2014, allowed Tata Power and Adani Power to recover power dues from March 2013 on account of rise in imported fuel cost.[91]

However, the ruling would provide a cushion to the companies against escalation in cost of imported coal for the plant, as rendered posthumously by the Tribunal, as to the extent of passing the decision to the detriment of the Distribution Companies, as many of the companies, broadly categorized under the umbrella definition of ' Affected Consumers'.

According to an estimate, pre-March, 2013 dues for Tata Power's 4,000 megawatt Mundra Plant in Gujarat stand at Rs 330 crore, while the same for Adani's 1,980-MW Mundra project in Gujarat is Rs 830 crore. While post March 2013, Tata Mundra UMPP will be awarded compensatory tariff at 52 paise per unit, which will fetch the company Rs 25,000 crore over the

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[89]Ravinder Nagar, *Energy Infrastructure: 5 States to appeal the ATE against CERC incentive for Adani and Tata Power*, ENERGY INFRASTRUCTURE, (March 20th, 2014), http://energyinfraprofessionals.blogspot.in/2014_03_01_archive.html

[90] Observer Research Foundation, *PSPCL Petitions APTEL About CERC's Compensatory Tariff Order*, 10 ENERGY 44

[91] PTI, *Discoms to Challenge APTEL Order on Adani Power, Tata Power*, THE ECONOMIC TIMES (July, 2014), http://articles.economictimes.indiatimes.com/2014-07-27/news/52089019_1_compensatory-tariff-adani-power-central-electricity-regulatory-commission

remaining life of the plant[92] to the insignificant financial and corporate commercial losses incurred by the Discoms.

In the case of Adani's Mundra project, the power company will receive compensatory tariff at 41 paise per unit, more than ascertained in the contract, a move that will fetch the companyRs 18,500 crore over the remaining life of the project, over and above the tariff estimated in the project.[93]These firms had sought relief on account of adverse impact of the 'unforeseen', 'uncontrollable' and 'unprecedented' escalation in the imported coal price, while still in various petitions, IndiaBulls claims compensatory tariff, under 'zero price escalation'.

In April last year, Central Electricity Regulatory Commission (CERC) said in its orders that Adani Power should be granted compensation packages for their projects.[94]

As per the Order, 2012, the Commission asked the states which buy electricity from Tata Power's Mundra plant to form an expert panel to decide on compensating the firm for higher cost of coal imports from Indonesia, characterizing the naïve, and discriminative act of granting orders to the Discoms to pay a heavy amount, and equally hike the tariff over and above the charge stipulated under the Power Purchasing Agreement, since the Commission has ordered tariff relief only on account of change in Indonesian coal pricing Rules and Regulations& shortfall in domestic coal supply from Coal India (CIL)under the Fuel Supply Agreement (FSA)linked by APL for Mundra-III (PPA with Haryana Discoms).

It hereby becomes a point of disappointment to accept the order, since the CERC has not gone into the merits of the case, and has not considered the under-recovery of fixed costs, mentioned in the Deepak Parekh Committee report, constituted by the Commission, deeming it to be beyond the scope of the Committee's mandate. Also, it is hereby contended that the compensation for 'change in law' should be outrightlyexcluded, while the Commission asks the Haryana Discoms to settle the matter in terms of the Power Purchasing Agreement.[95]

It is hereby observed that the inordinate delay in passing stay on the orders by the Honorable Supreme Court could have a negative impact on the companies earnings, as against the power

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[92]*Id.*
[93]*supra* n. 10
[94]*supra* n. 76
[95] NOMURA, *CERC Quantifies Tariff Relief in Mundra PPA's: Key Aspects of Compensatory Tariff Awarded*, (February 24th, 2014), http://breport.myiris.com/NFASIPL/ADAPOWER_20140224.pdf

plant which depends entirely on imported coal, which turned unviable following a change in Indonesian laws in 2011 that made coal imports from the country expensive.[96]

In the midst of the speculations of the orders passed by the APTEL and the CERC, a few Distribution companies have accepted the order, without protesting the same before any other regulator or Court of law. As per the Committee Report submitted by the adhoc-panel constituted by the Commission which further commented that, "These tariffs still remain within the range of 25-50 per cent of merit order dispatch for all the Discoms. Thus, Discoms stand to gain even after compensatory tariff hikes as most of recent Case-1 and Case-2 bids are being clinched at higher tariffs Rs. 4.5-5 per unit."[97]

The Appellate Tribunal has also rejected return on equity (RoE) on inflated equity of Punjab State Power Corporation Ltd (PSPCL) and Punjab State Transmission Corporation Ltd. (PSTCL) and has directed the Punjab State Electricity Regulatory Commission (PSERC) to re-determine the Rate on Equity and the excess amount allowed to the PSPCL with carrying cost shall be adjusted in the next Annual revenue requirement (ARR).[98]The claim in this petition was to increase the rate of return of equity (ROE) causing increased distress to the Distributors on account of increased tariff.

Aggrieved by the CERC Orders, other Discoms like the Rajasthan Corporation Limited have now filed a composite petition along with other Discoms before the CERC, where many they have compositely claimed that the Commission had'erred' in considering the 'reduced price' considered by Tata Power during bid, though there was no firmed up coal supply agreement for supply at the discounted price.[99]

It has now considered as a recommendation for devising a new model bid documents by the government to allow for fuel price pass-through, albeit incompletely in terms of importing coal. It is under intense speculation, although, even if the fuel prices are for a consideration fully

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[96]MaulikTewari,, *Uncertainity in Tariff Hike Haunts Power Stocks*, THE HINDU BUSINESS LINE (Aug. 26th, 2014), http://www.thehindubusinessline.com/companies/uncertainty-in-tariff-hike-haunts-power-stocks/article6353494.ece

[97] PTI, *CERC Won't Burden Discoms Consumers: Care*, THE HINDU (Mar. 16th, 2014), http://www.thehindu.com/business/Industry/cerc-compensatory-tariff-wont-burden-discoms-consumers-care/article5791702.ece

[98] APTEL, *M/s Mawana Sugars Ltd. vs. Punjab State Electricity Regulatory Commission*, Appeal Nos. 142 of 2013 & 168 of 2013,http://aptel.gov.in/judgements/Appeal%20Nos.%20142%20of%202013%20&%20168%20of%202013_17.12.2014.pdf

[99] Agency, *Rajasthan moves APTEL against CERC's order for Adani and Tata*, KSEB OFFICERS' ASSOCIATION (April 8th, 2014), http://www.kseboa.org/news/rajasthan-moves-aptel-against-cercs-order-for-adani-and-tata-08043239.html

passed on to the customers, it hardly changes events *in situ*, given that every cost input into a power supply contract is now up for renegotiation, as witnessed in the ongoing cases filed by the power producers and the aggrieved distributors; albeit going by the current crop of cases pending in various regulators across the country.

This by far gives little incentive to States to issue competitive bids to procure electricity at all under the given rules and regulations, governing determination of tariff. Apart from these, there are other basic issues. It is justified on account of the financial and constructive losses which the Distributors have suffered on account of the payment imposed upon them by the regulator in order to curb the demand-supply situation, as even observed in the current budget for the year (01st April, 2014-31st March, 2015). For long, and often justifiably so, Industry has criticised government for violating the sanctity of contracts, maintaining as the base argument.

4. The Legal Analysis of the Power Purchasing Agreement

The doctrine of *Pacta Sund Servanda*[100], governing the principle of every agreement, is closely associated around the necessity of assuring the parties, privy to the contract that reliable promises are made; and that any miniature defaults made by either party are precisely evaluated and addressed during adjudication of contractual disputes. In the International spectrum, this doctrine is best practiced, and is applied strictly with very few permissible exceptions; and in exceptional cases of public contracts, additional theories of '*exceptionalism*'operate in order to protect public interest or vitiate any act, which is against public policy even in case of omissions by public officials vis-à-vis important requirements of public procurement policy.

India, on the contrary has off late witnessed certain Tariff Orders passed by its premier or apex regulator in the power sector, where the '*common but differentiated principle*' of *PactaSuntServanda*doctrine was conveniently derogated from, potentially resulting in misallocation of risk and liability, unnecessarily taxing the Independent Power Producers (IPP's), burning their heavy pockets. Likewise there have been many such instances of procedural and substantive deviations passed by the Indian regulator, either expressly or impliedly concluding with suggestions for restoring the balance in public contracts, with a view

[100]Latin for "agreements must be kept"

to assure the sanctity of contractual promises made in public domains within the bounds of the contract.

"Exceptionalism" is a key defining construct of the legal framework for government procurement in the United States—one that recognizes a special status for the State in its public contracting activities by reducing the obligations or expanding the power of the US Government as a contracting party, as compared to purely private contracts.[101]To this extent that the *State* is also a custodian of public interest and rights of the individual; the *exceptionalism*doctrine therefore impliedly recognizes and confers a special status that safeguards cumulative public interest of US citizens as well. Relevant instances in this regard are special constitutional rights of the State not to be sued without its consent or without express waiver of its immunity[102] in the US, with the logical outcome that the contractors, regulators and courts of legislature can go only to a certain extent and no further, while claiming relief or while passing illegitimate orders against the State. On a similar contention, the US Government cannot be enjoined from further unauthorised use of third-party intellectual property rights, or be subjected to enhanced damages for their willful infringement during the performance of a government contract[103], thereby granting adequate primacy to the statutory rights of US citizens to uninterruptedly avail public goods and services over competing claims for third-party IPR protection.

There has been yet another instance of '*exceptionalism*'favouring the over-powered public interest in the US is the "Christian" doctrine[104], which permits the incorporation by operation of law, of mandatory contract clauses that express a significant or deeply ingrained strand of US public procurement policy, if procurement policies are beingavoided or evaded,[105] either deliberately or negligently, by lesser officials.

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[101]For an exceptionally insightful analysis of the doctrine of exceptionalism; *Seegenerally*, J.I. Schwartz, *The Centrality of Military Procurement: Explaining the Exceptionalist Character of United States Federal Public Procurement Law*, http://scholarship.law.gwu.edu/cgi/viewcontent.cgi?article=2024&context=faculty_publications

[102]For details, *see generally*, V.C. Jackson, *Suing the Federal Government: Sovereignty, Immunity and Judicial Independence*, http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=1111&context=facpub;*Seealso*, Porter R., *Contract Claims Against the Federal Government: Sovereign Immunity and Contractual Remedies*, http://www.law.harvard.edu/faculty/hjackson/ContractClaims_22.pdf

[103]*Seee.g.*W.C. Bergmann, and A. Bukola, ,*Intellectual Property Rights in Government Contracts*, http://www.bakerlaw.com/files/Uploads/Documents/News/Articles/INTELLECTUAL%20PROPERTY/Andrews_Litigation_Reporter_Bergmann_Aina_7-2009.pdf.

[104]Cohen Seglias,*Christian Doctrine*, http://www.cohenseglias.com/federal-contracting-database/christiandoctrine.

[105] Sandeep Verma, *Regulatory Exceptionalism to PactaSuntServanda during Performance of Public Contratcs in India*, (May 06th,2014)

In a number of other instances, it has been observed keenly that application to incorporate less fundamental or significant mandatory clauses if they were not written to benefit or protect or provide any incentive to the party seeking the incorporation. Thus, even if any public procurement agreement or contract in the US fails to specifically provide for any mandatory or exclusively focused oriented clause, either because of omission by or of officials, the clause can be "*read into*" such a contract if it represents a significant or deeply ingrained strata of US public procurement policy.

Simultaneously, certain evolving legal developments in the EU seem to indicate an even harsher type of the *Christian* doctrine, where for the first time in 2004, the Regional Court of Munich stated an exception from the dogma that there could not be any detraction of concluded public procurement contracts because of an infringement of (European) Public Procurement Law[106]. The Court essentially held that under special circumstances, there could be a right for a public authority to terminate a contract as *ultima ratio* (a means of last resort) where there was an infringement of EU procurement law.[107]

India, on the other hand, presents a lop-sided vigour, stacking large number of cases where the State is usually at the receiving end, with little recognition of the underlying public policy implications of such adversarial pronouncements and adjudication that causes undue financial hardship and burden the Discoms and associated consumers, leading to a substantive rise in the litigation costs of the Power Producers; filing injunctions against the State and against the public utilities amount to, *per se*, undue financial hardship and injunctions against the citizens who are the ultimate consumers of relevant and conceivable public good and service. Whilst, realistically, the negotiating authority of citizen stakeholders is too submissive to effectively match strong litigation resources available with private parties making claims against the State or against state public utilities; and it therefore stands to reason that public for a tasked with adjudicating upon disputes involving such stakeholders may need to exercise some basic degree of caution and due diligence in the interest of meaningful and fair resolution of disputes relating to public contracts.

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[106]E. Marschner, *Contract and Adaptation of Contracts in the European Public Procurement Law—A Comparative Study on the German and English Law of Public Procurement*, http://www.nottingham.ac.uk/pprg/documentsarchive/phdconference2007/contractandadaptationofcontractsintheeuropeanpublicprocurementlawerikmarschner.pdf

[107]*Id.* at ¶ 56

4.1. Appreciation of the Orders of the Commission

India recently witnessed two such orders[108] by the Central Electricity Regulatory Commission (CERC)[109]—India's premier electricity regulator—that passed on added costs and unnecessary expense to the shoulders of the public utilities engaged in procuring power from certain private or power producing companies, and thereby in effect, added frivolous costs to the prospective consumers, arising out of certain additional fuelcosts; the risks under contract were required to be borne exclusively by the electricity producers, signing the Fuel Supply Agreement (FSA) with the Indonesian entitites.

In effect, these orders confirmed and considerably expanded the interim orders, increasing the litigation expenses at the behest of the Discoms and the Producers that were issued in this regardin 2013. The dispute before the regulator was related to the unprecedented hike in electricity tariffs that were the result of a fixed-price contract substantially, if power tariffs had been more proportionate to changing dynamics in coal markets.[110]

With the current key tariff regulations beginning to change, as settled by a competitive bidding process in accordance with the provisions of the Electricity Act, 2003; and certain electricity producers subsequently claimed higher tariffs ostensibly attributable to an, unforeseen, unavoidable change in circumstances governing the existing law due to a postaward coal pricing regulations by the Indonesian Government. The regulator has finally allowed claims for *compensatory tariffs* outside the contractual framework, and in the course, making Indian electricity consumers pay more for public and private welfare in Indonesia[111], against the potential risks that were to be primarily borne by electricity producers themselves.

While this leaves virtually no incentive for mitigation of input costs for electricity producers, a better problematic ramification amongst these orders is the resultant disruption of the sanctity of a competitive contracting process or the existent Power Purchasing Agreement (PPA), that has virtually frustrated the consideration and the object behind such a commercial transaction, other

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[108]*Coastal Gujarat Power Ltd. Vs. Gujarat Urja Vikas Nigam Ltd. & Others* (Petition No. 159/MP/2012), http://www.cercind.gov.in/2014/orders/SO159.pdf.; *See also*, *Adani Power Ltd. Vs. Uttar Haryana Bijli Vidyut Nigam Ltd. &Others* (Petition No. 155/MP/2012, February 22, 2014), http://www.cercind.gov.in/2014/orders/SO155N.pdf.

[109] CERC, *About Us*, www.cercind.gov.in

[110]*supra* n. 13

[111]N. Gulzar, *Moral Hazard from CERC Ruling is a Reflection of India's Corporate Culture*, http://gulzar05.blogspot.in/2013/04/moralhazard-from-cerc-ruling-is.html.

than disruption of the sanctity of contracts[112] caused by these regulatory interventions. Despite, clear evidences before the regulator that *force majeure* or *change of law* clauses in the contracts did not apply to the benefit of the companies in the instant case; and the constant risk of input costs fluctuation were consciously borne by them while entering into these contracts, such a decision was rendered uninterrupted.

Given the significant cost implications on public utilities and electricity consumers, the CERC orders have generated considerable public attention and debate in India.[113]

Hence it is pertinent to explore some of the important legal complications that could both logically and legally emanate from various procedural and substantive aspects of the CERC orders. A substantive legal analysis is particularly important in light of the minority opinion[114] expressed during the initial interim orders of the CERC, where one dissenting member had noted adverse implications of excessive regulatory intervention on contractual disputes between electricity producers and procurers. Though, the issues raised in the dissenting opinion at the time of the interim orders, were important from public policy perspective, remain unaddressed even at the time when final orders were issued by the CERC in the past two years.

4.2. Regulation vs. Dispute-Handling

The CERC has the authority under Section 79(1)(b)[115] of the Electricity Act2003, to regulate tariffs for the Companies engaged in Generation of Electricity other than those owned or controlled by the Central Government as specified in Section 79(1)(a)[116], if such generating companies enter into or otherwise have a composite scheme for generation and sale of electricity in more than one State. However, the CERC's jurisdiction to handle disputes regarding tariffs is

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[112]U. Varottil, *CERC Order in the Adani Power Case*, http://indiacorplaw.blogspot.in/2013/04/cerc-orderinadani-power-case.html

[113]*Seee.g.*, *State Utilities Upset by Recent CERC Orders in Favour of Adani Power and Tata Power*, THE ECONOMIC TIMES (March 3, 2014), http://articles.economictimes.indiatimes.com/2014-03-03/news/47859291_1_new-tariff-norms-tariffregulations-private-power-producers; *Why CERC's compensation to Tata, Adani for high coal prices sets dangerous precedents and dentscompetition*, THE ECONOMIC TIMES (March 2, 2014), http://articles.economictimes.indiatimes.com/2014-03-02/news/47799790_1_central-electricity-regulatorycommission-tata-power-and-adani-high-coal-prices; *CERC Bails Out TataPower, States May Challenge Order*, MINT, (Feb. 22, 2014), http://www.livemint.com/Industry/PegcwBtILxHhBm5gbVyN5H/CERC-bails-out-Tata-Power-states-may-challengeorder.html

[114]*Coastal Guarat Power Ltd. Vs. Gujarat UrjaVikas Ltd. & Others* (Petition No. 159/MP/2012, April 15, 2013), http://www.cercind.gov.in/2013/orders/159_mp_2012.pdf.

[115] To regulate the tariff of generating companies 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;

[116]To regulate the tariff of generating companies owned or controlled by the Central Government;

set under its Section 79(1)(b) which is covered by Section 79(1)(e)[117] of the Electricity Act, which*mandatorily requires* the CERC to *refer such disputes to arbitration*; and the CERC canitself appoint an arbitrator[118] under certain circumstances if not provided under contract. These powers of the CERC to adjudicate can at best be delegated to members of the Commission itself[119]; and cannot be delegated any further[120].

The principle contained in the law implies, unarbitrariness of the CERC to adjudicate on matters to be referred statutorily to the appropriate authority, while adjudicating upon the contractual disputes, retaining itself to assume the role of an arbitrator; and that while adjudicating upon disputes, the CERC should maintain an arms-length distance at all times, while rendering decisions concomitantly in the interest of justice, equity and good conscience; keeping in minda fair play between competinginterests of producers, procurers and consumers.

In the instant case, while exercising its jurisdiction to adjudicate upon disputes with regard to tariff stipulated in the agreement, the CERC did not refer the dispute for arbitration as required by law, but implicitly *read* the power to adjudicate into disputes *within itsauthority to regulate tariffs*[121] under Section 79(1)(b) of the Electricity Act, even though the Act explicitly differentiates between *regulation of tariffs per se* and *adjudicationof disputes* by providing two *different sub-sections* for each of these legal actions.[122]

This seemingly procedural deviation in the CERC's orders is imperative in terms of its substantive implications, as under the Arbitration and Conciliation Act[123]1996, an arbitral tribunal has the authority, at the request of either party to a dispute, to order any party to take any interim measure of protection as the arbitral tribunal may consider necessary in respect of the subject matter of the dispute[124]. In addition, this Act also empowers a party to a dispute to make an application to a Court of competent jurisdiction for taking certain specific interim measures[125]in relation to contract performance during the course of arbitral proceedings.

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[117]To issue licenses to persons to function as transmission licensee and electricity trader with respect to their inter-State operations.

[118]§158 of the Electricity Act, 2003

[119]§143 of the Electricity Act, 2003

[120]§97 of the Electricity Act, 2003

[121]COASTAL GUJARAT POWER LTD.*supra* n.65; ADANI POWER LTD.*supra* n.59.

[122]§ 79(1)(f) of the Electricity Act, 2003

[123]*Act No. 26 of 1996*

[124]§17(1) of the Arbitration and Conciliation Act, 1996

[125]§9 of the Arbitration and Conciliation Act, 1996

Therefore, even if the contractual dispute had been indeed referred to by the CERC for arbitration as required by the statutory provision, the ability of either party to the disputeto request interim orders would not have been impaired at all. One of the problems witnessed in the CERC orders, is the jurisdictional error in assuming power for regulation of tariffs under Section 79(1)(b) corollary with powers of dispute handling under Section 79(1)(e), when the legal requirements for the two are procedurally and substantively different. Another problem is that the CERC, while adjudicating upon a contractual dispute between two parties, assumed *unto itself* the role of an arbitrator—something that Section 79(1)(e) of the Electricity Act clearly does not provide for. Thirdly, the CERC utilised the services of an 'ad-hoc committee' to assist it in resolving the dispute[126] rather than the arbitration methodology required under the Act.

In this process, the CERC has equally failed in maintaining an arms-length distance between the 'process of regulation of tariffs' and the 'process of resolution of contractual disputes',clearly envisaged under the Act. On an earlier occasion in the instant dispute, the Chairman of the CERC had expressed a clear preference for requiring resolution of contractual disputes by core processes of arbitration[127], rather than using tertiary authority of the regulator for mediating and influencing contractual risk and liability allocation between electricity producers and procurers.

4.3. Transparency and Consultation Requirements

Under Section 79(3)[128] of the Electricity Act, the CERC is compulsorily required to ensure transparency while exercising its powers and discharging all its functions, including regulation of tariffs and the process of adjudication of claims. It is for this reason primarily that the CERC regulations require an extensive process of publication of the proposed tariffs and is required to holdpublic consultations.

As a fundamental legal corollary principle, the transparency and consultation protocols and procedures that apply to original tariff determination, as per the Tariff Determination Policy Rules, need to apply equally to the process of post-award tariff re-negotiations, otherwise the

[126] *Committee Report for CERC: For Determination of Compensatory Tariff in the Matter of Coastal Gujarat Power Ltd*., http://www.cercind.gov.in/2013/Reports/COMREP_CGPL.pdf

[127] Rajiv Ranjan Singh, *AG Says CERC Can Alter Tariff. Will it?*,DAILY NEWS AND ANALYSIS(August 30, 2012), http://www.dnaindia.com/money/report-ag-says-cerc-can-alter-tariff-will-it-1734391.

[128] The Central Commission shall ensure transparency while exercising its powers and discharging its functions.

very purpose of embedding transparency and consultation as mandated by law can be easily frustrated by non-transparency during post-award renegotiation of contracts[129].

As discussed earlier, the CERC referred the dispute to an ad-hoc "expert" committee rather than an arbitrator as required by law; and this committee apparently conducted its deliberations with considerable amount of secrecy, without holding any public consultations or publishing a draft report and inviting comments thereon. Rather, the Committee thought fit to classify its report as "*Strictly Private andConfidential*", a classification that is in clear contradiction to the transparency principles laid down under Section 79(3) of the Electricity Act, although later on the Committee Report was published as a public document, easily accessible.

It is evident to observe that, if the Actexplicitely requires the Commission itself to observe transparency in exercising its powers and discharging its functions, then this principle of transparency *ipso facto* flows into the conduct of anybody that performs any functions deligated to it by the CERC, as otherwise the core transparency requirements imposed by law on the Commission can be simply whittled down by delegation of functions by the same.

On a deeper examination, it appears that the ad-hoc committee has deviated from the transparency requirements enshrined in the Electricity Act by: (i) not inviting public comments on the dispute referred to it by the CERC; (ii) by not publishing an interim report in the public domain asking for public comments thereon; and (iii) by classifying its report as "Strictly Private and Confidential", when instead the subjectmatter before the Committee warranted it to conduct public consultations, and its report to be readily available for public inputs or suggestions.

In the final orders, the Commission did not take note of the requirements of Section 79(3) that needed to be satisfied by itself, as well as by the ad-hoc committee functioning in pursuance of its directions, whereas, the submissions of merely one consumer organization and two consumers who proactively got themselves impleaded before the CERC were treated by the regulator as an

[129]As a matter of fact, some of these pro-public consultation arguments were specifically brought to the notice of the CERC but did not get requisite due attention, perhaps due to the public policy focus of Prayas' submissions instead of a legal and/ or regulatory focus. *See*, *for instance*, Prayas, *Prayas Submissions to CERC Regarding Petition for Tariff Revision Filed by Coastal Gujarat Power Ltd.(Mundra UMPP)*, http://www.prayaspune.org/peg/publications/item/239-prayas-submissions-to-cercregarding-petition-for-tariffrevision-filed-by-coastal-gujarat-power-ltd-mundra-umpp.html;*See also*, Rajiv Diwan,*CERC Suggested to HoldPublic Hearing on Tariff Issues*, MINT(August 27, 2013), http://www.livemint.com/Industry/9NOJM6JwuwPwAw2i2l0DFP/CERC-suggested-to-hold-public-hearing-on-tariffissues.html.

"adequate opportunity to interested parties", when Section 79(3) of the Electricity Act clearly required the CERC to involve consumers in a far more transparent and meaningful manner.

In this context, it may be important to note that the Act provides for a Central Advisory Committee (CAC) to advise the CERC on, inter alia: (i) major questions of policy; (ii) matters relating to continuity of services by licensees; and (iii) protection of consumer interest[130]. Even though all three elements listed above were attracted in the facts and circumstances of the case, the Appropriate Commission did not consider referring the matter to the Committtee for its advise at any stage of the regulators's interim or final orders on the dispute.

Thus, a critical legal paralysis has been created with this nudging development, which includes– lack of involvement of affected stakeholders in the process. Both electricity consumers and public stakeholders have rights originating from the Electricity Act, as well as from the Commission's own regulations, to be involved in the determination for an appropriate tariff (and as a natural corollary, in re-determination) of tariffs. While the original tariffs were set through an elaborate process of public consultations, the re-negotiation thereof has now been conducted without following an equally transparent and consultative process, merely by adopting a different phraseology of a "*compensation package*" for the re-negotiation exercise[131], which, de facto, amounts to tariff re-negotiation, which currently stands outside the purview of the Power Purchasing Agreement (PPA).

4.4. Doctrine of Impossibility and Frustation of Contracts

The Indian Contract Act[132],1872 exclusively contains abundant guidance on "Impossibility of performance" and "frustration" of contracts under Section 54[133] and 56[134] respectively. Under these provisions, contracts can be declared as 'void' by a party unable to perform its contractual obligations due to unforeseen circumstances only after claiming "impossibility of performance" or "frustration of contract", but *commercial hardship* or *difficulty* cannot be a ground for

[130]*supra* n.40
[131]*supra* n.9
[132]"Act No. 9 of 1872"
[133] "When a contract consists of reciprocal promises, such that one of them cannot be performed, or that its performance cannot be claimed till the other has been performed, and the promisor of the promise last mentioned fails to perform it, such promisor cannot claim the performance of the reciprocal promise, and must make compensation to the other party to the contract for any loss which such other party may sustain by the non-performance of the contract"
[134]"A contract to do an act which, after the contract is made, becomes impossible, or, by reason of some event which the Promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.

invoking such claims[135]. In fact, if the circumstances surrounding such a claim are such that, if any promising party would have known, upon due diligence, contract performance to be impossible in the first instance, then it is the promisors (in the instant case, the Power Producers) who would need to compensate the promisees (i.e. State Utilities or the Discoms)[136]and not vice-versa.

The Power Producers had claimed that their contracts be frustrated on account of the principle of 'Impossibility of the Contract', but it is unknown if there was any insistence by the Commission to require the claimants to comply with certain basic and preliminary requirements usually required for successful incitement of impossibility and frustration under the Indian Contract Act. This is particularly important, since Section 175 of the Electricity Act clearly establishes that the provisions of the Electricity Act, 2003 (and therefore, implicitly, the orders of the CERC) are *in addition to* and *not in derogation of*the provisions of *any other law in force*.

As a corollary rule, the regulatory or dispute handling authority should not be in derogation of the Indian Contract Act, 1872, laying down substantive and procedural requirements for claiming impossibility and or frustration of contracts. In fact, in the instant case, there were two ways in which Power Producers could have claimed impossibility and frustration: *firstly*, under their contracts with Indonesian suppliers before an appropriate forum[137] in order toavoid the burden of Indonesian regulations; and *secondly*, before an Indian arbitral or judicial forum[138], in respect of their contracts with Procurers, under the obligation of discharge of duties in the Power Purchasing Agreement (PPA).

It appears that Power Producers made no claims in respect of the effects of Indonesian regulations on their contracts with Indian purchasers before any of these regularized and recognized forums. It is also imperative that Section 63 of the Electricity Act requires the Central Commission to adopt the tariff, if such tariff has been determined through transparent process of bidding in accordance with the guidelines issued by the Central Government, which indeed is incidental to the instant case.

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[135]For an insightful discussion on impossibility of performance and frustration under the Indian Contract Act, including important case law"; *See*G. Sharma, *Impossibility of Performance and Frustration*, http://drgokuleshsharma.com/pdf/frustration.pdf.

[136]§56, *supra* n.85

[137]The particular forum as agreed under their cross-border contracts with Indonesian suppliers of coal.

[138] As applicable under relevant provisions of the *Electricity Act, 2003*read with the Arbitration and Conciliation Act, 1996

However, in effect, the Appropriate Commission has ended up re-determining the tariff it had adopted earlier, including changing the fundamental risk-allocation principles forming an essential part of the contractsconcluded under policies on competitive determination of tariff issued by the Central Government: an intervention that could be seen as an interference with Section 79(4)[139].

4.5. International Best Practices on Sanctity of Contracts

In international legal practice, *sanctity of contracts* and *reliability of promises* are typically considered to be basic principles of contractual relationships under the principle of *pactasuntservanda*that has evolved over time[140]. Over a period of time, in view of practical commercial experience, two limitations to this principle which have evolved are: (i) *clausula rebus sic stantibus*(contract contained an implied term that certain important circumstances remain unchanged); and (ii) *jus cogens*(compelling law).

Of these two competing principles, the former oneis of relevance to severe commercial hardship, and is often applied to contracts of such nature; whereas the latter *jus cogens*refers to certain fundamental, overriding principles of international law such as crimes against humanity and law of genocide from which no derogation is ever permitted.[141]

In United Kingdom, for instance, under the *clausula*principle, "frustration" can be invoked by an affected party to term a contract as 'void', where the change of circumstances makes the performance drastically dissimilar and ineffective from what was originally agreed upon in the contract, mutually.[142]"Frustration depends, at least in most cases, not on adding any implied term, but on the true construction of the terms which are in the contract and the relevant surrounding circumstances when the contract was made."[143]

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[139] In discharge of its functions, the Central Commission shall be guided by the National Electricity Policy, National Electricity Plan and tariff policy published under Section 3

[140] Y. Jiafeng, *A Study of Economic Hardship*, http://library.umac.mo/etheses/b24876458_toc.pdf "An excellent treatment of grounds forexemption from contractual duties"; *Seealso*, I. Kull, *About Grounds for Exemption from Performance under the Draft EstonianLaw of Obligations Act*, http://www.juridicainternational.eu/public/pdf/ji_2001_1_44.pdf

[141] Anthony D'Amato, *It's a Bird, It's a Plane, It's juscogens!*, Northwestern University School of Law Scholarly Commons, Faculty Working Papers, (2010), http://scholarlycommons.law.northwestern.edu/cgi/viewcontent.cgi?article=1060&context=facultyworkingpapers

[142] Ibrahim SaadAlhowaimil, *Frustation of Performance of Contracts: A Comparative and Analytical Study in Islamic Law and English Law*; *supra* n.56, ¶2

[143]Halsbury Laws of England, *Seventy-First Report of the Law Reform Committee of South Australia to the Attorney-General relating to the Doctrine of Frustration in the Law of Contrac*t(1983),

The American Courts have been slow to adopt the phraseology of the English Courts. The term 'Frustation' is not being found, or at least, not frequently found, in the language of the American Courts dealing with this phase of Contract Law.[144] In the United States, "impracticality" can be invoked as a defence for non-delivery, if performance has been made impracticable by the occurrence of a contingency, the non-occurrence of which was a basic assumption on which the contract as made[145]. This exception is therefore applied very narrowly in most legal jurisdictions; and dispute resolution forum typically require claimants to prove all of the following elements: (i) *lack of foreseeability and lack of risk-allocation*; (ii) *exploration ofalternative performance*; and (iii) *timely notice*.[146]

Public procurement law governing federal contracts in the United States is equally strict in its treatment of claims of exemption from non-performance due to impracticality of performance; and a contractor needs to clearly show: (i) that performance is *substantially more difficult or expensive* than foreseen by the parties at the time of entering into a contract; and (ii) that it has *notassumed the risk of this difficulty or risk either by agreement or by custom*.[147]

Under these narrow requirements, claims by contractors typically fail, for instance in the case of fixed-price contracts with conscious assumption of input cost risk, and where cost fluctuations are considered as normal, foreseeable risks in the ordinary course of business[148].

These principles are similar to that of Indian law, that require a change in circumstances and contingenciesthat have not been specifically addressed at the time of contract formation.

In contrast, a bland perusal of the orders passed by the Commission is a blunt display that the 'risks of input cost escalations' were consciously borne by the electricity producers at the time of entering into contracts with procurers, allowing the Commission of having an effect of overturning the cardinal principle of contracts in India, by granting benefits to a non-performing supplier on account of commercial hardship, and vitiating the doctrinal requirements of a valid

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https://law.adelaide.edu.au/research/law-reform-institute/documents/committee-reports/71-Doctrine-of-Frustration-in-the-Law-of-Contract.pdf

[144] D. Rudolph, Doctrine of Frustration as Applied to Contracts, 41 UNIVERSITY OF PENNSYLVANIA LAW REVIEW 85, 90

[145] *Id.*

[146] M. Augenblick & A.B. Rousseau, *Force Majeure in Tumultuous Times: Impracticality as The New Impossibility*,http://www.pillsburylaw.com/sitefiles/publications/bylinedarticleforcemajeureintumultuoustimesjournalofworldinvestmenttrade031312.pdf

[147] CIBINIC JR., NASH JR., R.C.& J.F. NAGLE, ADMINISTRATION OF GOVERNMENT CONTRACTS, 4 WOLTERS CLUWER 314-322

[148] *Id.*

contract–"impossibility" and "frustration", that are important elements whileempowering the sanctity, governed by the Indian Contract Act, 1872 as well as the principles of International Law.

These benefits have been extensively granted to the Power Producers in a non transparent manner and in an arbitrary fashion without fully taking into account the legal rights of consumers, Distribution Companies and other associated stakeholders. It is pertinent to note that in the interest of public policy, transparency and competition in the public contractual framework, oversight and regulatory guidance in India typically requires public authorities to ensure that, variation in terms and conditions of any contract should not be resorted to as a matter of routine. At the pre-contract stage, for instance, any variation in an Request for Proposal(RFP) needs to be notified to all potential bidders, giving them adequate time and opportunity to comment on such changes, or to file revised bids.

Insofar, as the post-award changes in the public contracts are concerned, the Central Vigilance Commission[149](CVC) guidance on contract administration[150] issued in 2002 specifically requiring that any relaxation in contract terms should be severely discouraged after conclusion of a contract, and in exceptional cases where modifications are considered absolutely essential, the same can be allowed only after taking into account corresponding financial implications.

4.6. Implications of Forum Shopping

The orders passed by the Appropriate Commissionshowcase severe public interest implications of unbridled forum shopping, arising out of the failure to require exhaustion of alternate remedies by claimant parties. In the firstinstant, the *impossibility* effects of Indonesian regulations should have been agitated by the power producers before an appropriate forum under their contracts with the Indonesian suppliers of coal–something that was apparently erred while approaching the correct forum. The case clearly required the aggrieved power producers to agitate their dispute before an Indian Arbitral forum, both under the dispute-handling provisions of the Electricity Act, 2003 as well as under the specific contractual arrangements governed by provisions of the Indian Contract Act, 1872 and the Arbitration and Conciliation Act, 1996.

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[149]Central Vigilance Commission, *About Us*, www.cvc.nic.in

[150]Central Vigilance Commission, *Common Irregularities/ Lapses Observed in Award and Execution of Electrical, Mechanical and Other Allied Contracts and Guidelines for Improvement Thereof*, http://cvc.nic.in/COMMON%20IRREGULARITIES.pdf.

In the instant case, the dispute was handled directly by the Commission (CERC) itself, assuming and exercising over-jurisdictional powers and authority without invoking an arms-length arbitration process.

If at all the dispute was to be referred to a committee rather than the arbitrator, a proper course of action was statutorily required to be followed in due process by the Commission to refer it to the CAC rather than an ad-hoc committee as has happened in the instant case which could have fetched better legal resources with the committee members.[151]

A glaring example of potential forum shopping in this case is that of a power producer separately filing a petition in April 2013[152] before one of the state regulators—the Rajasthan Electricity Regulatory Commission (RERC), requesting essentially, identical reliefs as had been sought from the Commission in a number of other potential occasions. This was followed by an interlocutory application (IA), within a fortnight of the main petition, asking the RERC to allow an ad-interim pass-through of imported coal costs. Strangely, the State Utilities failed to bring these important developments to the notice of the ad-hoc committee as well as the CERC: that similar relief had been claimed by manyCompanies from the State Regulator, or that the IA had beenrejected by the State Regulator; thus resulting in a situation where the Commission's orders have remained oblivious and uninformed of these important legal developments.

5. Mining and Development in Indonesia: An Overview of the Regulatory Framework and Policies

Over the past four decades the International coal market has been ranged, bound and stable in terms of price and availability. Internationally, the required coal commitments are typically for short term i.e. less than5 years for supply and less than 1 year for price. In order directly establish a close nexus with the major exporting countries; the most suitable sources for India's requirements include countries like Indonesia, Australia, and South Africa. However, over the

[151] Even though the ad-hoc "expert" committee utilized the services of a legal consultant, it is clear from a bare reading of various legal defects in the dispute-handling process outlined that this committee remained bereft of proper legal advise on risk-allocation principles under the Indian Contract Act, 1872.

[152] *Adani Rajasthan Power Limited vs. Jaipur Vidyut Vitaran Nigam Ltd. & Others* (Petition No. RERC-392/13, (January 30, 2014), http://rerc.rajasthan.gov.in/Orders/Order216.pdf

years, ‘Indonesia has emerged as the preferred choice for Indian developers, with almost 50% of tie-up being from Indonesia due to advantages in logistics and mining costs.’[153]

On account of the economic and commercial hardship, in particular ‘the non-availability of domestic coal linkage, the Indian Power Companies started importing thermal coal from Indonesia, as mentioned earlier due to the existing wide gap between the import and export of thermal coal. Power Companies like Adani and Tata Power are required and are equally obliged to import coal from Indonesia to meet the requirement under the contractual obligations of the Power Purchasing Agreement (PPA) for supply of power to the third parties, the Distribution Companies, thereof.

To meet the coal requirement, the power companies enter into several Coal Supply Agreements with the holding company of supply of imported coal from Indonesia which were later merged into the Consolidated Supply Agreement; in the Petition No.155/MP/2012, before the Central Electricity Regulatory Commission (CERC), the consolidated supply agreements existing between the parties provided for a supply of 10MMT of coal per annum for use in Phase I to Phase IV of the Mundra Power Project at CIF USD 36/MT for a period of 15 years from the Scheduled Commercial Operation Date of last Unit of Phase IV of the project.[154]

A sudden procedural change in Indonesia, led to a humongous breakdown of the energy market in the country for an interim period, leading to increased cost of import, and incessant and unnecessary litigation expenses at the cost of the exchequer, leaving with colossal losses due to the recent pronouncement by the Minister of Energy and Mineral Resources, Republic of Indonesia promulgated “Regulation of Ministry of Energy and Mineral Resources No.17 of 2010” (hereinafter referred to as 'Indonesian Regulations')[155] which recognized the direct sale contract (spot) and term sale contract (long term) which had been signed by the holders of mining permits and special mining permits and further provided that the existing direct sale contracts and term sales contracts would adjust to the regulations within a period not later than 6 months and 12 months respectively.[156]

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[153] Tata Power, *International Coal Prices - A Challenge for Mundra*, http://www.tatapower.com/cgpl-mundra/pdf/umpp-greener-future121015.pdf

[154] *supra* n. 10

[155] Ministry of Coal & Coal Reserves, *Regulation of Director General of Minerals and Coal No:644.K/30/djb/2013* ; *Regarding Amendment to Regulation of Directorate General of Minerals and Coal Number 999.k/30/djb/2011*; *Regarding Procedure for Determining the Amount of Adjustment Costs to Benchmark Coal Prices*, ¶4

[156] *supra* n. 149

The Regulatory framework for Mineral and Coal, is enshrined under Article 33 of the Indonesia's 1945 Constitution, while the law governing the Mineral and Coal mining is the 'Law No.04/2009 Regarding Coal and Mining'. Under the umbrella law, consists various Regulations, such as−Government Regulation No.22/2010 Regarding Mining Zone, Government Regulation No.23/2010 Regarding Mineral and Coal Enterprises Activity revised by Government Regulation No.24/2012, Government Regulation No.55/2010 Regarding Supervising and Controlling Mining Activity, Government Regulation No.78/2010 Regarding Reclamation and Post Mining.[157]

This regulation provides that mineral and coal producers are obliged to sell minerals and coal based on a regulated benchmark price, while determining the amount of adjustment costs to Coal Benchmark Prices[158]whether for domestic or export sales. The benchmark pricing obligation applies to all minerals and coal sales to third parties, including any affiliate of the mineral and coal producer (which includes any party that has direct ownership in the holder of a Production Operation International Usability Partners or a Production Operation IUPK as well as any party that may indirectly influence the decision making of such holders).[159]

The Indian power developers have recently caught themselves into a web of litigations, due to the sudden change in the legislation, and have subsequently sought government intervention as a new law in Indonesia, the largest coal supplier, making imports economically and technically unviable. The situation has got worsen for India, whileIndonesia displays its dominating, political pressure towards the other exporting nations, denying them to sell coal at prices below notified range.

Australia issued a draft mining law 10 days ago to impose levy on coal and iron ore projects from next year. Association of Power Producers, a group of 13 private companies, has asked power ministry to set up an expert committee to find appropriate solution to tackle rise in imported rates.[160] The body representing companies like Tata Power, Reliance Power, Adani Power, LancoInfratech and Essar Power, has also demanded that change in fuel cost be allowed to be passed on to the consumers as tariff hike or reduction.

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[157] Ministry of Coal and Coal Reserves, *Coal Policy and the New Mining Law no. 4/2009 in Indonesia ministry*, http://www.jcoal.or.jp/coaldb/shiryo/material/2012day1_session1_4.pdf

[158] *supra* n.150, Article.1

[159] *supra*, n.148

[160] S. Ramamurthy, *Indonesia Law to Upset Coal Price Equation*, http://articles.economictimes.indiatimes.com/2011-06-22/news/29689883_1_coal-prices-coal-imports-coal-india

Indonesia is simultaneously considering 'imposition of export duty' on coal and minerals by imposingfurther restrictions on low-grade coal exports in the future. South Africa is also considering restrictions on coal export to preserve coal for domestic use. Australia has imposed a green tax on coal exports in the process boosting international coal prices.[161]Ironically, India's need for coal to fire its growing thermal power sector has also driven up coal prices in Australia and Indonesia, the principal sources of imported coal for the country. The demand from China has further added to the impact on the global prices.These changes have made the coal market highly volatile for many power producers currently the wrath of litigation. Tata Power for Mundra UMPP had contracted coal from Indonesia on terms that were reflected in bid tariffs.[162] Tata Power had tied up the coal for its various projects including Mundra from the Indonesian mines. This contract was at a steep discount to the prevailing market prices. The Company had also made shipping arrangements by entering into long term contracts. The promulgation of the new regulations have rendered the existing contract invalid between the parties, thereby severely impacting the purchase cost of coal for Mundra. Due to above mentioned unforeseen circumstances; there has been an unprecedented rise in imported coal prices.

5.1. The Indonesian Minerals and Coal Benchmark Price

The Minister of Energy and Mineral Resources ("MoEMR") issued the most affected and financially impacting regulation regarding minerals and coal price benchmarking, which changed the market dynamics drastically in many importing countries. This regulation intends to impact all the mining companies, both domestic and companies present in the International market, their sales activities and their royalty calculation. Having said that, there are concerns or issues that have not been addresses of the adequately, and developments in this area should be monitored effectively.[163]

The mineral resources sector plays a vital role in the Indonesian economy.Mining contributes approximately five per cent of the total Indonesian Gross Domestic Product (GDP) and a much greater share within the regional economies of some resource-rich provinces such as West Papua, East Kalimantan and West Nusa Tenggara (PwC, 2012).[164]Indonesia is a key minerals supplier to

[161] Ministry of Mining, *Briefings on Indonesian Mining Law*, http://www.hfw.com/Indonesian-mining-law
[162] *supra* n.10 at Petition No.159/MP/2012
[163] Ajay Baral, *Global Coal Trade Patterns in the Coal Market*, http://www.iitk.ac.in/India.pdf
[164] IM4DC Action Research Report, *Mining and Development in Indonesia: An Overview of the Regulatory Framework and Policies*, (March, 2013), Ministry of Mining, *Action Research Report Commissioned by the*

the global market. This industry has attracted many investors with 'newcomers' of mining players from China, India, Russia, and South Korea penetrating the Indonesia market. The current market situation in India has been tremendously changing from the past four years due to the unprecedented, unavoidable and unforeseeable dynamism in the pricing regime of the Indonesian Government of 'export price'.

Indonesian coal miners will now be required to obtain a registered exporter status namely'EksportirTerdaftar Batubara (ET Batubara)' from the Ministry of Trade in order to export coal to any other territory of State. The new rule applies to miners that hold Coal Contracts of Work (PKP2B) and Mining Business Permits (IUP)The implementation of the new export permit regime in Indonesia (as of 1 October 2014) is causing uncertainty under international coal sale contracts, with many suppliers not being able to secure their export license amidst widespread confusion on the procedure for obtaining one.[165]

Apart from the new Regulation which seeks a sudden shift from international pricing regime to 'benchmark price', which is in hand linked to the market price of the commodity in the domestic market of Indonesia, there have been promulgation of such laws which have had deep impact equally on the exporters from Indonesia, as the exported coal is made to undergo tedious procedural process.

According to the figures depicted in the year 2013 of the Ministry of Energy and Mineral Resources, (MEMR) there are almost 4,000 IUP holders producing coal in Indonesia.[166] These are mainly small and medium sized mines. It aishereby estimated that only half of them have to date secured the valid certificate, which is a condition precedent to obtaining the required recommendation from the Ministry of Energy and Mineral Resources.

According to the Indonesia's Ambassador to India estimations, Rizali W Indrakesuma, said, since Indonesia accounts for 70 per cent of India's annual thermal coal import of around 110 million tonnes (mt). "It's imperative for Indonesia to tighten its control on exports to secure long-term supply. As there is low domestic consumption of coal till date, the Indonesian

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International Mining for Development Centre, http://im4dc.org/wp-content/uploads/2013/09/Mining-and-Development-in-Indonesia.pdf

[165] Lexology, *Indonesia Tightens its Coal Export Policy*, (October , 2014), http://www.lexology.com

[166] *Id.*

government is still evaluating the new regulation that could ban the export of low-grade coal (that below 5,100 kcal) by 2014," [167]

India is not considered to be a market for 'speculators', since this term 'speculation' is usually associated with nations engaged in less imports, and those which export the product or the commodity more. Indonesia is a land for a much awaited speculation, headed by the committee of Speculators, analysing the market situation within the territory of the nation, and examining its impact in the international arena, while keeping the international price regime as the standard price determination mechanism.

Experts, mainly the panel of speculators have analyzed various conditions prevailing in the Indonesian market would bear immediate impact on the operational cost of producers. "Considering that the ban is coming into play, costs could go up by 7-11 per cent if low gross calorific value (GCV) is substituted with higher GCV in Indonesia, and 15-20 per cent if companies look for other export destinations like Australia, South Africa and the US (at the current exchange rates)," Kalpit Dubey, analyst with commodity-focused research firm Ore Team, told Business Standard

It is hereby also predicted that there would be a direct impact on the domestic prices in working condition in India, especially for plants dependent on imports, with the current pass-through rates for imported coal in the current phase.

Many power companies facing the burgeoning cost of unnecessary litigation like Tata Power, Adani group, LancoInfratech and Reliance Power, among other Indian coal importers, are assessing the impact of the Indonesian government that attempts to benchmark its coal prices to international indices. The new system has the potential to increase the cost of thermal power generated using imported coal in India, as noticed in the Tariff Orders adjudicated by the Power Regulators.

The new method that will come into effect from 23rdSeptember, 2010, that attempts to link the royalties paid to the Indonesian government to a Benchmark index of coal prices for Australian and South African coal in addition to others.[168]Although the Indian firms have estimated that

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[167] Indian Power Sector, *New Fuel Shortage Threat Looms on Power Firms, Tata, Adani, Lanco to be Hit as Indonesia may ban Export of Low-Grade Coal*, http://indianpowersector.com/home/tag/gcv/

[168] DigitalFC, *Indonesian New Coal Policy Worries Indian Power Firms*, http://www.mydigitalfc.com/news/indonesia-new-coal-policy-worries-india-power-firms-738

Indonesian coal is of lower calorific value and hence, priced cheaper compared with Australian and South African coal.

Deepak Amitabh, Director (Corporate Finance) of PTC, said there are lots of issues, which still need to be sorted before the coal prices are determined. "We are still not clear how the government will work out the price differentials between Indonesian coal and that produced by Australia or South Africa, for example.[169]'Total income from operations increased by 5 percent to Rs 2,823.24 Crore during the interim period from Rs 2,751.47 Crore in the corresponding period of the last financial year', as per the predictions of PTC India.[170]Also the spot prices are always costly compared with the long-term sales contracts. We need to find out if the long term contracts for Indonesian coal would be at discount to international market prices or not."

VijaykumarBupathy, a senior analyst with Spark Capital Advisors, estimated in a report that "Assuming a $50 per tonne increase in the free on board (FoB) price of coal, there would be Rs 1,040 crore incremental fuel cost to the group to the extent of the committed 4.6 mtpa of supply alone."[171] However, when observed, the company estimated that there shall not be anydirect impact on the company, since its total cost of mining and transporting Indonesian coal to Mundra is $25 per tonne.He also said that, "Any hike in price would only increase the royalty payments by around $1 or $2 per tonne. This may have a marginal impact on the company," said a senior finance official of Adani Enterprises.[172]

It is pertinent to undertake the challenges which abound us in this global crisis, as in the current market regime, China, India and Indonesia are expected to account for nearly 80% of the total incremental growth in demand for coal. As per projections, by 2035, China will remain the world's largest consumer of coal, followed by India, US and Indonesia.[173] Coal-based thermal power projects will be the main drivers of demand in China and India. The projected coal fired generation capacity in Asia will rise to 1,464,000 MW in 2020 up from 918,000 MW this year,

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[169] Dipesh Shiv, *Indonesia New Coal Policy Worries India Power Firms-Quoted in the Financial Chronicle: GVK Power to Buy 2 Australian Coal Mines*, http://dipeshbiv.blogspot.in/2011_06_01_archive.html

[170] PTC India, *Posted Good Operating Margins Despite Lower Vols*, http://www.moneycontrol.com/news/results-boardroom/posted-good-operating-margins-despite-lower-vols-ptc-india_1294256.html

[171] Ben Line Agencies, *Coal Mining in Indonesia: Your Partner in Asia*, http://www.benlineagencies.com/userfiles/file/Ben%20Line%20Coal%20Market%20News%20Vol_%2067.pdf

[172] *Id.* at ¶ 2

[173] Pratim Ranjan Bose, *Coal India Offered Up to 70 MT of Coal Lying at Pitheads to Power Producers, Highlighting the Inadequacy of Transport Infrastructure*, http://www.thehindubusinessline.com/industry-andeconomy/economy/article3606803.ece?ref=wl_industry-and-economy

while for India it will rise from 95,000 MW to 294,000 MW over the next 11 years (a 300% increase).[174]

The Recently issued Regulation outlines the mechanism for determining the Indonesian Minerals and Coal Benchmark Price ("IMCBP"). Regulation No.17 is one of the implementing regulations to the Mineral and Coal Mining Law No.4/2009, which duly accorded recognition with effect on 23rd September, 2010. It is hereby important to analyse the compliance mechanism adopted by the recent change in the existing Regulatory structure in place with the Indonesian Government.

There have been certain discussions which must have initiated between stakeholders and the Director General of Minerals, Coal and Geothermal ("DGoMCG"), which includes the following obligations to be complied with all the mining companies, they are as follows:

a) Use of the average mineral/coal price from international market indices and the use of Free on Board (FOB) mother vessel as the sale point to determine the IMCBP;

b) The acceptance of certain costs as adjustments to the ICMBP (if the actual sale point is not FOB mother vessel;

c) The use of "floor" price approach, i.e. IMCBP vs. actual sales price, whichever is higher, for the Non-Tax State Revenue calculation.[175]

The Benchmark price for mining products must be determined pursuant to a market mechanism and or in accordance with the prevailing prices in international market. In selling the mining products, the Production Operation IUP/IUPK's are obliged to comply with the benchmark price, which is applicable to sales made to either domestic parties or foreign parties (pursuant to export trading activities) and any sales made to the affiliates of the Production Operation IUP/IUPK holders.

While this benchmarking shall be determined on monthly basis, especially for (Steaming Coal) and (Coking Coal) made with reference to the average coal price index as determined in accordance with the market mechanism or prevailing prices in the International market.[176] Where, it also states that the violation of the same shall result in serious default in administrative actions.Parliament has currently asked the government to increase the ongoing non-tax revenue

[174] PWC, *The Indian Coal Sector: Challenges and Future Outlook*, https://www.pwc.in/assets/pdfs/industries/power-mining/icc-coal-report.pdf

[175] Ali Mardi, *Minerals of Indonesia and Coal Benchmark Price, Energy, Utilities and Mining*, https://www.pwc.com/id/en/energy-utilities-mining-newsflash/assets/EUMNewsFlash_37.pdf

[176] WILLIAM A. SULLIVAN, MINING LAW AND REGULATORY PRACTICE IN INDONESIA: A PRIMARY REFERENCE SOURCE: PROCEDURES FOR MINERALS AND COAL BENCHMARK PRICE DETERMINATION (Kluwer Law, 2008)

from coal and metals mining to 52.2 trillion rupiah ($4.1 billion) from 35 trillion rupiah in 2014, Sujatmiko, as per the Ministry's Director of Mineral and Coal Program Supervision, said in an interview Thursday in Jakarta. It will be the first change in coal royalties in three years.[177]

A key step in hand was to overhaul the licensing system, replacing the Contract of Work (COW)[178]or the Coal contract of Work (CCoW) System for foreign investors and the permit system with three categories of mining licences. Further, the licences are issued for two phases of the mining lifecycle.[179]

The Regulation clarifies many incessant doubts raised by many mining companies engaged in the business of importing coal from Indonesia, which may give rise to a number of implications:

a) If the IMCBP is considerably higher than the price that could be commercially agreed between the parties and as stipulated in the contract (PPA), the Mining Company would have to pay royalty or an exploitation fee based on higher sales price that can actually be achieved, which represents nothing but an additional burden on the mining companies, unless the additional costs are allowed to pass-through.

b) The IMCBP will also be applicable to domestic sales, including those made to fulfill the coal Domestic Market Obligation, in this fiasco, what is apparently intriguing is the fact of the burden that may be shifted in this due course to the consumers to pay at the price set by the IMCBP, if they can afford the same?

c) In case where the IMCBP is higher than the actual sale price, question arises as to whether the IMCBP will also become the basis for relevant mining companies Income Tax Calculation.

d) The adjustment to the sale price with non-FOB vessel terms will need to be approved by DGoMCG, since the royalty has to be paid on a monthly basis.[180]

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[177] Bloomberg Business, *Indonesia Plans to Raise Coal Royalties by End of First Quarter*, http://www.bloomberg.com/news/articles/2015-02-13/indonesia-plans-to-raise-coal-royalty-in-end-1q-ministry-says

[178] Regulation of the Minister of Energy and Mineral Resources of the R.I. Number: 32 year 2013 concerning the procedures of issuing special license in mineral and coal mining by the grace of the one god almighty the minister of energy and mineral resources of the R.I., General Provisions, Article 1(15)'Contract of Work refers to an agreement between the Government of Indonesia and a company of Indonesian legal body in the framework of foreign capital investment to realize the business of mining extractive materials, exclusive of petroleum, natural gas, geothermal, radioactive and coal'

[179] PWC, *Coal Mining is Private Participation the Answer?*, https://www.pwc.in/en_IN/in/assets/pdfs/industries/power-mining/coal-mining-icc-report-v2-300613.pdf

[180] PWC, *Coal and Mineral Price Benchmarking, Mining in Indonesia, Investment and Taxation Guide*, http://www.pwc.com/id/en/publications/assets/Mining-Investment-and-Taxation-Guide-2012.pdf

Indonesian Government's decision to benchmark export coal prices against international prices has caused immense problems in the Indian power market that have prompted calls for political intervention. The present existing concerns have been exacerbated by the recent Indonesian Government mandate that requires the Indonesian coal producers must allocate 24.2% of their annual production for domestic use.[181]

The present need is to meet the energy deficit; the Indian Government has initiated a step towards 'energy security' in the Budget 2015, by commissioning five Ultra Mega Power Plants in five states, in order to be energy sufficient. As the world's largest thermal coal exporter, Indonesia is looking to gain from the country's booming coal industry and Jakarta has already brought in measures that will swell its coffers through higher taxes and bigger royalty payments. This includes the introduction of the pricing benchmark which initiated in the year 2010 which is linked to four other major coal indexes.

5.2. Requirements to follow a determined 'price'

Under the current 'Law on Mineral and Coal Mining', Law No.4/2009, a plethora of Regulations have been promulgated by the Indonesian Government. The Government promulgated'Regulation of the Minister of Energy and Mineral Resources No.17, 2010' concerning the Procedures of Determining the Standard Selling Price of Mineral and Coal (State Bulletin of the R.I. of 2010 No.463).

Under the given set of Rules and Regulations, there are determinants in order to calculate the 'Benchmark price', which includes the following:

For coal, an important energy product, the regulation provides that, coal sales can be conducted in the form of (i) Free on Board (FOB) mother vessel, (ii) FOB barge, (iii) inside an island to an end user and (iv) on a Cost, Insurance & Freight (CIF) or Cost and Freight (C&F) basis. What isnot clear is how other forms of sales are to be treated (e.g. selling coal to trader on ex-mine basis, selling coal to another mine owner for blending at stockpile etc).[182]

[181] Mondaq, *Indonesian Coal Law and its Impact Thereof*, Jan. 25th, 2012, http://www.mondaq.com
[182] HADIPUTRANTO, HADINOTO & PARTNERS, *Minimum Coal and Mineral Pricing Regulations Issued*, http://www.hhp.co.id/files/Uploads/Documents/Type%202/HHP/al_hhp_minimumcoalmineralpricing_oct10.pdf

The Mining Law requires all mineral ores to be processed in Indonesia before being exported. Under the law, raw ores and semi-processed minerals with purity levels below the Government's threshold can no longer be exported after 12th January, 2014.[183]

The reference price for the exported coal will be an FOB mother vessel price, and accordingly where coal sales are made by a mine owner on an FOB mother vessel basis, the contract price agreed by the mine owner should be based on the reference price. Where the sale is further upstream from the mother vessel point of sale(e.g. FOB barge), the regulation contemplates subtracting an "adjustment price" as approved by the Directorate General.[184]

It is presumed as per the political and economic viability of the product that the "adjustmentprice" is designed to cover thetransportation costs of barging, surveyor costs, transshipment costs and/or insurance costs.[185]

That the promulgation of the 'Director General Regulations of 2010' are foreshadowed to implement this adjustment price concept, in order to allow pass-through concept for import of coal. Given that the Government has adopted a methodology to adopt the new change in 'adjustment price', it is however not entirely clear, as to how this will be implemented.

5.2.1. Reference price used in calculation of royalties

For the purposes of royalty calculation, the Regulation provides that where a sale is effected on FOB mother vessel basis, in calculating the royalty, the Government will take the higher of the contractually-agreed coal price or the reference price. This indicates that the production royalty (e.g. for coal IUP companies currently ranging between 3-7% of sales price) will effectively be imposed on not just the coal costs, but also the barge transportation and transshipment costs; although in the past, the Ministry for Mineral Resources(MEMR) has permitted coal mining companies to deduct certain expenses from thecalculation of coal production royalties; However it appears that the MEMR has currentlydecided that no such deductions shall be made on any such claims, and instead, the royalties shall be assessed on the full delivered cost FOB mother vessel. An open interpretation to this effect is the likeliness to be viewed as an indirect way of

[183]Chris Scott & L. Gates, *Indonesian Mining Law – What's going on?*, Jan. 28, 2014, http://m.klgates.com/indonesian-mining-law--whats-going-on-01-24-2014/

[184] *supra* n. 150

[185] *Id.* at ¶2

the Government to increase the effective rate of royalties (without changing the headline numbers of 3-7% as set out in Government Regulation 45/2003).[186]

As per any ordinary Contract for developing minerals on a given land area, various adjustments are made to the percentage to account for any transportation costs from the delivery point to the point of export. In the Indonesian Coal Contract of Work (CCoW), the royalty is to be delivered to the State in cash at the FOB price.

For coal and other minerals which are sold with 'on spot contracts' further upstream than FOB mother vessel (e.g. FOB barge), the regulation states that the production royalties will be calculated using[187]:

(i) the contracted sales price, where the contracted sales price is higher than the coal reference price after subtracting or adding the adjustment price;[188] or

(ii) the reference price after subtracting or adding the adjustment price, where thecontracted sales price is the same or lower than the reference price after subtracting or adding the adjustment price.[189]

Hence, for a better understanding, where the coal reference price is US$80/tonne, and the Government has agreed an adjustment price of US$25/tonne where coal is sold, where the IUP holder sells coal on Free on Board at US$80/tonne, the royalty is estimated to be calculated as 3-7% (depending on GCV) of $100, whereas if the coal mining company sells coal at US$75/tonne FOB barge, then the royalty will be calculated as 3-7% (depending on GCV) of $75.[190] Accordingly, it might appear that any coal mining company selling any Free on Board vessel shall be penalized by having the coal 'royalty' imposed on the barge and transshipment component of its costs, whereas the same company selling on 'barge' will be charged the royalty solely on the basis of the coal production costs.[191]

[186] Sidharta & Widjaja, *Investing in Indonesia*, http://www.kpmg.com/Ca/en/External%20Documents/investing-in-indonesia-2013.pdf

[187] PWC, *Coal and Mineral Price Benchmarking: Mining in Indonesia, Investment And Taxation Guide*, http://www.pwc.com/id/en/publications/assets/Mining-Investment-And-Taxation-Guide-2011.pdf

[188] Ministry of Coal, DGMC Regulation No. 999.K/30/DJB/2011("Reg-999"), (Aug. 26th, 2011), "The Determination of Cost Adjustments to the Coal Benchmark Price"

[189] *supra* n. 177

[190] *Id.* at 3

[191] *supra* n. 173 at Article16(3)(c)

5.2.2. Hedging and Speculative Market Concept

The conceptual meaning of the term ‘Hedging’ is ‘mitigation of risk’; a concept which is often observed in a non-competitive market like Indonesia, due to which the quantity of imports of ‘purported low Gross Calorific Value’ of coal is allowed.The question of whether mining companies will be able to tackle the financial hedging instruments, to their detriment to bring down the effective sales price of the coal or mineral still remains unknown.

Whilst the use of hedge instruments with a price lower than the applicable ‘reference price’shallnot under any circumstances change the Indonesian Government from receiving the full production royalty since the calculations as explained above are based purely on the higher of the sales contract price and the reference price, not any net price applicable under a separate hedge instrument[192], the question whether the Indonesian tax authorities will permit mining companies to deduct the hedged losses as ‘legitimate business expenses’remains untested and variable in terms of the current economic position of the Mining Companies and the Indonesian Regulations regarding Coal Benchmarking.

The chase behind the minimum pricing regulations or the change in the pricing regime from the international benchmarking was not only to ensure that the Government receives royalties based on ‘*market*’ prices, but to ensure equally that the companies paid corporate taxes on the market prices received from selling Indonesian coal and minerals. If mining companies are permitted to enter into "out of the money" hedges, incur hedge losses and thereby [193]reduce their taxable profits, this second reform objective of the IndonesianGovernment is not being met.

Indonesia has tax incentives for specific mining activities such as basic iron and steel manufacturing, gold and silver processing, certain brass, aluminium, zinc and nickel processing activities and quarrying of certain metal and non-metal ores. The Indonesia incentives consist of a 30% investment credit, accelerated depreciation, reduced withholding tax on dividends and increased tax loss carry forward period from 5 years to a maximum of 10 years.[194]

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[192] D. Menon, *Regulatory Round-Up Edition, Energy, Utilities & Mining*, NEWSFLASH (Jan. 2012); Coal Benchmark Pricing-What’s the Issue?

[193] Deloitte, *Taxation and Investment in Indonesia 2014 Reach, Relevance and Reliability*, https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-indonesiaguide-2014.pdf

[194] PWC, *Corporate Income Taxes, Mining Royalties and Other Mining Taxes, A Summary of rates and rules in Selected Countries*, https://www.pwc.com/en_GX/gx/energy-utilities-mining/publications/pdf/pwc-gx-miining-taxes-and-royalties.pdf

Indonesia is seeking to retain greater revenues from its coal mining industry. In early 2012, the government declared that all foreign investors must sell a majority of existing mine equity to local investors by the 10th year of production. In late 2012, this regulation was followed by a government declaration to raise the mining royalty rate for major foreign-owned mining firms to at least 10%, more than double its ceiling at the time.[195]

5.2.3. Sales Contract and Post-sale Reporting

The post-sale reporting requirements imposed on mining companies consists of a monthly report of all coal or minerals sold, setting out prices, volumes, points of sale and details of buyers. Supporting information to be included with the reports includes invoices, bills of lading, quality reports and barging costs.[196]This shall significantly addadministrative burdens to mining companies.

The regulation requires all contract prices to be submitted to the MEMR, pre-dominantly andnot the local governmentwho may have issued the bid prior to that price being concluded in a sales contract. This requirement applies for both spot and term contracts.For spot contracts being contracts with a term of less than 12 months, the price used for the spot sale must be based on the 'reference price' for the month when the coal is being delivered.[197] Accordingly, it is expected that the reference price willbe issued monthly in advance, whereas for term contracts or contracts with a term of 12 months or longer, similar to what has been agreed under the Fuel Supply Agreement, between the Power Company, for instance Adani Power Limited, having a fixed share in the Mining Companies of Indonesia, a fixed price is agreed in that contract based on the average coal reference price in the last 3 months prior to the coal sales agreement being signed.

The 'reference price' is to be used by coal producers and suppliers for all future spot and term contracts. This *coal benchmark price is stated as using a formula based on the index average of*

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[195] U.S. Energy Information Administration, *Overview: Indonesia,* http://www.eia.gov/countries/cab.cfm?fips=id "Indonesia is reorienting energy production from serving primarily export markets to serve its growing domestic consumption. The Indonesia's energy industry has faced challenges in recent years from regulatory uncertainities and inadequate investment",

[196] World Bank Institute, *Guide to Extractive Industries Documents − Mining*, http://wbi.worldbank.org/wbi/Data/wbi/wbicms/files/drupal-acquia/wbi/World%20Bank%20Extractive%20Industries%20Programme%20-%20Mining%20Guide.pdf

[197] *supra* n.157 at ¶3

ICI-1 (Indonesia Coal Index), Platts-1, Newcastle Export Index, and global Coal Index. The assessment basis of the coal price reference was calculated considering coal with GCV.[198]

The escalation rates approved by the CERC for imported coal are determined today using API4 (price of South African coal) for short-term data series. Almost 60-70 percent of the fuel contracts are long-term contracts on which these escalation rates (based on short-term data) are applied. Major fuel imports in India are mostly from Indonesia, followed by Australia. The current indexation does not incorporate price fluctuations or indexes for import from these countries and this would appear to be a major problem area.

Given the large quantum of coal imports required for large-sized thermal power units planned under supercritical technology in India, it makes sense to provide tailor-made indexes for each country of import rather than arriving at a composite index. PPAs could then recognize the primary country of import and allow country-specific price indexation. This adjustment would closely reflect the underlying pricing structure in the long-term coal supply agreements and would remove any index-related uncovered risks for bidders.[199]

There are special rules that apply specifically to coal supply contracts, in the instance case (Adani Power Limited Case) under the regulation and these rules do not apply to mineral sales. It is observed that in the usual parlance of contracting with any state, once the agreed coal price for either a spot or term sales contract is notified to the MEMR, the contract signing must occur at the latest 1 month after the initial agreement on price was reached.[200]

Ordinarily the usual industry practice agrees to'pricing' as part ofthe contract signing, and hence the over-shadowed measure by the MERC is still unclear and unsatisfied. It may be a matter of serious consideration that the 'interim time period' by the Ministry between receipt of thenotification of the agreed price or the price agreed, prior to the accent to the Agreement, and contract signing, as a periodfor the Ministry to notify the mining company of any objections, that may arise in the midst of such negotiations, the Ministrymay have to the pricing. However this objection period is not explicitly provided for inthe regulation, and there is nothing to prohibit the parties from notifying the Ministry and immediately signing the coal sales contract.

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[198] Reswara, *Indonesian Government Declared HBA Fell Again in October*, (October 25th, 2012), http://www.reswara.co.id/news4

[199] MOHUA MUKHERJEE, PRIVATE PARTICIPATION IN THE INDIAN POWER SECTOR 45, (World Bank, 2014)

[200] *Id.*

For 'Term coal contracts', the regulation provides that the first delivery under a sales contract must be conducted 2 months at the latest subsequent to the coal purchase contract signing, and must be completed within 1 year at the latest. If the first coal delivery is made later than 1 year after contract signing, then the next year's reference price should be used. The mining company must adjust the coal price for term contracts once every 12 months.[201]

More than 60% of India's coal imports are through spot or short-term contracts and experts say the power producers are finding the sudden increase in price too sharp for comfort. Costlier imports are likely to impact the quantity of coal imported from Indonesia.[202]

On a plain reading of these provisions in detail, itmight appear that there is a *prima facie* need to prohibit long term contracts, since the deliveries are scheduled for so long.

However, the provision should not be given partial meaning or words should not be imported in the provision, so as to give the provision an over-estimated constructive meaning, while the provision is aimed at ensuring that a fixed price term contract cannot be locked at a price not less than thereference price, but with the commencement of the deliveries being deferred such that, at the time the deliveriesare made, the fixed contract price may diverge significantly from the reference price applicable at that time.[203]

It is stillunclear how strict the Ministrywould be in implementing these provisions. Even though, it is hard to entrust master believes in contractual structures that theycan be developed and given internal aides to construction to accommodate any of these restrictions, provided the principle continues to be recognized – i.e. that fixed prices are permitted for 12 months, but they must be refreshed every 12 months.

It is a matter of speculation that the coal sales are falling outside the reference price regime. Coal of all types including fine coal, as well as coal with certain impurities that are being used domestically, have a tendency that the same may be sold below the 'reference price'of coal post

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[201] Coal Lateral, *Coal Concessions Process or JV Takeover Process*, http://www.coallateral.com/coal_concessions.html; Mongbay, *Indonesia Tries to Clamp Down on Coal Sector's Worst Excesses*, http://news.mongabay.com/2014/1016-gfrn-fogarty-indonesia-coal-1.html

[202] Tapash Talukdar, *Indonesian Coal Price Hike Singes Indian Power Companies*, http://articles.economictimes.indiatimes.com/2011-10-03/news/30238480_1_thermal-coal-coal-india-imports-coal

[203] *supra* n. 195

the approval granted by the Ministry.The Director General will issue separate regulations regarding various types of coal that may fall within this exception.[204]

Similarly, coal which is required to be used for certain purposes in the Indonesian market may also be sold at a price lower than the reference price; whilst the regulation provides that the DirectorGeneral will further regulate the purposes, the regulation flags that coal used for individual needs and or coal for development of poorly developed areas will fall within this exception.[205]

Importantly for the captive foreign owners of Indonesian coal mines, having subsequent share in the mining companies of Indonesia, focusedon importing coal at the lowest plant load factor and land cost possible for burning in power plants abroad, for instance the Indian power companies acquiring Indonesian coal mines to fuel India's power generation plants, whilst an exception to the imported coal, is the low Gross Calorific Value of the coal or the poor-quality coal, or special purpose, implying extensive use to meet the domestic needs, against the exported coal quantity. As a result, the distressed Indian Power Companies have to share the burden of contracting with the Indonesian Government (MERM), to attain low quality coal destined for India and abide by the 'coal reference price requirements'.

5.3. Reflections of the Past and its Impact on the Indian Power Projects

Indonesia remains the world's largest exporter of coal by weight and exports about 75% of its production.[206] Its abundant coal reserves have provided attractive opportunities to investors and coal buyers and the like. In particular, the wide variety of quality within the Indonesian coal allows for blending to meet specific buyer requirements, whilst the lack of a generally applicable minimum purchase quantity appeals to a wider variety of buyer.[207]

These reserves have been relatively low priced and their geographical position have meant that theIndian power companies have looked to Indonesian coal supplies as an important part of the solution to the thermal power generation.

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[204] Bartlucarelli, *Determining an "Indonesian Coal Price Reference"(ICPR):'The History and Future of Indonesia's Coal Industry: Impact of Politics and Regulatory Framework on Industry Structure and Performance*, http://iis-db.stanford.edu/pubs/22953/WP_93_Lucarelli_revised_Oct_2010.pdf

[205] *Id.* at 12

[206] *supra* n.190

[207] Paul M. Dhillon et.al, *Indonesia: Reflections on the Indonesian Coal Market in 2011 and Its Impact On Indian Power Projects,* http://www.mondaq.com

It is hereinafter observed that the Indonesian Government's landmark promulgation of the Regulation[208] to benchmark export coal prices against international prices has initiated a catastrophe in the Indian power market and have prompted calls for political intervention. Existing concerns have been exacerbated by a recent Indonesian Government mandate that requires that Indonesian coal producers must allocate 24.2% of their annual production for domestic use.

The Indian power projects have been kept in 'abeyance' because the price of off-take agreements have been negotiated on an assumption that Indonesian coal would remain at pre-September 2010 levels.[209]This recent development, as the Directive has exponentially increased concerns that there will be a reduction in exported quantum of coal from Indonesia which may in turn push prices up further. It is evident that that the Indian government is currently seeking a formal 'special status exemption agreement' with the Indonesian Government after the India-Indonesia coal operational fiasco.

At present, approximately 57% or 118.7 GW of India's total installed generating capacity of 207.9 GW is coal-fired, while over two-thirds of electricity generation is from coal-based plants.[210] At a global level, coal accounts for 30% of the world's primary energy consumption. Ever since India opened up the power sector in 1991 for large scale privatization, there have been serious concerns that the process has 'pre-eminently' big corporate interests over those of other stakeholders and consumers.The focus always lies on having a balancing process whereby ash and grade are as per the desired input to the various consumers, while providing a maximum yield.[211]

There have been several apprehensions which have once again reared fate witnessed in the Tariff Orders and various petitions filed before the many Regulators against the Power Companies. In spite of the complicated legal and financial nuances, in its essence, the matter is fairly straightforward.

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[208] Government of India, *Regulation of the Minister of Energy and Mineral Resources No.17 Year 2010 concerning the Procedures of Determining the Standard Selling Price of Mineral and Coal* (State Bulletin of the R.I. of 2010 No.463)

[209] Gautam Bhattacharya, *Indonesian Coal Market and its Implications*, (Jan. 20th, 2012), http://www.reedsmith.com/Reflections-on-the-Indonesian-Coal-Market-in-2011-and-its-impact-on-Indian-Power-Projects-01-20-2012/

[210] PWC, The Indian Coal Sector: Challenges and Future Outlook, Indian Chamber of Commerce, https://www.pwc.in/assets/pdfs/industries/power-mining/icc-coal-report.pdf

[211] Coalnomics, *Implications of Coal Quantity for the Indian Market*, http://indianpowersector.com/wp-content/uploads/2013/04/Power-Plus-Coalnomics-Brochure.pdf

The methodology adopted by the Committee appointed by the Central Electricity Regulatory Commission (CERC) to determine tariff, which was mostly done through the so-called cost-plus method. In this, the company was to be reimbursed for all its costs, and an additional amount for profit.Petiton No.159/MP/2012 raised significant questions relating to the spectre of massive cost padding, cost rigging with collusion between officials and company, and required, at the least, an elaborate and expensive mechanism to monitor the costs.[212]In a negative move that has prompted the Association of Power Producers — representing 13 Indian independent power developers — to seek higher tariffs for upcoming projects; The Association has claimed that projects of about 13,000 Mega Watt (MW) in total be affected by this regulation.[213]

"The new regulations or the new 'Coal price Benchmarking Index' will allow the Indonesian government to get the right amount of royalty (in excess of the stipulated), and simultaneously the taxable revenues from the sector will also gradually move up to the correct levels. It will also stop the practice of transfer pricing. The government has put in a strong framework," said Rudi Vann, an analyst at Wood Mackenzie.[214]

The present market economy of Indonesia; the suppliers have been able to resist Indian consumers demands for better prices by selling their coal in the spot market, even though the Regulation passed by the Indonesian government in 2010 forbids the mining companies from exporting their product at rates lower than international benchmarks, to the detriment of a slew of Indian companies looking to source cheaper coal.[215]Whether this strategy has the ability to sustain hinges on revival of a previous situation in demand, by way of re-negotiation, is yet to be observed. India accounts for a fifth of Indonesia's coal exports, and the South-East Asian country recently trimmed its production estimates for the current calendar year to 390 million tonnes from 400 million tones.[216]

Shortage of coal has had an adverse impact on the country's power sector, and is speculated to have a continuous bearing with the present quality of imported coal (with highly low gross calorific value), with a new capacity build-up being affected.

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[212] Shripad Dharmadhikary, *Corporate Interests Rise Above All*, http://indiatogether.org/power-economy--3

[213] Devjyot Ghoshal, *Regulation Flares Indonesian Coal Prices*, http://www.business-standard.com/article/economy-policy/regulation-flares-indonesian-coal-prices-111071900009_1.html

[214] *Id.*

[215] Indian Power Sector.com, *Coal Price to Remain Under Pressure*, http://indianpowersector.com/home/tag/imported-coal/

[216] Id.

About 100 GW of thermal power plants are under various stages of development currently and among these, progress of about 20 to 25 percent of the capacity has been stuck due to coal supply and availability issues.[217]

Similarly, the existing coal-based plants in Tiroda, Rajasthan and Maharashtra are suffering as well since they are operating on low Plant Load Factor (PLF). At present the viability of any power plant is based upon the plant load factor and not its installed capacity or the capacity of the plant to produce power, given, both the escalable and the non-escalable costs.

Power utilities have been increasingly and constantly looking at coal imports as viable option to ensure coal linkages for their plants, due to the reduced supply of coal from CIL (Coal India Limited).

With a large of number of captive coal blocks stuck in various pre-implementation stages, companies have been encountered more comfortable with their dependence on coal imports. Coal linkages, by way of a significant shareholding in the Mining Companies of Indonesia through imports have become extremely important for power utilities to ensure timely commissioning of their planned power capacities.[218]

The Central Electricity Regulatory Commission (CERC) in the recent orders have allowed unequivocally, without adhering to the 'principles of justice, equity and good conscience' for a post-contractual reopening of the competitive bid under Section 63 of the Electricity Act, 2003, even though the Commission is unable to provide a suitable nomenclature, displays dedication by using the term 'compensatory tariff' for an interim period till the cause of this economic problem remains.

The principle evolved through a catena of tariff orders, as previously observed and passed diligently and unhesitatingly by the Commission. The fact that, absence of a clause or provision for 'price escalation' under the non-escalable componential contract cannot and should not be deemed to be avalid ground on the merits of the case to deny a compensatory package on account of actual expenditure and real price rise, having a direct bearing on the increased fuel costs and decreasing return on equity (ROE) share. Therefore, if the actual cost of production of electricity goes beyond the stipulated terms of the Power Purchasing Agreement (PPA),

[217] Anmol Kotwal, 'India's Power Sector Reeling under Fuel Resource crunch', http://asian-power.com/power-utility/commentary/india%E2%80%99s-power-sector-reeling-under-fuel-resource-crunch

[218] Ashish Gupta, 'Coal Imports & its Impact on Power Sector', 16th September(2011), Vol.VIII Issue.13, www.orfonline.org

thencompensation should not be denied merely on the ground that there is no such provision in the Agreement explicit to that effect.

Tariff Orders overwhelmingly justifies the same as being in the 'consumer's interest', as ascertained by the panel constituting the Committee commissioned by the Central Commission.

The consumer's interest is protected not only by fixing competitive tariff but it is equally imperative to ensure continuous, uninterrupted and reliable supply of electricity. For the purposeof qualitative supply of electricity, it is necessary that adequate investments are made for creating infrastructure for generation, transmission, distribution and supply of electricity and this is possible only when the investor gets adequate return on the investments made.[219]

Therefore, it was pertinent for the Power Companies or the Generators to recover costs of fuel and other expenses that serve consumer's interest by attracting investments in the sector by improving quality of supply of electricity to the consumers.

Even if the judgment renderedis a '*possibility*',justified in the name of consumer interest, there has been no 'consumer representative hearing', nor are any of the suits pending in any of the courts, nor is any consumer representative nominated in the committee appointed to be constituted to work out the compensatory tariff.

There have been serious implications of the decisions passed by the 'Appropriate Commission'[220]whichmight encourage Companies engaged in Generation and Transmission to apply for an aggressive bidding to win contracts by quoting the lowest tariff; post winning the bid, quoting terms that they never intended to fulfill, and subsequently push for post contractual 'renegotiations or re-determination' on the ground that the project is unviable; however this shall render the competitive bidding process meaningless. Competitive bidding will lose its significance that it leads to lowest tariffs and the best economic efficiency.

The process of 'post contractual renegotiation' will be deemed to be unfair to the other competing members who lost the bids, as they were evaluated against the terms quoted by the winning company which it never intended to keep. It is a matter of moot point, whether other companies wouldquestion such arbitrariness discharged with such unfairness.

[219] *Supra* n.206

[220] Section 2(4) of the Electricity Act, 2003 defines 'Appropriate Commission', which means Central Regulatory Commission referred to in sub-section (1) of 76 or the State Regulatory Commission referred to in Section 82 or the Joint Commission referred to in Section 83 as the case may be.

The consumer is at the heart of the complex relationship between utilities, regulators and policy-makers.[221] With electricity prices expected to increase, owing to the tariff orders passed by the Appropriate Authority, it is the State utilities who determine the tariff applicable to the consumers who likely to be affected parallel to the Discoms.

5.3.1. Imported and Domestic Coal Uncertainties

The speculations reveal that the failure of Coal India Ltd (CIL) to meet the Fuel Supply Agreement (FSA) commitments could have been solved by CIL purchasing coal for import and that the prices of such purchases should be eligible for a pass-through in the Fuel Supply Agreement (FSA), as well as the associated Power Purchasing Agreements (PPAs). The given proposal appears to be a workable solution, but only if the quantities of shortfall are minimum, which are in the nature of interim deficits. Hence, separate projects should be planned for projects which are developed on the basis of domestic coal and imported coal. After CIL had failed to meet the March 31st, 2012, deadline for signing the FSA's, as set out in the Directive issued by Prime Minister's Office, The Ministry of Coal announced a presidential decree forcing CIL to guarantee long term fuel supply, even if it is under the obligation to import coal. Accordingly, the CIL Board approved the modified FSA applicable to thermal power station commissioned between April 01st, 2009 and December 31st 2011, as recommended by the Central Electricity Authority and Ministry of Power. The FSA to be signed with almost 48 Companies, contains the mandate to supply 80 percent percent of the coal requirement of each company. The lasting solution given to the companies in the power value chain is to honour the commitments made under the contract. Therefore it is imperative for CIL to be more transparent and sign binding FSA's with Developers, which could have pre-determined, serious penalties for defaulters.

It has been projected that there are two fundamental issues that have been raised by stakeholders with regard to the bidding framework adopted for competitive bidding of imported coal-based projects:

- Does framework ensure that the least cost power is being procured at all times?

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[221] EY, *Utility Companies Facing Ever Increasing Regulatory Burden, Look to Rapid Growth Markets to Mitigate Risk*, http://www.ey.com/GL/en/Newsroom/News-releases/News_Utility-companies-facing-ever-increasing-regulatory-burden

- Does the framework adequately compensate bidders for regulatory changes in the country from which the coal is being imported?

With regard to the first question, there have been concerns voiced by many procurers and power companies, as witnessed in many cases discussed before, about the efficacy of the competitive bidding framework because of outcomes of the Mundra Ultra Mega Power Plant (UMPP) bid process and the current tariffs that the project is incurring. There is a difference in the tariff bids of Tata Power and Adani Power Ltd. It was observed that in contrast of Tata Power Tariff's, which have escalated significantly−45 percent charges are linked to international coal indexes, which have risen from around US$50/tone at the bidding stage to the current level of US$120/tonne. Following table shows the list of projects facing fuel related issues:

Table 1

Project	*Developer*	*Fuel type*	*Status update/ COD*	*Issues*
Mundra UMPP	Tata Power	Imported coal	All five units have been commissioned	The regulatory changes in the pricing of Indonesian coal makes the product market linked, which poses critical challenges for imported fuel–based projects.
Krishnapatnam UMPP	Reliance Power Ltd.	Imported coal	Construction work stopped	
Mundra Phase 1	Adani Power Ltd.	Imported coal	2009–10	Developers of projects that have already been bid are seeking rate revisions to ensure viability. CERC has granted rate revisions to a few projects; this has been challenged by procurers before the ATE.
Mundra Phase 2	Adani Power Ltd.	Imported coal	2010–11	
Mundra Phase 3	Adani Power Ltd.	Imported coal	2010–11	
Ratnagiri	JSW Steel Ltd.	Imported coal	2010–11	
Mundra Phase 4	Adani Power Ltd.	Blended coal (domestic + imported)	2012–13	Fuel security issues have arisen from both domestic and imported fuel sources, because the domestic coal link lacks sufficient quantity and Indonesian coal prices have increased.
Mundra Phase 3	Adani Power Ltd.	Domestic coal	2012–13	Even after signing the FSA with GMDC to supply 4 MTPA of coal from Morga II block, supply of the committed quantity could not be ensured because the MOEF refused to permit mining in the blocks falling under the "no-go" area.
CLP Jhajjar	CLP India Private Ltd.	Domestic coal	2012–13	This is a case 2 project, which has continued to face coal supply shortages.
Tiroda Phase 3	Adani Power Ltd.	Domestic coal	2012–13	The MOEF withdrew terms of reference for mining in allocated Lohara block because of its proximity to a tiger reserve.
AES Chhattisgarh	AES Ltd.	Domestic coal	2016–17	The MOEF declared the allocated Sayang coal block a no-go area.
Mahan	Essar	Captive coal	2012–13	The MOEF declared Mahan coal block in Madhya Pradesh a no-go area.

Source: Private Participation in the Indian Power Sector: Lessons from Two Decades of Experience

The effect of the regulatory changes is undoubtedly substantial and the changes would have clearly been difficult for any bidder to anticipate The most likely secneario is that noe of the bidders factored these changes into their bids for the Mundra UMPP. Tata Power (the winning bidder) has argued that regulatory changes should be considered as a force majeure incident, given the bidders' lack of control over such an eventuality and given those changes' critical relevance to the project. This argument is made even though the PPA did not provide for any political force majeure for regulatory or policy changes outside India. Although the circumstances in which Tata Power finds itself are unfortunate, Tata Power may be able to successfully claim the regulatory changes as a force majeure incident under the agreement. A preferable approach may be for the government of India/CERC to mediate and work with both Tata Power and the concerned distribution companies to reach a mutual agreement on revisions ti the PPA.

In revisions to the standard bidding documents, a fundamental in law in countries from which coal is being imported should be allowed in the PPA.[222]

6. Conclusion and Suggestions

Compensatory Tariff is seen as a 'domestic benchmark' for contract re-negotiation or for re-determination of tariff in future infrastructure investments; and is evident from the augmented cost of litigation that power firms incur, proactively indicates that the legal battle is still on. The pad accessible to assimilate forex vacillation has been devoured by change in coal costs and the change in the wellspring of coal.

At the heart of the cases mentioned and discussed earlier are two offers dispatched in 2007 and 2008 by the States, for example, Haryana and Gujarat, among others — approaching an era of generating companies to seek the privilege to supply power (the winner inany particular event that offers for the least tariff). Adani and Tata won those two bids, and they bid tariffs on the premise that they would assimilate changes in the cost of coal over the life of the offer, however they had the decision to make the bid in a manner in order to pass on the fuel expenses to the costumers (The Distribution Companies). Both Companies chose to import coal from Indonesian mines for the tasks, found in Gujarat.

[222]PRIVATE PARTICIPATION,*Supra*n.194

The Tariff Order passed by the Commission in the Adani and Tata Power Limited Cases outrightly refers to a post-contractual reopening of the bid, although the Commission on grounds of economic strains is granting a 'compensatory tariff relief' for an interim period till the problem is adequately addressed.

Absence of any clause in the Power Purchasing Agreement(PPA), which is implied and is open to any rule of construction for interpretation, may be imported for price escalation in the contract. This in the general sense cannot be any ground for denying the compensation on account of actual expenditure on account of price rise. Therefore, if the actual cost of production of electricity goes beyond what was agreed in the PPAs, compensation should not be denied merely on the ground that there is no provision in the PPAs."

The ultra-mega power project (UMPP) producers have conveniently managed to convince the government, bearing the economic and forex conditions, as an important escalable component and the power regulator or (Appropriate Authority) that they intend to increase the power tariff over and above the tariff mentioned and quoted in the Agreement to offset the hike in price of Indonesian coal.In being allowed to do so, we shall be coerced to reflect backwards to the times of input prices being passed through to power distribution companies and consumers. The 'promise' of a fixed tariff from UMPPs, stipulated in the power purchase agreements, has been effectively put aside.

With the Discoms unable to recover the higher costs from the consumers, namely farmers, industry and business who will have to bear the brunt, the burden to pay high compensation adds to the cost of procuring coal. Apart from the brutality that the 'unbundled' Distribution segment will have bear in terms of the lump sum compensatory costs towards the loss incurred to the Power Companies on account of imported coal from Indonesia due to the (change in law and force majeure)the finances of Discoms will sink drastically, requiring a further injection of relief from the Centre and states, in turn impacting their fiscal deficit.

As far as an in depth analysis of the tariff orders are concerned, the Orders passed by the Appropriate Authority have had enormous implications and impact on the Indian power industry and possibly other infrastructure sectors in India, as it consequently raises important legal questions, the first being'erosion of the principle of sanctity of contract'. While the Indian Judicial system, comprising of the courts of law are usually hesitant to interfere in contractual understandings between the parties, however in the particular matter in hand, the

Commissionexercised overt jurisdictional powers by stepping in to alter the contractual relations between the parties. Any Power Purchasing Contract(PPA) is not a plain-vanilla contract, but any changes made to any of the clauses of the agreement, or importing meaning to any of its provision which is susceptible to industry regulation should be deemed to be improper.

Secondly, this may be considered to be a 'point of interference' which is not contractually implied, but rather through the exercise of its general powers as an industry regulator, enshrined under the auspices of the Electricity Act, 2003 (State Government and Central Government)

Instance may be drawn in through the 'contractual principles of frustration' and 'impossibility of contract' and their practical manifestations in the Power Purchasing Agreement (PPA) in the form of 'force majeure'and 'change in law' which were held inapplicable herein.

Usurping the jurisdictional powers granted to the Central Regulator on general powers to intervene in contractual matters would lend an element of subjectivity to commercial contracting in the sector. In its zeal to resolve a dispute in an existing situation, it remains to be seen whether it has opened a Pandora's Box that is likely to cause some uncertainty and instability in the sector.

In seeking to protect and secure the commercial viability of the electricity sector through the consummation of the Power Purchasing Agreements (PPAs) and the access to power to the populace in the states under acute distress are involved, the Commission in its orders have dampened the sentiment. A Consistent approach may incite power generators to carry the risk, which may cause additional concerns to the sector.

The issue of moral hazard has frequently been raised. The classic way of addressing risk is through contract, imposing the risk allocation task on the shoulders of the Commission to decide.

For India, the situation will be nuanced by concrete stagnation in the domestic production even as demand for coal has increased tremendously.

Domestic coal production has been unable to keep pace with the demand from power producers. However in 2010, domestic production has remained at a flat level, while there has been a sudden increase in the quantum of imports by Indian power companies, from Indonesian Coal firms, and with such substantial part of the imported coal requirement *in situ*being imported from Indonesia, India's energy hunger is expected to accelerate the growth of India, in terms of coal requirements.

In 2010, it overtook Japan to become the second largest importer of Indonesian coal after China, as discussed the dynamics surrounding such commencement. The promulgation of the new Regulation No.17 regarding coal benchmark pricing is likely to increase the price of coal mainly for all Indian Power Projects using imported coal from Indonesia. The impact on the tariff of such projects may vary, depending upon the quality of imported coal and fuel mix, since Indonesia exports coal with low Gross Calorific Value.

The element of negativity involved with such commercial transaction, is that, all existing supply agreements with Indonesian mining firms will have to be brought in line with this new benchmark by 23rd September 2011, as discussed before in the previous chapters.

The implementation of this new regulation will adversely impact all existing and future Coal based power plants importing Coal from Indonesia.The new regulations will allow the Indonesian government to get the right amount of royalty, and the taxable revenues. Given the long-term demand fundamentals and predictions, the current high coal price scenario may continue to squeeze margins of Indian power producers, unless the government prepares a report on the financial status of the Discoms, to address their grievances following the consumer interests thereof, and by adopting and implementing the previous decision of 'Financial Structuring' of the Companies engaged in distribution and generation.

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