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Alternative Remedy for Imported Coal Price Escalation

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Of all the available sources of power generation like coal, nuclear, hydro, natural gas, and the renewable energy sources like solar, wind etc., coal continues to be the major and cost effective source of power generation in India, contributing to 70% of the country's power requirements[1]. Coal utilised for the power generation could be acquired either indigenously or may be imported. Different power generating companies may have different combination of indigenous and imported coal in their power generating plants which then is clearly stated in the Power Purchase Agreements (PPAs).

The PPA's to be executed between the power generating companies and the distribution companies have been standardised by the Ministry of Power and contain clauses to maintain a regulated and hassle free production and sale of power. The power generating company bidding the lowest tariff for the sale of power is selected through a 2 stage competitive bidding process. The standard bidding documents prevailing in the year 2005 governed the long term power purchase by distribution companies and required the bidders to quote their tariff, being a combination of capacity charge (i.e a charge associated with annual fixed cost) and the energy charge (i.e a charge associated with the cost of fuel). While quoting the capacity charge and the energy charge, the bidders also had to indicate their (i) escalable/ variable component which was to be subject to an increase, based on the indices provided for in the PPA and the (ii) non-escalable / fixed component which was to remain fixed throughout the term of the PPA. The tariff quoted by the lowest bidder was then required to be *adopted* by the Central Electricity Regulatory Commission (CERC) or the State Electricity Regulatory Commission (SERC) (collectively, the 'Regulatory Commissions'), as the case may be, under Section 63 of the Electricity Act 2003 ('Act').

Price therefore plays a pivotal role in awarding the projects and in a way is a commitment obtained from the power generating company (being the lowest bidder) to supply power to the distribution companies at the quoted tariff during the entire term of 25-30 years of the PPA . However, considering the long duration of the contract, the PPA does recognise revision in the tariff on account of reasons being attributable to a force majeure event or a change in law. Force majeure refers to the occurrence of events, which are beyond the control of the parties and which may

1 Infraline, August 2015, Vol 4, Issue 4, Article" World Bank will not Fund Coal Projects in India"

cause delays or prevent them from fulfilling their obligations under the terms of the PPA. These events are unforeseen, unavoidable and external, which may make the execution of the contract impossible. On the other hand, change in law refers to the issuance of any new regulations, legislations or modification in the existing regulations, legislations, interpretations of laws, court decision etc, which may have an adverse financial impact on the power generating company.

Of late, escalations in the price of coal being imported from Indonesia, has resulted in the power generating companies seeking a revision of their tariff, claiming it to fall under the heads of force majeure and change in laws in terms of their PPAs. This has led to disputes between the power generating companies and the distribution companies which have been tried in the CERC and in the Appellate Tribunal for Electricity (Appellate Tribunal). The case of *Adani Power Limited* ('Adani Power') is a major highlight in this regard as it covers the concerns and disputes of all the other power generating companies such as Tata Power Company Ltd and Reliance Power Limited, supplying power through their subsidiaries relying on Indonesian coal.

Adani Power had set up the Mundra thermal power plant in Gujarat, with nine units, having a total capacity of 4620MW. With all the nine units operational, Adani Power, pursuant to the competitive bidding processes, supplied power to various distribution companies including Haryana Discoms and Gujarat Urja Vikas Nigam Limited (*GUVNL*), bound by the terms of their respective PPAs. The capacity charge and the energy charge under both the bids were specified as being non-escalable, meaning thereby that power was opted to be supplied for a uniform tariff, without any escalation criteria for the entire duration of both the PPAs. Further, for the power supply under both the PPA's, fuel arrangements was required to be taken care of by power supplier. In view of the concerned jurisdictions, the tariff quoted for power supply to GUVNL was adopted by the Gujarat Electricity Regulatory Commission while the tariff quoted for the supply to Haryana Utilities was adopted by the CERC u/s 63 of the Act.

The price escalation woes for Adani Power started when Government of India in accordance with the new Coal Distribution Policy, slashed the supply of indigenous coal to the power generating companies and restricted the supply to 70% of the capacity owing to the shortage of coal in India. The power supply to GUVNL was to be made from a unit, based on domestic coal although eventually, it was to depend 100% upon imported coal as the arrangement with the domestic coal supplier failed; while the power supply to the Haryana Utilities was to be made from units based on a blend of domestic and imported coal in the ratio of 70:30, although as alleged by Adani Power, it got only about 42% of domestic coal and had to cover the shortage by sourcing more of imported coal from Indonesia which in effect increased the quantum of imported coal from the earlier contemplated 30% to 58%.

Furthermore the problems for Adani Power increased when the Ministry of Energy and Mineral Resources, Indonesia notified the benchmarking of coal export prices with effect from September 2011. In terms of Indonesian regulation, the export price of the coal mined in Indonesia was benchmarked to the International market prices of coal, which meant that the exporters were prohibited from exporting coal at a rate which was less than the benchmarked international market rate.

CERC's Order & Compensatory Tariff

Adani Power appealed to the CERC for a revision of the tariffs under both the PPAs to mitigate the price escalation of Indonesian coal on the grounds of force majeure and change in law in terms of the provisions of the PPAs.

CERC vide its interim order dated April 02, 2013, concluded that the revision in tariff being prayed for cannot be benefitted from the provisions of force majeure on the basis of various reasons including *inter alia* that increase in the price of a commodity does not lead to the impossibility of performance under a contract and that there was no explicit provision in the PPA stipulating that change in procurement of prices would constitute a force majeure.

The CERC further held that Adani Power can also not be benefitted under the provisions of change in law as the PPAs defined the term 'law' as the laws of India and hence change in law can only mean change in Indian law, and not Indonesian law.

Observing that Adani Power had taken huge risk by quoting the energy charge under non-escalable head thereby eliminating the prospect of compensation on account of escalation in price of fuel, the CERC however stated that "*there is an imminent need to find out a practical and acceptable solution to the problem for ensuring supply of power to the consumers at competitive price while seeking to ensure sustainability of the electricity sector*". Exercising its regulatory powers u/s 79(1)(b) of the Act, which gave CERC the power to regulate tariff of generating companies that have a composite scheme for generation and sale of electricity in more than one State, the CERC awarded Adani Power, '*compensatory tariff*', to be proportionate to the hardship being faced by it and only till the time the said hardship continued to exist. In other words, CERC ordered the compensatory tariff to be revised or withdrawn as and when the hardship gets removed or lessened.

The CERC considered the award of compensatory tariff as the best way of ensuring the continuity in the supply of power at competitive rates rather than requiring the parties to re-negotiate the tariff as it held that re-negotiation would undermine the sanctity of the bid. The compensatory tariff was to be determined by a specially constituted Expert Committee comprising of the representatives of Adani Power, state governments, the concerned distribution companies and independent experts.

On the basis of the report furnished by the Expert Committee, and also the views expressed by some consumer organisations, the CERC passed its final order dated February 21, 2014, quantifying the compensatory tariff awarded to Adani Power. In the meantime, appeals were filed by GUVNL, the Haryana Utilities[2] and some consumer organisations before the Appellate Tribunal against the order of the CERC Order dated April 02, 2013 awarding the compensatory tariff.

Appeal before the Appellate Tribunal

To ensure sanctity of the competitive bidding process and to preserve the tariff discovered therefrom, the Appellate Tribunal vide its Order dated April 07, 2016, overruled the CERC's order and observed that the CERC does not have regulatory powers u/s 79 of the Act, to award compensatory tariff. It was held by the Appellate Tribunal that the tariff so determined cannot be reopened, altered or varied by the Regulatory Commissions, except that they have the power to reject the application for adoption of tariff so discovered u/s 63 of the Act, in the event it is found that the bidding was not conducted as per the statutory framework. Relief, if any, for the price escalation could be sought by a power generating company only on the basis of the provisions of force majeure or change in law as provided in the PPAs. Thus, in the event a case of force majeure or change in law is made out, relief provided under the PPAs can be granted to the power generating companies, by the CERC in terms of its adjudicatory power under section 79(1)(f) of the Act.

Interpreting the meaning of the terms 'law' and 'change in law' as provided for in the PPAs, the Appellate Tribunal held that these were confined to only Indian law in terms of the PPAs and did not encompass foreign law. Hence any change in foreign law such as the Indonesian law/regulations prescribing the benchmark price for export of coal would not get covered within the ambit of 'change in law' under the PPAs.

Relying on the observation of the Supreme Court in the case of *Dhanrajamal Gobindram* v. *M/s Shamji Kalidas & Co*[3] that the term, *force majeure,* should be given the widest meaning with the intention of saving the performing party from the consequences of anything over which he has no control, the Appellate Tribunal upheld force majeure as the ground for claiming relief for price escalation of Indonesian coal under the PPA. The Appellate Tribunal observed that the escalation in the price of imported coal owing to an amendment of the Indonesian regulation was an unforeseeable event beyond the control

[2] Appeal No.100 of 2013, Appeal No. 98 of 2014, Appeal No.116 of 2014, Appeal No 134 of 2014 and Appeal No. 135 of 2014

[3] AIR 1961 SC 1285

of Adani Power that hindered its performance, notwithstanding the fact it continued to honour its contractual obligation of generating and supplying power. The word "hindered" was construed to mean as impaired and/or interfered with, and not necessarily rendering the performance of the contract impossible. Exorbitant expenses to import coal against the backdrop of abnormal increase in the price of Indonesian coal, as also the non-availability / short supply of domestic coal resulted in unreasonable losses, making it economically and financially unviable for Adani Power to perform and honour its PPA's for a long term period. Moreover, the PPA contemplates that if the agreement becomes onerous because of circumstances beyond the control of the Affected Party, it shall be covered by force majeure event.

As observed by the Appellate Tribunal escalation in the price of Indonesian coal did not fall either under the natural (act of God), or the non-natural instances of force majeure listed in the PPAs (eg., compulsory acquisition, act of war, embargo etc). However, it could very well be brought within the ambit of a provision that listed 'force majeure exclusions' which had a qualification that if the listed exclusion events are themselves the result of a force majeure, then they would be construed as force majeure. Changes in cost of fuel has been recognised as one of the exclusions, however since this condition has been triggered owing to a force majeure, which is not within the reasonable control of the parties, it should be construed as a force majeure in the view of the Appellate Tribunal. A power generator cannot be denied relief just because it had quoted non-escalable Energy Charge in its bid. In view of the fact that the promulgation of the Indonesian regulation was an unexpected and drastic event, Adani Power would be entitled to seek recourse. The Indonesian regulation wiped out the fundamental premise on which Adani Power had quoted its bids.

The Appellate Tribunal accordingly set aside the interim and the final orders of the CERC granting compensatory tariff, and redirected the appeals to the CERC to review them on the grounds of force majeure and award the compensatory relief to the aggrieved power generating companies as per the provisions under the PPA.

Relief for Force Majeure Under the provisions of the PPA

The PPA lays down the following consequences of a natural and non-natural force majeure event:

In the case of a natural force majeure event, no tariff shall be paid to the power generating company for the entire duration of such natural force majeure event for that part of contracted capacity which has been affected by a natural force majeure event, and that the tariff shall be paid only for the balance part of the contracted capacity, which is declared to be 'available' for scheduling and dispatch to the concerned distribution companies.

In the case of non-natural force majeure events (both direct and indirect), the power generating companies are entitled to receive from the distribution companies, 'debt service', i.e the amounts due from the power generating companies to the lenders in terms of the financing agreements, only after the cessation of the non-natural force majeure event.

Conclusion

The Appellate Tribunal has quashed the regulatory powers of CERC under Section 79(1)(b) of Act, to alter or modify the tariff which has been determined by way of a competitive bidding process, holding that the CERC may by way of its adjudicatory powers under section 79(1)(f) of the Act, award relief to the power generating companies *as per the provisions of the PPA* if a case of force majeure is made out.

In light of the fact that the Appellate Tribunal, under the provision of the PPA's has recognised escalation in the price of Indonesian coal as neither a natural nor a non-natural force majeure event, it remains to be seen how the CERC shall be quantifying the compensation as directed by the Appellate Tribunal, and also whether the amount as and when quantified, shall be available to the power generating companies as an immediate relief or as a deferred relief as applicable in the case of the non-natural force majeure events.

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Notifications & Circulars

Foreign Direct Investment (FDI) Policy – Consolidated Policy and further liberalization: The Department of Industrial Policy and Promotion has issued the Consolidated FDI Policy on June 7, 2016 subsuming and superseding all Press Notes/ Press Releases/Clarifications/Circulars issued by DIPP, which were in force as on June 06, 2016. It may be noted that said Policy has failed to capture the recently inserted Regulation 10A in the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 which *inter alia* allows a non-resident investor to pay up to 25% (Twenty five per cent) of the total consideration on a deferred basis and/or create an escrow account for this purpose, for a period of up to 18 (eighteen) months, without obtaining prior approval from the RBI.

Foreign Direct Investment regime has been further liberalized by the Indian Government on 20-6-2016 and multiple sectors have been opened up for the FDI. Some of the major changes are,

- Local sourcing norms for *single brand retailers* has been relaxed with an extended window of 8 (eight) years before the 30% local sourcing norms come into play.
- FDI beyond 49 % has been permitted through government approval route in *Defence* sector, in cases resulting in access to modern technology. Further, condition of access to 'state-of-the-art' technology has been done away with.

- FDI upto 74% is now permitted in *Brownfield Pharmaceuticals* under automatic route.
- 100% FDI permitted under automatic route in *Brownfield Airport Projects.*

Constitution of National Company Law Tribunal: The Ministry of Corporate Affairs has issued a Notification on June 1, 2016 constituting the National Company Law Tribunal having its Principal Bench at Delhi and eleven other benches across the Country. Although the Companies Act came into force three years ago, the legislative status of the NCLT was sub-judice in light of pending cases in the Supreme Court challenging it's constitutionality. However it is to be noted that provisions with respect to amalgamations, capital reductions, winding up are yet to be notified by the Ministry of Company Affairs, therefore such powers will remain with the High Court till the NCLT becomes fully operational.

SEBI amends definition of 'Willful Defaulter': The Security Exchange Board of India ("SEBI") has amended the definition of "Willful defaulter" across a number of SEBI regulation to include the directors or promoters of the Company who are adjudged as willful defaulters or categorized as such by the RBI. Accordingly, in terms of the amended SEBI (Issue of Capital and Disclosure Requirements) (Third Amendment) Regulations, 2016, issue of convertible debt instruments is prohibited where the issuer or any of its promoters or directors is a willful defaulter. Similarly in terms of the amended SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013, if the issuer of Non-Convertible Redeemable Preference Shares on the date of filing of draft offer document or final offer document is a willful defaulter or is in default of a payment of interest or repayment of principal amount, in respect of non-convertible redeemable preference shares issued by it to the public for a period of more than six months, then, the issuer shall not make any public issue of non-convertible redeemable preference shares.

Ratio Decidendi

Compliance with MPS norms - All promoters are equally responsible: All the promoters in a listed company are equally responsible to ensure that the MPS norms are complied. The order made by SEBI, is to guarantee that there is an equitable participation of all the promoter/promoter group and directors *qua* the public shareholders in the affairs of a listed company. In the present case, the public shareholding of the company was below the required 25% since 2006. The promoters of the company had entered into a share purchase agreement (SPA) with prospective acquirers for the sale of shares constituting 90.60% shares of the company. Pursuant to the said agreement, the acquirers issued a detailed public statement tendering 7,660 shares out of which 3,060 shares were accepted. Despite the completion of open offer requirements well in time, due to the inability of the promoters to fulfil the obligations under the SPA, the agreement was rescinded and thereafter neither the promotors or the Company made any attempt to raise it's shareholding from the mere 9.40%. Since the promoter shareholding was more than three times the existing public shareholding, SEBI passed an order to freeze the excess promoter shareholding (62.40%) till such time the company complied with the MPS norms. The SEBI further held that in case of more than one entity in the promoter/promoter group in a company, the excess promoter holding for the purpose of taking action shall be computed on a proportionate basis. [*Southern Fuel Ltd.* v. *SEBI* - WTM/PS/52/CFD/JUNE/2016, decided on 8-6-2016, SEBI]

Non-payment of a disputed debt is not 'neglect to pay', dismissal of winding up petition: A winding up petition brought about by a creditor was dismissed by the Gujarat High Court on the ground that there was a *bona fide* dispute over the debt claimed by the petitioner company. In the present case, there was a business relationship between the petitioner company and the respondent company and proceedings under Section 138 of the Negotiable Instruments Act was pending before the competent court. In addition to this, the respondent company has brought on record, that it is a 'going concern' with permanent employees and wagers. Based on the aforesaid facts, the Gujarat High Court clearly stated that the amount claimed by the petitioner company is a disputed debt and the respondent Company is a commercially viable company. The Court relied upon a number of precedents and was of the view that in order for a dispute on a debt to be *bona fide,* it must be so in the subjective and objective sense. There must be an honest belief of a dispute which is based on substantial or reasonable grounds. There has to be so much doubt that the court sees that there is a question to be decided. The petition was accordingly dismissed. [*Tropicana Exports Pvt. Ltd.* v. *Shaligram Laminates Pvt. Ltd.* – Company Petition No. 238 of 2013, decided on 7-6-2016, Gujarat High Court]

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