

It's Time to End the 'Bid Low, Raise Price Later' Strategy of Power Sector Players

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An appellate tribunal has done well to limit the amount to which electricity producers can pass on higher input costs to consumers for when the bids they made were meant to have factored in such risks. But more needs to be done.

Putting a pause to a case that had dragged on for four years, the Appellate Tribunal for Electricity (ATE) recently issued a [judgment](#) regarding Tata Mundra, Adani Mundra, Sasan and a few other power projects that were seeking an increase in the tariffs they had quoted to win their respective contracts.

Around 2012, the promoters of these projects had approached the Central Electricity Regulatory Commission (CERC) seeking revision of tariff on the grounds of increase in the price of Indonesian coal, shortfall in domestic coal supply, rupee depreciation, etc. While concluding that no relief is possible under their respective contracts, the CERC still chose to use its regulatory powers to grant the projects what it termed as “*compensatory tariff*” over and above the contract terms, to mitigate the claimed hardships. This meant converting the discovered tariff – i.e. the tariff they had agreed to charge for the power they would supply – into an actual cost-based *determined* tariff.

In light of the CERC's post facto hiking of quoted tariffs, the ATE judgment is significant because it overrules the discretionary use of regulatory powers to make projects viable – even when there is no possibility for relief under the actual contract. Thus, while defending the sanctity of contracts, the tribunal has also strengthened accountability and ensured that regulators do not overstep their mandate.

Background and context

In order to grasp the implications of the judgment, it is important to understand the process through which these tariffs were discovered and the nature of the contracts.

The promoters won their contracts under a competitive bidding framework that gave them the option of passing on fuel price variation and capital cost related risks transparently at the time of bidding. Based on commercial considerations, the projects made certain choices in terms of how much risk they wanted to pass on to the consumers at the time of bidding. The power purchase contract they signed allows change in the agreed tariff only under two circumstances;

1. Change in law: whereby a legal action of a government body or a court imposes any cost (or results in benefit) and
2. *Force majeure*: which implies an unforeseen event that prevents or unavoidably delays the performance of obligations under the contract.

After emerging as lowest bidders under such a process and signing their respective contracts, the promoters were now seeking an increase in tariff.

Since the introduction of the competitive bidding process in the power sector in 2005, thermal generation capacity of more than 40,000 MW has been added under this route. More than half of this capacity is under litigation, with the promoters seeking revision of the quoted tariff which, if allowed, would have significantly increased the tariff burden on electricity consumers and defeated the purpose of introducing competition.

The wrong regulatory precedent

In April 2013, the CERC through [interim orders](#) ruled that no relief was available under the terms of the contracts. However, it still decided to use its regulatory powers to make the projects viable and appointed a committee to evaluate the extent of the tariff increase required to offset such claimed impacts. In [February 2014](#), based on the [committee's recommendations](#) and its own analysis, the CERC allowed what it termed as “compensatory tariff”, over and above the contractually agreed tariff. No public process was undertaken for this purpose, which is otherwise routinely followed for tariff revision matters in the electricity sector. Further, in spite of not being bound by the decision of the CERC, the electricity commissions in various states such as [Maharashtra](#), [Uttar Pradesh](#) and [Rajasthan](#) chose to adopt the CERC's approach of revising discovered tariffs. Thus, even in the absence of any possibility of relief under the contract, they used their regulatory powers to grant compensatory tariff without proper public notice or consultation.

Implications of the ATE judgement

Given the above context, the most remarkable feature of the ATE judgment is its striking down of the use of regulatory powers to bail out projects when no relief is possible under the contract. In other words, the ruling states that relief if any, can strictly be as per the provisions of the contract. Overruling the CERC decision for the Sasan power project, the ATE has held that increased cost on account of foreign exchange rate variation cannot be passed on to the consumers.

While declaring that there was no change in law event, the tribunal has however granted some relief to the projects under the provisions of the *force majeure* clause. The emphasis on due process and the need to hear all parties to decide the extent of this relief is yet another silver lining.

Without going into the validity of the ruling on the issue of the applicability of *force majeure* or some other limitations of the judgement, there is still a major difference between the tribunal's decision and the approach adopted by the CERC. By allowing deviations from bid assumed values of performance parameters, exchange rate variation impact and other such considerations, the CERC had restored the profitability of the project developers as if the events causing claimed hardships had not occurred. As against this, the ATE judgment provides relief only under the *force majeure* clause and that too strictly as per the contract. Therefore, the tariff impact of this

ruling would be much lower than the compensatory tariff allowed by the CERC, contrary to what is being reported in [some sections of the media](#).

The tribunal's judgment has thus not only limited the relief provided, but also sent the right signals to aggressive bidders and lax lenders that they will be held accountable for the risks they have assumed to win their contracts. The effectiveness of this judgment now rests on the CERC's ability to stick to the contractual framework for granting limited relief and by following the due process.

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