

# ● PRAYAS

Initiatives in Health, Energy,  
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Amrita Clinic, Athawale Corner, Karve Road Corner, Deccan Gymkhana, Pune 411 004; INDIA

Tel.: (020) 65205726: Fax: (020) 2542 0337. E-mail: [energy@prayaspune.org](mailto:energy@prayaspune.org) Web-site: [www.prayaspune.org](http://www.prayaspune.org)

4<sup>th</sup> January 2013

To,  
The Secretary,  
Central Electricity Regulatory Commission  
3 rd & 4 th Floor, Chanderlok Building,  
36 Janpath, New Delhi- 110001

**Subject:** Prayas comments regarding the petition under Sections 61, 63 and 79 of the Electricity Act, 2003 for establishing an appropriate mechanism to offset in tariff the adverse impact of the unforeseen, uncontrollable and unprecedented escalation in the imported coal price due to enactment of new coal pricing Regulation by Indonesian Government and other factors.

**Ref:** CERC Petition No.159/MP/2012, hearings dated 4<sup>th</sup>, 11<sup>th</sup> and 20<sup>th</sup> December 2012, Submission made by Prayas dated 29<sup>th</sup> October 2012

Dear Sir,

This submission is regarding the matter mentioned above. We were present for the hearings held on 4th, 11th and 20th December 2012 and have submitted our comments orally and have filed our preliminary submission on 29th October 2012. In addition to our earlier submission, please find attached additional submission in response to the arguments made by the petitioner during the subsequent hearings.

We request the commission to place this submission on record and allow us to make further submissions based on subsequent proceedings in this matter, if any.

### **Brief facts of the matter:**

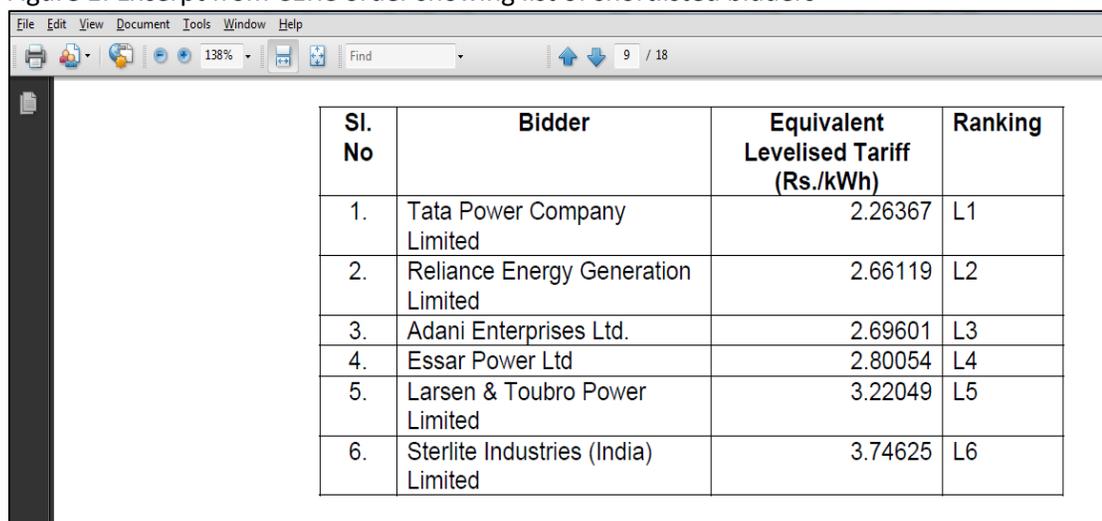
1. The section 63 of the Electricity Act 2003 allows regulatory commission to directly adopt a tariff that has been discovered through a transparent process of bidding conducted as per the Guidelines issued by the Central Government for this purpose. Accordingly, the Government of India notified Competitive Bidding guidelines in January 2005<sup>1</sup>. The bidding guidelines emphasize on a fair and transparent process for bidding and allow bidders to pass through risks by quoting various escalable and non-escalable charges. The guidelines provide a two part tariff structure comprised of capacity and energy charge and allow bidders to quote escalable parameter for both these components and also their sub-components.
2. Using this provision and framework, the Ministry of Power launched what it called Ultra Mega Power Projects (UMPP) Policy which defined UMPPs as: “very large sized projects,

<sup>1</sup> [http://powermin.nic.in/acts\\_notification/electricity\\_act2003/pdf/CBG%20notified%2027.9.07-clean.doc](http://powermin.nic.in/acts_notification/electricity_act2003/pdf/CBG%20notified%2027.9.07-clean.doc)

approximately 4000 MW each involving an estimated investment of about Rs. 16,000 crore. These projects will meet the power needs of a number of States/ distribution companies located in these States, and are being developed on a Build, Own, and Operate (BOO) basis.<sup>2</sup> The same policy also states that: “In order to enhance investor confidence, reduce risk perception and gets a good response to competitive bidding, it was deemed necessary to provide the site, fuel linkage in captive mining blocks, water and obtain environment and forests clearance, substantial progress on land acquisition leading to possession of land, through a Shell Company. In addition, Shell companies would also be responsible for tying up necessary inputs from the likely buyers of power. In addition shell companies would also facilitate tying up of power off takes from these projects with appropriate terms and conditions and Payment Security Mechanism.”

- Under this Policy, Power Finance Corporation Ltd is designated as the nodal agency to conduct bidding process. Accordingly, Coastal Gujarat Power Ltd (CGPL) was incorporated on 10th Feb. 2006, as a special purpose vehicle (SPV) to implement the Mundra Ultra Mega Power Project. The project was conceived as an imported coal based UMPP for which bidding was initiated in March 2006 and completed in December 2006 and M/s Tata Power Company Ltd emerged as the successful bidder for this project. The CERC order in petition no 18/2007<sup>3</sup> for adoption of tariff in this process, states that six bidders qualified for the final stage and following were the levelised tariffs quoted by them:

Figure 1: Excerpt from CERC order showing list of shortlisted bidders



Sl. No	Bidder	Equivalent Levelised Tariff (Rs./kWh)	Ranking
1.	Tata Power Company Limited	2.26367	L1
2.	Reliance Energy Generation Limited	2.66119	L2
3.	Adani Enterprises Ltd.	2.69601	L3
4.	Essar Power Ltd	2.80054	L4
5.	Larsen & Toubro Power Limited	3.22049	L5
6.	Sterlite Industries (India) Limited	3.74625	L6

The same order further states that: “Based on the facts placed on record, we find that the **tariff discovery for the Mundra UMPP was the result of a transparent process of bidding in conformity with the “Guidelines for Determination of Tariff by Bidding Process for procurement of Power by Distribution Licensees”**. Accordingly, in terms of Section 63 of the Act, we adopt the tariff as quoted by the selected bidder, M/s Tata Power Company Limited for Mundra Ultra Mega Power Project to supply power to the procurers as per their respective shares as indicated at para 4 above. The adopted tariff shall be charged in accordance with Schedule 7 of the PPA signed on 22.4.2007.”

<sup>2</sup> [http://powermin.nic.in/whats\\_new/pdf/development\\_of\\_project.pdf](http://powermin.nic.in/whats_new/pdf/development_of_project.pdf)

<sup>3</sup> [http://cercind.gov.in/03022007/No\\_18-2007.pdf](http://cercind.gov.in/03022007/No_18-2007.pdf)

4. The Petitioner i.e. CGPL, is now a wholly owned subsidiary of Tata Power Company Ltd and is building the Mundra UMPP with a total capacity of 4000 MW. Two units of the project (1600 MW) have already declared commercial operation and the project is likely to achieve COD for all units by the end of this year. The bidding guidelines give the bidders the option of deciding the level of fuel cost related risk that they want to share or pass through. Under the proposed tariff structure bidders can quote escalable and non-escalable rates for capacity, fuel cost, fuel handling and fuel transportation charges. Accordingly the petitioner in its bid quoted a certain percent of fixed parameters while escalating the remaining part. The bid submitted by the petitioner can be seen in the Figure 2 below.

Figure 2: TPC bid for the Mundra project as published on the website.

TATA POWER COMPANY LIMITED										
Contract Year	Commence Date of Contract Year	End Date of Contract Year	Quoted Non-Escalable Capacity Charges (Rs./kwh)	Quoted Escalable Capacity Charges (Rs./kwh)	Quoted Non-Escalable Fuel Energy Charges (US\$/kwh)	Quoted Escalable Fuel Energy Charges (US\$/kwh)	Quoted Non-Escalable Transportation Energy Charges (US\$/kwh)	Quoted Escalable Transportation Energy Charges (US\$/kwh)	Quoted Non-Escalable Fuel Handling Energy Charges (Rs./kwh)	Quoted Escalable Fuel Handling Energy Charges (Rs./kwh)
1	27-Jun-12	31-Mar	0.872	0.033	0.00705	0.00585	0.00285	0.00109	0.042	0.046
2	1-Apr	31-Mar	0.870	Same as Above	0.00707	Same as Above	0.00284	Same as Above	0.046	Same as Above
3	1-Apr	31-Mar	0.868	Same as Above	0.00707	Same as Above	0.00284	Same as Above	0.048	Same as Above
4	1-Apr	31-Mar	0.866	Same as Above	0.00707	Same as Above	0.00284	Same as Above	0.047	Same as Above
5	1-Apr	31-Mar	0.864	Same as Above	0.00707	Same as Above	0.00284	Same as Above	0.051	Same as Above
6	1-Apr	31-Mar	0.862	Same as Above	0.00707	Same as Above	0.00284	Same as Above	0.051	Same as Above
7	1-Apr	31-Mar	0.859	Same as Above	0.00707	Same as Above	0.00285	Same as Above	0.051	Same as Above
8	1-Apr	31-Mar	0.857	Same as Above	0.00707	Same as Above	0.00284	Same as Above	0.056	Same as Above
9	1-Apr	31-Mar	0.854	Same as Above	0.00707	Same as Above	0.00284	Same as Above	0.055	Same as Above
10	1-Apr	31-Mar	0.852	Same as Above	0.00707	Same as Above	0.00284	Same as Above	0.055	Same as Above
11	1-Apr	31-Mar	0.849	Same as Above	0.00707	Same as Above	0.00284	Same as Above	0.060	Same as Above
12	1-Apr	31-Mar	0.846	Same as Above	0.00711	Same as Above	0.00286	Same as Above	0.060	Same as Above
13	1-Apr	31-Mar	0.842	Same as Above	0.00714	Same as Above	0.00287	Same as Above	0.059	Same as Above
14	1-Apr	31-Mar	0.839	Same as Above	0.00714	Same as Above	0.00287	Same as Above	0.065	Same as Above
15	1-Apr	31-Mar	0.836	Same as Above	0.00714	Same as Above	0.00287	Same as Above	0.065	Same as Above
16	1-Apr	31-Mar	0.832	Same as Above	0.00714	Same as Above	0.00288	Same as Above	0.063	Same as Above
17	1-Apr	31-Mar	0.828	Same as Above	0.00714	Same as Above	0.00287	Same as Above	0.071	Same as Above
18	1-Apr	31-Mar	0.824	Same as Above	0.00714	Same as Above	0.00287	Same as Above	0.069	Same as Above
19	1-Apr	31-Mar	0.819	Same as Above	0.00714	Same as Above	0.00287	Same as Above	0.067	Same as Above
20	1-Apr	31-Mar	0.550	Same as Above	0.00714	Same as Above	0.00287	Same as Above	0.076	Same as Above
21	1-Apr	31-Mar	0.545	Same as Above	0.00714	Same as Above	0.00287	Same as Above	0.074	Same as Above
22	1-Apr	31-Mar	0.540	Same as Above	0.00719	Same as Above	0.00289	Same as Above	0.072	Same as Above
23	1-Apr	31-Mar	0.534	Same as Above	0.00721	Same as Above	0.00290	Same as Above	0.082	Same as Above
24	1-Apr	31-Mar	0.529	Same as Above	0.00721	Same as Above	0.00290	Same as Above	0.079	Same as Above
25	1-Apr	31-Mar	0.523	Same as Above	0.00721	Same as Above	0.00290	Same as Above	0.076	Same as Above
26	1-Apr	25th anniversary of the Schedule d COD of the first Unit	0.516	Same as Above	0.00723	Same as Above	0.00291	Same as Above	0.088	Same as Above

5. The petitioner is importing coal from Indonesia for this project. As per the petition, on 23.9.2010 the Indonesian Government notified a regulation which directed the holders of mining permits for coal mines in Indonesia to sell coal in domestic as well as international market, as per the prescribed benchmark price and all pre-existing contractual arrangements were to be aligned accordingly. As per a press release issued by Tata Power Company Ltd in March 2007, the company has acquired 30% stake in two coal companies owned by PT Bumi Resources<sup>4</sup>. The petitioner has signed Fuel Supply Agreement (FSA) with Indocoal Resources (Cayman) Limited, which is a subsidiary of PT Bumi Resources Tbk. It is claimed by the petitioner that after Indonesian Regulation came into effect on 1.9.2011, the petitioner had to pay higher cost for import of coal on account of which they would lose about 67 paise/kWh, aggregating to annual loss of around 1800 crore. Therefore, to

<sup>4</sup> <http://www.tatapower.com/media-corner/presslease/07mar30.aspx>

mitigate this purported financial loss the petitioner has filed this case before the commission.

6. **Main contentions raised by the petitioner:** The petitioner has claimed relief primarily under article 13 of the PPA dealing with 'Change of Law'. Alternatively the petitioner has claimed that if prayers under this clause are not entertained, relief may be considered under article 12 of the PPA concerning 'Force Majeure' events. And ultimately if none of these can be considered, then the commission should use its power under section 79 of the Electricity Act 2003 and intervene in this matter to help the petitioner achieve a tariff that will be financially viable for the project. This is the sum and substance of the petitioners claims, as submitted by them during the course of the hearings. The points below will make it clear how neither of these claims are correct or legally tenable under the present PPA and bidding framework.

7. **Claims by the petitioner regarding applicability of 'Change of Law' related provisions:**

- a. The Article 1 of the PPA defines "Law" as: *"Law means, in relation to this Agreement, all laws including Electricity Laws in force in India and any Statute, ordinance, regulation, notification or code, rule or any interpretation of any of them by any Indian Governmental Instrumentality and having force of law and shall further include all applicable rules, regulations, orders, notifications by an Indian Governmental Instrumentality pursuant to or under any of them and shall include all rules, regulations, decisions and orders of the Appropriate Commission."*
- b. The petitioner has claimed that definition of Law, as per PPA can be construed to mean not just all Indian Law but 'all Law' that can be related to this agreement. Therefore, the petitioner claimed that change or rather formulation of new regulation by the Indonesian Government regarding benchmarking the price of coal in that country can be considered as 'change in law' and hence relief as per section 13.4 of PPA (which deals with Tariff Adjustment Payment on account of Change in Law) should be granted to the petitioner.
- c. It is very misleading to say that price of Indonesian coal has increased on account of change in law. The Indonesian regulation merely requires contracts to align coal prices with a Government determined benchmark price which in turn is decided based on market price of Indonesian coal. It is the market price that has increased since 2011 and has in fact started decreasing again since the last quarter or so. Therefore, the change in the price of coal is simply on account of market dynamics. It is more important to note that even with the Indonesian regulation being in place, had the market price of Indonesian coal dropped to say USD 30 or 40 per ton, the petitioner would have made significant profits and would have never filed this case. Thus, increase in coal price is merely on account of market dynamics, a risk that the petitioner was well aware of and had the discretion to pass it through at the time of bidding.
- d. The present PPA does not bind the petitioner to any particular source for coal supply. At any point of time, the petitioner is free to source coal from anywhere in the world. Therefore, it is indeed a farfetched contention to say that law under the

PPA means any law anywhere in the world and in fact such argument will make implementation and interpretation of law almost impractical. Further, section 17.1 of the PPA which defines the governing law clearly states that: *“This Agreement shall be governed by and construed in accordance with the Laws of India.” (Emphasis added)* Thus, the law under the PPA can in no circumstances be construed to mean any law other than the Indian Laws.

- e. The Annexure P-17 (Pages 890-897, volume 4) of the petition contains copies of communications dated 12<sup>th</sup> December 2011 issued by Tata Power to various Government agencies. Through these letters the petitioner has stated the following: *“It is important to add that bidding documents for the first set of UMPPs – Mundra and Sasan UMPP, were released at the same time in 2006. While Mundra was conceptualized as an imported coal based project, Sasan was conceptualized as domestic Pithead coal based project. The Clause relating to ‘Change of Law’ as it appears in the PPAs for both these UMPP, is exactly same i.e. change of law under Indian Statutes are only allowed as pass-thru. Due to this while domestic coal based project enjoys the pass through of impact in change in law, similar benefit has not been given in case of a change in law in foreign country...”*
- f. These letters make it absolutely clear that right from the time of bidding the petitioner was aware that the ‘Change of Law’ provision only applies to laws under Indian Statutes and not to foreign laws. This means that the petitioner entered into this agreement with complete knowledge of this and in fact agreed with this interpretation of the said clause. Without prejudice to our above arguments and the basic contention that petitioner’s present interpretation (as argued by the petitioner’s counsel) of the term “Law” is not tenable under the existing PPA, we would request the commission to direct the petitioner to submit the minutes of all the pre-bid conferences conducted for Mundra UMPP to clarify this issue further.

**8. Claims of the petitioner regarding applicability of ‘Force Majeure’ clauses:**

- a. Alternately, to their contention regarding change of law, the petitioner has claimed that enactment and implementation of the Indonesian regulation is essentially an unforeseen and unavoidable event and hence their case for tariff revision should be considered under article 12 of the PPA dealing with Force Majeure events. As the points below will demonstrate, even this contention of the petitioner is not tenable.
- b. The clause 12.3 of the PPA defines Force Majeure event as: *“A ‘Force Majeure’ means any event or circumstance or combination of events and circumstances including those stated below that **wholly or partly prevents or unavoidably delays an Affected Party in the performance of its obligations under this Agreement, but only if and the extent that such events or circumstances are not within the reasonable control, directly or indirectly,** of the Affected Party and could not have been avoided if the Affected Party had taken reasonable care or complied with prudent practices:” (emphasis added).*
- c. As per the PPA definition a Force Majeure event implies inability of the affected party to materially perform its obligations as per the contract on account of events

beyond its reasonable control. However, the petitioner is not claiming any inability to perform its obligations under the PPA, as it is simultaneously seeking tariff revision which clearly implies that sourcing fuel or generating power is not the problem. Therefore, the petitioner is making it clear that there is no material impact on its ability to perform its contractual obligations and hence there is prima-facie no case for force majeure related claims. Beyond this obvious fallacy in seeking relief under force majeure while simultaneously asking for tariff revision, the points mentioned below make it further clear how force majeure claim cannot hold true on account of the PPA terms and conditions and the bidding framework design. As stated above, the petitioner through letters annexed as Annexure P-17 (Pages 890-897, volume 4) has explicitly acknowledged the fact that right from the time of bidding, the petitioner was aware that there is no recourse under the PPA for any change of law in a foreign country. Therefore this cannot be considered as unforeseen event.

- d. **Direct Non-Natural Force Majeure Event:** Without prejudice to our claim that no force majeure event has taken place, if for the sake of argument contentions of the Petitioner in this regard are considered, then such force majeure claim will have to be considered under direct non-natural force majeure event, as no other force majeure definition is applicable in this context. The section 12.3 (ii) of the PPA defines Direct Non - Natural Force Majeure Event based on following conditions:
- a) *Nationalization or compulsory acquisition by any Indian Governmental Instrumentality of any material assets or rights of the Seller or the Seller's contractors; or*
  - b) *the unlawful, unreasonable or discriminatory revocation of, or refusal to renew, any Consent required by the Seller or any of the Seller's contractors to perform their obligations under the Project Documents or any unlawful, unreasonable or discriminatory refusal to grant any other consent required for the development/ operation of the Project. Provided that an appropriate court of law declares the revocation or refusal to be unlawful, unreasonable and discriminatory and strikes the same down; or*
  - c) *any other unlawful, unreasonable or discriminatory action on the part of an Indian Government Instrumentality which is directed against the Project. Provided that an appropriate court of law declares the revocation or refusal to be unlawful, unreasonable and discriminatory and strikes the same down.*
- e. As the petitioner's claim is regarding change in Indonesian law, clauses 12.3 (ii)(a) and 12.3(ii)(c) cannot apply as they deal with changes in Indian laws. Therefore, in case the petitioner wants to make a claim under force majeure clause it will have to be under clause 12.3(ii)(b). This would mean that the petitioner should demonstrate that the actions of the Indonesian Government can be proved to be unlawful, unreasonable or discriminatory or are of such nature that clause 12.3(ii)(b) can be applicable. However, the petitioner has not given any evidence to this effect.
- f. **Force Majeure Exclusions:** Further, the section 12.4 of the PPA deals with Force Majeure Exclusions. This clause states: "*Force Majeure **shall not include** (i) any*

*event or circumstance which is within the reasonable control of the Parties and (ii) the following conditions, except to the extent that they are consequences of an event of Force Majeure: a) **Unavailability, late delivery, or changes in cost of** the plant, machinery, equipment, materials, spare parts, **Fuel** or consumables for the Project;”*

- g. The bidding framework gives bidders complete flexibility for sourcing fuel from any location at any point of time and passing through fuel cost related risks by quoting escalable components for fuel price, transportation and handling. Therefore, the force majeure exclusion clause clearly and explicitly excludes fuel cost and availability related issues from force majeure related concerns. The Maharashtra Electricity Regulatory Commission has already upheld this interpretation of the PPA through its order dated November 16, 2011 in Case No. 9 of 2011 by ruling that: *“Thus, Article 12.4 Force Majeure Exclusions, specifically excludes the unavailability or changes in cost of Fuel from Force Majeure unless the same are consequences of an event of Force majeure.”*
- h. **No relief under force majeure:** As would follow from harmonious reading of the PPA and bidding guidelines, force majeure related provisions are meant to address unforeseen and uncontrollable events which directly and significantly affect any Party’s ability to materially perform its obligations under the PPA. Therefore, naturally the PPA assumes that if Force Majeure event has taken place, then the affected Party will not be able to perform its material obligations which implies that Generation will not be possible. Hence, the Article 12 of the PPA provides relief only related to the capacity charge and not for fuel cost, as the same has also been explicitly excluded from force majeure definition. This is quite obvious, as the bidding guidelines give the bidder complete flexibility to quote escalable components for all constituents of fuel cost and pose no restriction on source from which fuel should be procured.
- i. Thus, harmonious reading of the bidding guidelines and PPA make it clear that concerns related to fuel price variation and economic profitability of the project cannot be the grounds for force majeure event. Hence, the contention of the petitioner to consider the enactment and implementation of the said Indonesian regulation dated September 2010 as a Force Majeure event under the PPA is not legally tenable.

9. **Claims of the petitioner regarding revision of tariff under clause 79(1)(b) of the Electricity Act 2003:** The petitioner has submitted that if not under the PPA, their plea for revising the tariff of the project can be considered under section 79(1)(b) of the Electricity Act 2003. The petitioner has contended that commission’s power to regulate is far and wide and it is using this power the commission can revise tariff and enable the petitioner to perform its obligations under the PPA.

- a. The section 79 (b) of the Electricity Act 2003 states the following: *“Section 79 (Functions of Central Commission):- (1) The Central Commission shall discharge the following functions, namely:-... (b) 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;”*

- b. In this context it becomes important to note that tariff for the concerned project was discovered through a transparent competitive bidding process and the commission had adopted the same under section 63 of the of the Electricity Act 2003 which states: *“Section 63. (Determination of tariff by bidding process): 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.”*
- c. The Electricity Act 2003 endeavors towards enabling and promoting competition in the sector and in fact the preamble of the Act itself says so quiet explicitly: *“An Act to consolidate the laws relating to generation, transmission, distribution, trading and use of electricity and generally for taking measures conducive to development of electricity industry, **promoting competition therein, protecting interest of consumers** and supply of electricity to all areas, rationalization of electricity tariff, ensuring transparent policies regarding subsidies, promotion of efficient and environmentally benign policies, constitution of Central Electricity Authority, Regulatory Commissions and establishment of Appellate Tribunal and for matters connected therewith or incidental thereto.”*

- d. Apart from the preamble, various other sections of the Act, as highlighted below, explicitly guide the commission to promote competition in the sector.

**Section 23. (Directions to licensees):**

If the Appropriate Commission is of the opinion that it is necessary or expedient so to do for maintaining the efficient supply, securing the equitable distribution of electricity and **promoting competition**, it may, by order, provide for regulating supply, distribution, consumption or use thereof.

**Section 60. (Market domination):**

The Appropriate Commission may issue such directions as it considers appropriate to a licensee or a generating company if such licensee or generating company enters into any agreement or abuses its dominant position or enters into a combination which is likely to cause or causes an adverse effect on competition in electricity industry.

**Section 61. (Tariff regulations):**

The Appropriate Commission shall, subject to the provisions of this Act, specify the terms and conditions for the determination of tariff, and in doing so, shall be guided by the following, namely:-

(c) the factors which would **encourage competition**, efficiency, economical use of the resources, good performance and optimum investments;

**Section 79. (Functions of Central Commission):**

(2) The Central Commission shall advise the Central Government on all or any of the following matters, namely :-

(i) formulation of National electricity Policy and tariff policy;

(ii) **promotion of competition**, efficiency and economy in activities of the electricity industry;

(iii) promotion of investment in electricity industry;

(iv) any other matter referred to the Central Commission by that Government.

Thus, as can be seen from the above points, the Act envisages tariff to be determined only if it cannot be discovered and not vice-versa.

- e. Further, the National Tariff Policy issued by the Central government also encourages commissions to promote procurement of power based on competitive bidding. Sub section 5.1 of the Policy states the following:

*“Introducing competition in different segments of the electricity industry is one of the key features of the Electricity Act, 2003. Competition will lead to significant benefits to consumers through reduction in capital costs and also efficiency of operations. It will also facilitate the price to be determined competitively. The Central Government has already issued detailed guidelines for tariff based bidding process for procurement of electricity by distribution licensees for medium or long-term period vide gazette notification dated 19th January, 2005.*

*All future requirement of power should be procured competitively by distribution licensees except in cases of expansion of existing projects or where there is a State controlled/owned company as an identified developer and where regulators will need to resort to tariff determination based on norms provided that expansion of generating capacity by private developers for this purpose would be restricted to one time addition of not more than 50% of the existing capacity.*

*Even for the Public Sector projects, tariff of all new generation and transmission projects should be decided on the basis of competitive bidding after a period of five years or when the Regulatory Commission is satisfied that the situation is ripe to introduce such competition.”*

- f. In fact a clarification issued by Ministry of Power dated 9th December, 2010 regarding clause 5.1 and 7.1 of Tariff Policy says<sup>5</sup>: *“States should fully migrate to procurement of power by Discoms through tariff based competitive bidding both for public & private sector generation and transmission projects. For the sake of abundant clarity, MoP would issue a clarification regarding the permitted exemptions in the Tariff Policy for the expansion/upgradation of projects, excluding the hydro sector.”*

- g. Therefore, the Act as well as policy has a clear focus and agenda of moving towards competitive discovery of tariff as far as possible. There is no doubt that the commission’s power to regulate is far and wide but that does not imply that using such power the commission can re-determine competitively discovered tariff, merely on the grounds of financial issues claimed by one particular project as that would not be in the interest of consumers or competition. It is particularly important to note that such revision would imply that risks knowingly and voluntarily assumed by a bidder for winning the contract can be passed through to consumers the moment they become real and apparent whereas profits (even when they are excessively high) will not be shared with consumers under any circumstances. Such one side risk allocation completely defeats the very idea of competition and economic efficiency. Hence, merely on the grounds of claimed

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<sup>5</sup> [http://www.powermin.nic.in/acts\\_notification/pdf/power\\_compendium.pdf](http://www.powermin.nic.in/acts_notification/pdf/power_compendium.pdf) (Page no 352)

financial unviability of one particular project, the commission cannot and must not re-determine tariff that was competitively discovered.

10. **Challenges in evaluating real impact on cash flows:**

Without prejudice to our primary contention that under the present PPA and bidding framework, the petitioner has no recourse to tariff revision, let us consider for a moment whether it is possible to evaluate the actual impact of the Indonesian regulation on the petitioner’s real cash flows. Points below will demonstrate that such process will be fraught with information asymmetries and the commission will at best be able to make an educated guess but never can be very certain of the real impact. It is of course assumed that the purpose of such exercise to evaluate extent of loss will not be to restore the level of profitability that the petitioner would have achieved had it continued to get fixed price coal from Indonesia, but only to make an estimate of the relief required, if at all, to make the project financially viable. This would imply that the return on equity should be just enough to make the project bankable and since it is the petitioner, who is primarily responsible for this loss (as the loss is on account of particular fuel strategy adopted by the petitioner at the time of bidding), procurers can share only a part of the loss and not the entire loss claimed by the petitioner. In such a situation, following issues will need to be considered for evaluating the real impact as well as loss sharing mechanism.

- a. **Multitude of options available to the petitioner:** As highlighted before, the petitioner is free to source coal from anywhere in the world. Even within Indonesia, coal of slightly lower GCV is much cheaper than the higher quality coal as can be seen from table 1 below. The difference in price of coal varieties is not proportional to the difference in their calorific values. Therefore, even while importing coal from Indonesia, the petitioner could procure slightly lower grade coal instead of coal based on its FSA, which means that the commission will need to monitor prices for all grades of coal traded in Indonesia.

Table No 1: Indonesian monthly coal price

Coal Brand	GCV (GAR)	Nov-11 (USD/t)	Dec-11 (USD/t)
Gunung Bayan I	7,000	125.55	121.24
Prima Coal	6,700	123.05	119.02
Pinang	6,200	110.92	107.29
Indominco IM East	5,700	95.07	91.86
Melawan Coal	5,400	89.53	86.67
EnviroCoal	5,000	82.53	79.99
Jorong J-1	4,400	66.55	64.5
Eco Coal	4,200	60.31	58.49

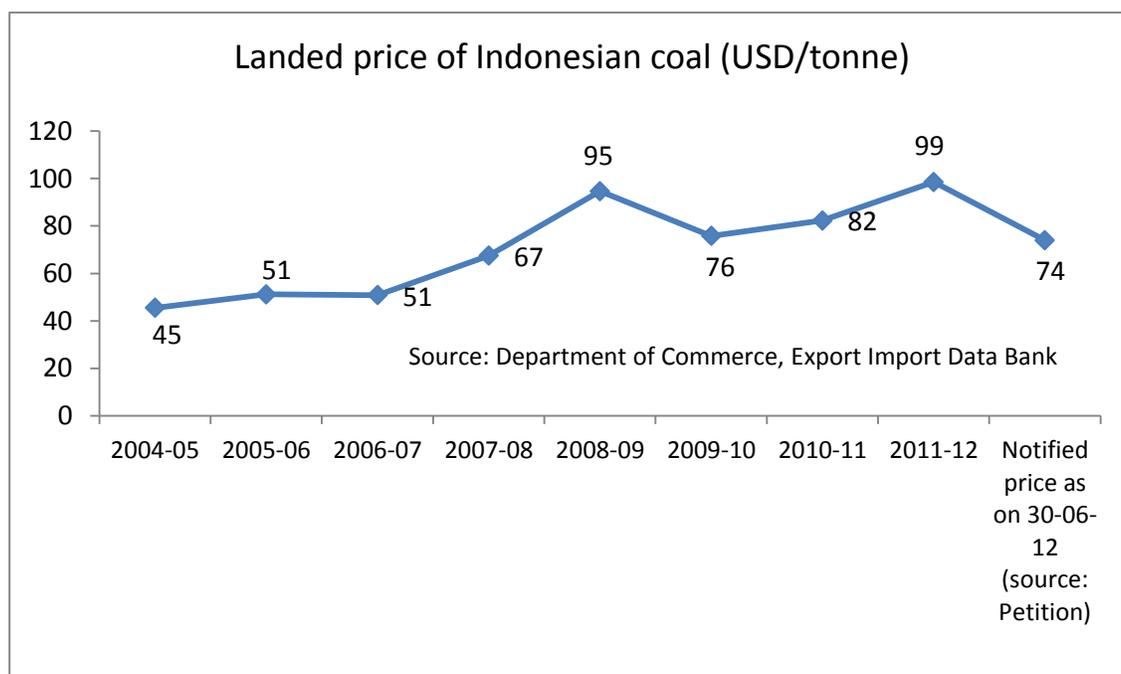
Source: Indonesian Ministry of Energy and Mineral Resources<sup>6</sup>

- b. **Transient nature of fuel price variation:** Fuel prices are volatile in nature are usually easily affected by not just demand-supply dynamics but also other geo-political events. The Figure No 3 demonstrates this point well. As mentioned above, because of variety of grades of coal and absence of uniform spot market, it is difficult to

<sup>6</sup> <http://alturamining.com/files/reports/2012%2001%2016%20Indonesian%20Coal%20Review.pdf>

measure trends accurately unless one is aware of the exact grade and source of the coal. In absence of such data, we have relied upon the landed cost of Indonesian coal imported by various Indian companies based on statistics reported in the Export Import Data Bank of the Department of Commerce. From this data it can be seen that landed cost of coal imported from Indonesia was around USD 45 per ton in 2004-05 which after several ups and downs rose to USD 99 per ton in 2011-12. As per the petition, the price notified by the Indonesian government as on 30th June 2012 was USD 74 per ton. There is also a possibility of coal imports from USA and various African countries becoming competitive in near future. In the long term there is a strong possibility that climate constraints may suppress coal demand globally thereby reducing coal prices further. Therefore, it is very much possible that the present problems claimed by the petitioner may be of transient and not permanent nature.

Figure No. 3: Landed price of Indonesian coal since 2004-05



- c. **Least cost coal to be considered:** While the petitioner may choose to procure coal from his identified sources, these need not necessarily be the least cost options available in the global market. Therefore, the commission cannot be bound by these arrangements as the contract allows coal to be procured from anywhere in the world. This would mean the commission will have to track global coal market and evaluate all possible options to ensure that it has considered the least cost alternative that was available while working out the tariff impact.
- d. **Monitoring performance parameters:** As soon as we talk about fuel price, performance parameters such as unit wise station heat rate, plant load factor, availability, as well as issues regarding coal quality will need to be monitored. As the commission is well aware, this is not at all a simple task and this will essentially

imply micro-managing plant operation. Further, unlike cost-plus projects, there is no break-up of various cost elements available to the commission and hence it will be tough to decide what part of tariff can be allowed as 'prudent' capacity charge and how much should be considered for fuel charge.

- e. **Increase in revenue due to increase in coal price:** As mentioned in the beginning, the petitioner owns 30% stake in the parent mine owning companies and hence is also partly benefited from the increase in coal prices. Therefore, the commission will have to look at profits and dividends declared by these parent mine owning companies to get a true picture of impact on cash flows, if any. This process will be fraught with information asymmetries as profits and dividends are declared by the companies themselves and are guided by various statutes of the country where the companies are located. As such, real impact on cash flows of the petitioner, if any will be very difficult to determine and/or establish and may require analyzing commercially sensitive data which may not be available to the commission.
- f. Thus, based on the points mentioned above, it becomes clear that the commission can have at best sketchy idea regarding real impact on financial viability of the project and even for making this estimate it will have to micro-manage the plant operation functionally and financially. World-over, it is an accepted proposition that on account of multitude of options available to private firms and the information asymmetries that exist between firms and regulators, it is never possible to evaluate 'real' or 'most prudent' cost and competitive discovery can be the only next best alternative possible in such cases. In fact the reasons mentioned above are often argued as the main motivations for the sector policy to move away from the traditional cost-plus approach of tariff determination and to rely on market discovery of tariff wherever possible.

#### 11. **Implications for the sector and public policy:**

Without prejudice to our basic contentions that the PPA and bidding framework does not provide any relief for the claims made by the petitioner, we would like to highlight the implications of any order by the commission that tries to revise the tariff discovered. As shown above changes in fuel price are transient by their very nature and hence financial troubles claimed by petitioner could be momentary and not permanent. Further it has also been demonstrated that any exercise to evaluate actual financial impact on petitioner's cash flows, if any, will be fraught with complexities and information asymmetries. Given such background let us consider for a moment that the commission considers the petitioner's plea and attempts at revising the tariff. Any re-determination of tariff in such case will imply that bidders can take un-due fuel risks to win contracts and later on pass-through such costs by requesting tariff revision on the grounds of financial un-viability. Such signaling will not only be detrimental for competition in general and governance in particular. While fuel price variation is a transient phenomenon and the petitioner's claimed financial troubles today may not exist tomorrow, an order issued by CERC will set a legal precedent and have long term implications for public policy. Therefore, any decision in this matter needs to be taken keeping in mind these long term implications for the sector and not from the point of view of claimed financial un-viability of a single project.

**12. Relief within the present PPA:**

Having mentioned the points above and considering its larger sectoral implications, this case should be approached from the point of view of ensuring sanctity of contracts and safeguarding the spirit behind introducing a fair and transparent bidding process in generation. Thus relief given, if any, must be strictly within the provisions of the PPA and as per the bidding guidelines. This would imply that procurer(s) must receive power in terms of both quantum i.e. normative availability of 80% and cost i.e. tariff as per schedule 12 of the PPA. Under the present PPA, the procurers cannot mandate the seller to generate beyond the normative limit of availability of 80%. However, if the generator manages to generate beyond this normative limit, the procurers have the first right of refusal. This provision of the PPA can be used to provide some relief to the petitioner, provided that all the procurers agree to such an arrangement and certain other conditions are also met. For the sake of abundant clarity, we would like to make it clear that this suggestion is without prejudice to our submissions above. Also it is made expressly clear that consumers and/or commission are in no way obliged to mitigate any financial loss claimed by the petitioner. However, if there is any alternative within the PPA which does not require the commission to re-determine the tariff and also ensures performance of the contract from the point of view of procurers (i.e. they get their due share at PPA specified tariff) then such alternative may be considered, provided the following conditions are met:

- a. All the procurers get their due share, i.e. normative availability of 80% at the tariff quoted as per the schedule 12 of the PPA.
- b. All Procurers agree to allow the petitioner to sell generation beyond the normative limit (i.e. 80%) at market rates to any third party.
- c. The mechanism for selling power to third party is vetted and approved by the commission.
- d. There is no tariff implication for the procurers whatsoever; in case the petitioner is not able to find suitable buyer or price for this third party sale. In short, the proposed mechanism cannot be construed as an assurance of completely off-setting financial loss claims made by the petitioner.
- e. The mechanism should be annually reviewed by the commission based on prevailing market prices of imported coal to verify whether such arrangement should continue. In case the market prices of imported coal fall below a certain threshold limit which the commission can set, this arrangement shall not be necessary and the procurers should be free to demand the additional generation to be either supplied to them or claim part of the surplus earned by the petitioner through sales to third party, as per the provisions of the PPA.
- f. The commission should also put in place appropriate checks and balances to avoid sale of the additional power to the same parties i.e. procurers at higher rates.
- g. Any other conditions that the commission may feel are necessary in this regard should also be incorporated.

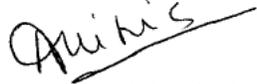
Based on the points mentioned above we urge the commission to look at this matter from the broader perspective of public interest and governance and not from the narrow lens of claimed financial unviability of a particular project. As submitted by us before, none of the contentions made by the petitioner are tenable under the present bidding guidelines and PPA. Further, fuel is a volatile commodity, prices of which are affected by market dynamics and financial troubles faced by the petitioner today could very well be of transient nature. Further, the petitioner had the full discretion to

pass through these risks to consumers at the time of bidding but it willingly chose not to do so and in return won the contract. After having secured the project, it is not at all fair and appropriate to revise tariff to pass through the risk that the bidder had voluntarily chosen to take. The commission needs to be aware to the precedent such revision will set, as it will mean that bidders can quote aggressively low tariff on the basis of risky fuel arrangements and later on pass through these costs by claiming unviability of the project. Therefore, relief given, if any, must be strictly within the provisions of the PPA and the bidding guidelines.

We request the Commission to kindly take this submission on record and allow us to make further submissions, if any.

Thanking you

Sincerely



Ms. Ashwini Chitnis  
Senior Research Associate  
Prayas Energy Group  
Athawale Corner, Karve Road,  
Deccan Gymkhana  
Pune, 411004 India  
Tel. 91-20-25420720, 65205726  
[www.prayaspune.org/peg](http://www.prayaspune.org/peg)