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NEWSALERT

APRIL 2017

SUPREME COURT RULING AGAINST COMPENSATORY TARIFFS FOR POWER PROJECTS

Earlier this month, the Supreme Court of India in *Energy Watchdog & Ors. v/s. Central Electricity Regulatory Commission*[1] set aside the orders passed by the Appellate Tribunal for Electricity ("**APTEL**") dated 7 April 2016 (the "**APTEL Order**")[2] and the Central Electricity Regulatory Commission ("**CERC**") dated 6 December 2016 (the "**CERC Order**")[3] relating to compensatory tariff awards granted to certain power generating companies, mitigating an increase in costs incurred by such companies where tariffs have been determined through a process of competitive bidding.[4]

1. BACKGROUND

A brief background to this matter is set out below.

(a) Adani Power Limited ("**APL**") had entered into separate power purchase agreements ("**PPAs**") with the Gujarat and Haryana state utilities for the supply of power. APL assumed responsibility *inter-alia* to *tie up* the fuel linkage and imported coal from Indonesia at applicable prices.

(b) Subsequently, due to an increase in the costs of coal imported from Indonesia, the PPAs became commercially unviable for Adani. The unforeseen rise in price of importing coal from Indonesia was on account of change in law in Indonesia that took place in 2010 and 2011 (the "**Indonesian Regulations**")[5] which aligned the export price of coal from Indonesia to international market prices (instead of the price that was prevalent for the last 40 years).

(c) As a result thereof, APL approached the CERC seeking either *discharge* from the PPAs on account of *frustration* or to restore APL to the same economic condition prior to implementation of the Indonesian Regulations.

(d) APL argued that the Indonesian Regulations effectively made the performance of the PPAs *impracticable* since the economic assumptions behind the bids were negated by an unprecedented and unforeseeable rise in the price of imported coal.

(e) The CERC initially rejected APLs claims on the grounds of *force majeure* and/or change in law. However, after constituting a committee to look into as well as find an acceptable solution for the difficulties alleged by APL, the CERC proceeded to grant a compensatory tariff.

[1] Please refer to: http://judis.nic.in/supremecourt/imgs1.aspx?filename=44760

[2] Please refer to: http://aptel.gov.in/judgements/Full%20Bench%20Judgment_07.04.16.pdf

[3] Please refer to: http://www.cercind.gov.in/2016/orders/155MP2012.pdf

[4] Tariff-based competitive bidding is a process in which the power generating companies quoting the lowest average electricity tariffs for a proposed project get to set up such a project.

[5] *Indonesia Regulations (No. 17 of 2010)*

(f) On appeal, the APTEL held that APL *was* entitled to relief, but disagreed with the CERC on the grounds that *force majeure* was made out on the facts and the CERC could not exercise its general powers to grant compensatory tariff upon the execution of the PPAs.

(g) The APTEL found that *inter-alia:*

(i) the relief available to APL should be determined by the terms of its PPAs with the respective state distributors and that the PPAs provided *inter-alia* for a broad range of circumstances which could be defined to be an event of *force majeure*; and

(ii) a change in Indonesian law pursuant to the Indonesian Regulations (which impacted the coal price for APL), did not constitute a change in law under the PPAs, but could constitute *force majeure*.

The APTEL referred the matter to the CERC to consider the impact of the Indonesian Regulations and whether they could constitute a *force majeure* event, granting compensatory relief. The CERC, by its order dated 6 December 2016, arrived at a certain determination for compensatory tariff to be granted on account of *force majeure*.

(h) The APTEL Order and the CERC Order was challenged before the Supreme Court.

2. KEY ISSUES

The key issues addressed by the Supreme Court are set out as below.

2.1 Whether the sale of electricity by a generating station in one state to a consumer in another state will qualify as a '*composite scheme'* under section 79 of the Electricity Act, triggering the jurisdiction of the CERC? ("**Issue 1**")

2.2 Whether the rise in fuel prices caused by the Indonesian Regulations qualify as a '*Force Majeure Event*' rendering the PPAs frustrated or impossible for performance? ("**Issue 2**")

2.3 Whether a change in law in India or a change in law in Indonesia will qualify as a 'change in law' under the PPAs? ("**Issue 3**")

3. ANALYSIS

3.1 Issue 1

In addressing Issue 1, the Supreme Court held that where a tariff was determined by a transparent process of bidding by power companies in India, such tariff must be in accordance with the guidelines issued by the Central Government.

The relevant PPAs, which dealt with the generation and supply of electricity, were governed either by: (i) the State Commission, in case the generation and supply takes place within the *same* State; or (ii) the CERC in case the generation and sale takes place between more than one State.

The Supreme Court held that in case of inter-State supply, the transmission or wheeling of electricity will qualify as a *'composite scheme'* as in such cases, the generation and sale of electricity occurs in more than one State. Further, the CERC, while exercising its jurisdiction in such cases, the Supreme Court noted that the CERC was bound by guidelines issued by the Central Government.

3.2 Issue 2

In case of *force majeure*, the Supreme Court cited various English and Indian case-law and held that a case of *'frustration of a contract'* under section 56 of the Indian Contract Act, 1872 *cannot* be made merely on the grounds of onerous performance or one mode of performance becoming impossible to perform.

If there are *alternative* modes of performance, it will not be a case of frustration under such contract. An event of *force majeure* leading to the frustration of a contract may be derived only in case of an unforeseen event or circumstance that wholly or partly prevents the affected party in the performance of its obligations under such contract.

The Supreme Court, also held that the mere rise in the price of coal will not amount to frustration of the PPAs. Further, as APL voluntarily agreed to quote energy charges as non-escalable (in order to be competitive) to procure the award of the contract, the change in price of the raw material cannot be held to constitute *force majeure*.

3.3 Issue 3

The Supreme Court held that a change in *Indonesian* law does not qualify as a *'change in law'* in India under the guidelines issued by the Central Government read along with the PPAs and took the view that the term '*all laws*' provided in the PPAs would only include the laws of India, including electricity-related laws *unless* any specific reference to foreign laws has been made.

In this context, it is pertinent to note that the Supreme Court rejected the contention of the power generators that in every other clause of the PPA, references had explicitly been made to *'Indian Law'* and stated that as such it would be unsafe to rely upon such other clauses of the PPAs.

However, a change in the *coal policy* of the Indian Government leading to economic implications and affecting the manner and extent to which coal is sourced *will* amount to a *'change in law'* clause in the PPAs.

The Supreme Court also held that the modification of the New Coal Distribution Policy, pursuant to a letter dated 31 July 2013 issued by the Ministry of Power and the revised tariff policy dated 28 January 2016, did amount to a change in Indian law and would be covered by the *'change in law'* clause in the PPAs.

Therefore, in the case of such *'change in law'* in India, the power generator will be entitled to compensatory tariff to the limited extent of the impact of the change in the policy and will be effective from such date as decided by the CERC.

IndusLaw View:

This landmark judgement by the Supreme Court drives home and settles the point that only the CERC will have jurisdiction over disputes relating to generating companies and power purchase agreements for the supply of electricity to more than one state. The judgement also underlines that the CERC will be governed by the guidelines issued by the Central Government and can grant relief in the exercise of its regulatory powers only with respect to power purchase agreements.

The Supreme Court has further cast in stone that a mere *rise* in price of a raw materials cannot be construed to be a case of *frustration* or *force majeure*. It is amply clear from the judgement that an unexpected rise in the price of coal will not absolve generating companies from performing their obligations under a contract, in particular, since such power generators factor in such commercial risks in the bid process.

The key take away from this judgement is that generally, a party will not be absolved from performing its contractual obligations, simply because its performance has become more *onerous* on account of unforeseen turn of events. Power generating companies will not be able to seek a revision in electricity tariffs merely because of a change in the cost of procurement of fuel sources.

The judgement is likely to lead to power companies to become much more cautious in agreeing to non-escalable rates in their PPAs while quoting energy charges in a process of competitive bidding. While hedging for currency fluctuations in case of the supply of off-shore resources is a common occurrence, bidders should carefully consider whether hedging for *change in law* is commercially available in the market.

Given the Supreme Court's comments on the meaning of law in the PPA, project developers would be advised to expressly negotiate that a change in law includes a change in law in a foreign jurisdiction to mitigate supply chain risk and we question to what extent the Supreme Court's judgement may have been different if the definition of *law* in the *change in law* clause was expressly defined to include the laws of Indonesia in the context of APL's fuel supply linkages.

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April 25, 2017

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