

Yet another commandment

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Though fair, the SC verdict denying compensatory tariffs for two mega power projects will add to the instability in the power, banking sectors



GAJENDRA HALDEA

Thou shalt respect the sanctity of contracts' seems the commandment emerging from the recent Supreme Court judgment that denies compensatory tariffs for meeting the increased costs of coal imported by Tata and Adani power projects. This casts an ominous shadow on the future of these two mega projects of about 4,000 Mw each — among the largest in the world. It will also have a significant bearing on the way we treat infrastructure projects in India.

I happen to be one of those not surprised by the judgment. After all, the tariffs were determined through open competitive bidding where all risks and rewards were specified upfront. If the two companies knowingly agreed to bear the risk of fuel price as part of their respective bids, the buyers of their power can legitimately refuse to pay any additional costs of imported coal.

Consider a situation where the coal prices decline. Would these companies share the profits with their buyers? No way. By its very nature, a commercial risk is not shared with any other party, unless the contract says so. If this rule is not respected, an orderly conduct of trade and commerce would be impossible.

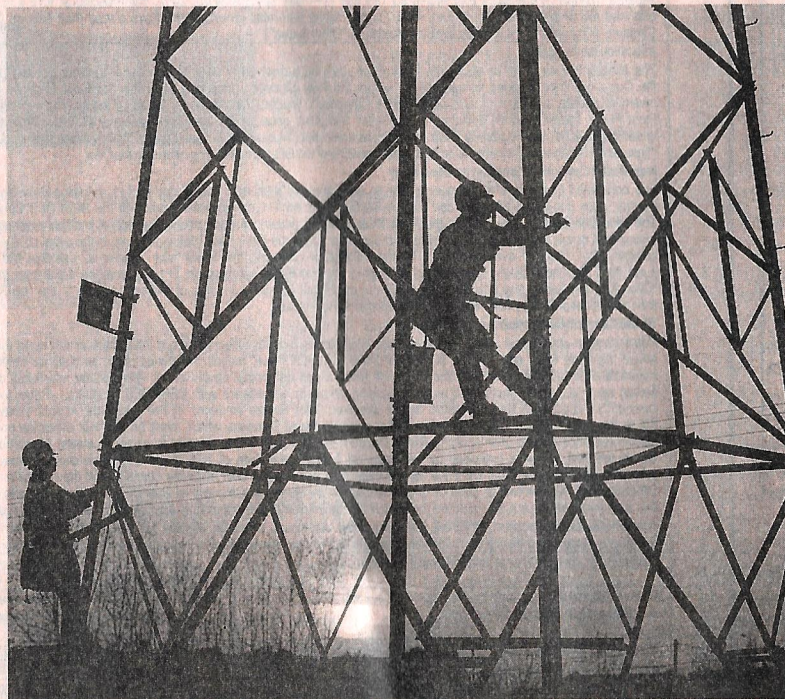
The format of Power Purchase Agreements (PPAs) for these projects was mandated by the power ministry under section 63 of the Electricity Act, which requires the regulator to adopt the tariff

determined by competitive bidding based on this format. As such, the regulator had no jurisdiction to set or amend the tariff in these cases. Hence its award of compensatory tariffs was fundamentally flawed, being contrary to law. Little wonder it was set aside.

India has an elaborate regulatory structure for the power sector comprising a regulatory commission in each state and one at the Centre. There is a dedicated Appellate Tribunal too. The principal role of these regulators is to oversee the implementation of the Electricity Act, which primarily unbundles the various segments of the electricity industry with a view to enabling competition and choice in the supply of electricity to consumers. That is the way power sector functions in the developed world. For example, if you are living in a flat in London, you can choose from among a dozen competing suppliers of electricity who would use a common network for transmitting the power — very much the way it works in telecom.

India's power regulators have steadfastly prevented any competition in the supply of power to consumers. As a result, virtually all bulk power must be sold to the government-owned entities, who in turn supply to consumers through a chain of inter-connected monopolies. In international literature, this arrangement is referred to as a "single-buyer model" which some experts describe as an evil practice.

The lack of competition essentially benefits the entrenched interests, never mind the enormous losses that distribution companies make year after year. These losses have accumulated in the form of debt exceeding a whopping ₹4,00,000 crore and are now being passed on to taxpayers through UDAY, much the same way it was done in 2002. The main beneficiaries would be the public sector banks who kept lending to bankrupt discoms. This can hardly be viewed as reform.



ROOT OF THE PROBLEM India's power regulators have steadfastly prevented any competition in the supply of power to consumers. Virtually all bulk power must be sold to the government-owned entities who in turn supply to consumers. Experts have described this model as 'evil'

Successive governments — be it United Progressive Alliance (UPA)-I, UPA-II and now National Democratic Alliance — have failed to bring about the much-needed structural reform in the power sector, as contemplated by the Electricity Act. On the contrary, they have willingly allowed the soul of Electricity Act to remain caged. The regulatory commissions have also abandoned the interests of consumers for whose benefit they were created. The consequences are predictable.

So far as PPAs are concerned, they are very complex contracts that require a high degree of skills and an honest intent to serve public interest. These elements are often deficient in the gov-

ernance of our power sector where the dominant sentiment is to somehow fix a deal and move on. In the process, unsustainable and unjustified benefits are cornered by influential companies. Public sector buyers also demand some unreasonable clauses, one such example being the allocation of fuel price risk to private sector companies.

Any student of commercial contracts will testify that it is patently unsustainable to pass on the inflation risk or commodity price risk to an individual company on a long-term basis because such prices are determined by market forces over which an individual company has no control. In essence, no person should

agree to bear a risk over which he has no control, unless he is in the business of speculation. Such provisions reflect poorly on all the contracting parties.

The standard bidding documents issued by the power ministry of UPA-I actually allocated the fuel price risk to private companies. Several other flawed provisions were also included in an environment of crony capitalism that has ultimately destabilised the power and banking sectors as we are currently witnessing. Objections raised by the author were often ring-fenced by the powers that were.

When these projects came under increasing stress, the power ministry approached me in the erstwhile Planning Commission to write the model PPAs afresh, which I did. These new model documents were notified by the power ministry in 2013 and have not faced any problems so far. In fact, several states (including Bihar and Kerala) have used them to their advantage in a fair, transparent and sustainable manner.

The tragedy of governance in India is that we often brush aside knowledge, past experience and lessons learnt. A lack of accountability enables successive decision-makers to engage in experimentation, which I call governance by trial and error. It imposes huge costs on the economy and the citizens. Professionalism and evidence-based policy making is often missing.

The power sector in India continues to be in a deep mess. Some window dressing has indeed given the impression of progress, but the initiatives taken so far will only lead to marginal improvements. One can only hope that the Supreme Court judgment would ignite an in-depth introspection for reform of this mother of all industries, which impacts the growth and welfare of all.

The author wrote the Electricity Act 2003 and several model power purchase/transmission agreements