INSIGHTS FROM JUDGEMENTS ON GAS SUPPLY & POWER PURCHASE AGREEMENTS

Wednesday Wisdom
21-02-2024

The Government of India has established Ministry of New and Renewable Energy in 1992 under which various acts, rules, regulations such as the Electricity Act, 2003 and the Electricity Rules, 2005 were enacted in order to provide a clear perspective in power purchase arrangements arrangements. However, the Parties need to be transparent about the terms that are being enumerated under such kind of arrangements.[1]

Such arrangements work for the power generator and for the consumer or the offtaker who is actually receiving the power from such plant. Under this arrangement, the seller is usually the entity developing or owning the power plant and the buyer (generally known as the "Offtaker") is the one obtaining the energy from such plants.

These arrangements establish a business relationship together for generation of power, creation and implementation of such power generation for a specific purpose. Power purchase agreements are generally detailed and lengthy agreements with elaborated provisions for lock-in, limited exit options, exit fees, liabilities, subsidies, minimum consumption requirements, commercials involving fixed charges, variable charges, implications of change in law etc. and are usually accompanied with equity arrangements, in case of captive power plants.

One must note that in these complex arrangements various aspects, like the quantum of power that is generated through such plants may sometimes be beyond the control of the parties.

Maharashtra State Electricity Distribution Company (MSEDCL) v/s Ratnagiri Gas and Power Private Limited and Ors (RGPPL) [2].

This judgement specifically attaches the importance to the intention of the parties and also takes into consideration the surrounding circumstances that may impact power generation.

[1] The article reflects the general work of the authors and the views expressed are personal. No reader should act on any statement contained herein without seeking detailed professional advice.
[2] Civil Appeal No. 1922 of 2023

Let us understand the facts of the case:

In this case the first respondent, RGPPL was a joint venture of NTPC Ltd., Gas Authority of India Ltd, MSEB Holding Company, ICICI, IDBI, SBI, and Canara Bank. It was established as a Special Purpose Vehicle to take over the assets of Dabhol Power Company Limited whose operations had to be closed down. RGPPL was a transmission company that owned a gas-based generating station at Ratnagiri, Maharashtra.

10th April 2007: RGPPL had entered into a Power Purchase Agreement ("PPA") with Maharashtra State Electricity Distribution Company ("MSEDCL") for a term of 25 years for the supply of domestic gas.

Till September 2011, the supply was continued.

After September 2011: There was a progressive decline in the gas supply to MSEDCL. The shortfall was attributed to the low yielding KG-D6 gas field and the said issue was also taken up with the Empowered Group of Ministers by the first respondent.

December 2011: To address this shortfall, RGPPL entered into a Gas Supply Agreement/Gas Transportation Agreement with Gas Authority of India Limited ("GAIL") for the supply of Recycled Liquid Natural Gas ("RLNG") under spot cargo on a take-and-pay-contract basis and informed MSEDCL. This meant change from one primary fuel to another primary fuel i.e. from natural gas to RLNG.

The target availability and the declared capacity of the plant was affected and MSEDCL was requested to reschedule its energy requirement.

The request to adjust the rates was rejected by MSEDCL by taking a stand that RGPPL had failed in obtaining a prior consent of MSEDCL for any arrangement arising due to and under the current PPA.

MSEDCL disclaimed its liability to make payment towards RGPPL and the disputes and litigation ensued amongst the parties.

CERC: 30th July 2013 order: CERC allowed the petition and directed MSEDCL to make the payment and stated that the consent was not mandatory. RGPPL filed an execution petition for payment of unpaid dues arising from such an event.

Appellate Tribunal for Electricity (APTEL) order: 22nd April 2015: MSEDCL filed an appeal and reiterated that they were not required to pay the fixed charges due to this change of fuel, but the appeal was dismissed.

MSEDCL thereafter chose to continue the litigation and unsuccessfully filed another appeal before the Supreme Court.

MSEDCL stated that before entering into the GSA/GTA, RGPPL was supposed to obtain approval from MSEDCL on the terms of the contract and the price since such a GSA/GTA has 'commercial implications'.

While analyzing the provisions of PPA in detail, the Supreme Court highlighted the fact that,

..... RGPPL has consistently stated that the alternate arrangement in the form of GSA/GTA with GAIL and capacity declarations based on RLNG were necessitated on account of the unprecedented nationwide shortage of domestic fuel. But for such an alternate arrangement, RGPPL would have been unable to meet the target availability, which would have in turn affected their ability to recover fixed costs and jeopardized the viability of the project. MSEDCL does not dispute the shortage of domestic fuel but merely objects to the "unilateral" decision to declare capacity based on RLNG, which the appellant states violated the mandatory approval requirement under clause 5.9 of the PPA, thereby exonerating it of the liability to pay fixed capacity charges."[3]

The Court also emphasized on the fact that the action taken by RGPPL had arisen due to an impossibility to provide the domestic gas as agreed in the PPA and therefore RGPPL was compelled to make alternate arrangements in view of the country-wide shortage of domestic gas, making RLNG a viable and contractually permissible alternative.[4]

[3] Para 27
[4] Para 31

The Court was also keen on commenting on the interpretation of a commercial document wherein it stated that, **"A commercial document cannot be interpreted in a manner that is at odds with the original purpose and intendment of the parties to the document. A deviation from the plain terms of the contract is warranted only when it serves business efficacy better.[5]"**

The Court also stated that, "In the present case, CERC and APTEL have correctly held that the GSA/GTA with Gas Authority of India Limited (GAIL) is permissible by the terms of the contract and the consent or approval of the appellant is irrelevant."[6]

Therefore, considering the intention of RGPPL for dealing with the shortfall of domestic gas the Supreme Court ordered that:

"In the present context, bearing in mind the background of the establishment of the first respondent, and the shortfall of domestic gas for reasons beyond the control of the first respondent, such a deviation from the plain terms is not merited and militates against business efficacy as it has a detrimental impact on the viability of the first respondent."

The appeal before the Supreme Court was dismissed by a detailed judgement on 9th November 2023 (after a decade and three rounds of litigation) and MSEDCL was directed to pay the charges. This highlights the importance to the intention of the parties and adherence to business efficacy is definitely a welcome judgement.

[5] Transmission Corporation of Andhra Pradesh Ltd v. GMR Vemagiri Power Generation Limited : 2018) 3 SCC
[6] Para 32

Uttar Haryana Bijli Nigam Limited and Another v/s Adani Power (Mundra) Limited (ADML) and Another[7]

The Supreme Court held that Uttar Haryana Bijli Vitran Nigam Ltd (Haryana Utilities) needs to pay compounded interest to Adani Power limited (Adani), on account of **"change in law".**

Change in law is a very important factor and generally power purchase agreements address this in detail. Let us understand the facts in detail:

7th August 2008: "ADML" entered into a Power Project Agreement ("PPA") with Haryana Utilities for supply of 1424 MW power from the said generating station.

20th May 2010 : Ministry of Environment and Forests, Union of India passed a notification wherein power generators were required to incur additional costs on installing Flue Gas Desulfurization (FGD) units.

17th July 2014: CERC proceedings: ADML filed proceedings before CERC for adjudication of compensation on account of certain Change in Law events including installation of the FGD.

6th February 2017: CERC allowed the compensation only for certain Change in Law events but disallowed the claim for carrying cost raised by ADML.

12th August, 2021: The Appellate Tribunal has not only held that ADML is entitled for carrying cost in respect of compensation for Change in Law events towards FGD installation, as approved by the Central Commission, reckoned from the date of Change in Law occurrence, but also entitled for interest on carrying cost.

Before the Supreme Court, Haryana Utilities accepted the liability to pay the compensation but contested their liability to pay **compound interest**, as there was neither any wrongdoing / default / unjust enrichment that can be attributable to the appellants for the delay caused in determination of the amount by the Central Commission / Appellate Tribunal nor was there any provision in PPA for compound interest.

[7] CIVIL APPEAL NO. 7129 OF 2021; August 24, 2022

It is interesting to note that the change in law event occurred in 2014. The claim was finally decided by the Central Commission only in the year 2018. Thus, Haryana Utilities contended that they would be required to pay costs only from 2018.

This was successfully objected as ADML had incurred the cost in 2014 itself.

Further, the terms of PPA came to rescue of ADML which clearly provided for an in-built restitutionary principle that compensation has to be paid from the date of occurrence of the Change in Law events.

13.2 Application and Principles for computing impact of Change in Law While determining the consequence of Change in Law under this Article 13, the Parties shall have due regard to the principle that the purpose of compensating the Party affected by such Change in Law, is to restore through Monthly Tariff Payments, to the extent contemplated in this Article 13, the affected party to the same economic position as if such Change in Law has not occurred.

Article 11.3.4 of the PPAs was successfully cited to buttress the submission that compound interest is payable for delayed payments, in the manner prescribed and since the Haryana Utilities had agreed to pay interest on compounding basis for delayed payments, the very same principle would apply for carrying cost as well, since both, carrying cost and late payment surcharge are to be factored in towards time value of money.

ADML had borrowed funds for installation of FGD and was paying compound interest to bank, and thus the same liability had to be passed over to Haryana Utilities.

The Court concluded that,

.... Adani Power is justified in stating that if the banks have charged it interest on monthly rest basis for giving loans to purchase the FGD, any restitution will be incomplete, if it is not fully compensated for the interest paid by it to the banks on compounding basis. We are of the opinion that interest on carrying cost is nothing but time value for money and the only manner in which a party can be afforded the benefit of restitution in every which way...

Therefore, it is important to understand that provisions such as change in law and force majeure are a helping tool to protect the interest of the parties involved. This helps in taking care of aspects when an unforeseen event or change in law occurs which may have a crucial impact on the performance of the PPA. The core object of this topic is more particularly explained in the Supreme Court judgement below.

M/s Penna Electricity Limited (Now M/s Pioneer Power Limited) v/s the Tamil Nadu Electricity Board[8] (Board)

This judgement has highlighted the importance of recording the provisions for any unforeseen event in the PPA. Let us understand the facts in detail.

2004: The Parties had executed a Power Purchase Agreement ("PPA") through a bidding process wherein Pioneer was selected by the Board. Under this arrangement, a certain Plant Load Factor ("PLF") percentage was agreed which the appellant was required to provide to the Board.

Pioneer, an Independent Power Producer (IPP) was operating and maintaining a Combined Cycle Gas Turbine Power Generating station in Tamil Nadu with a generating capacity of 52.8 MW and the said generating station is dedicated to the Board and the entire power generated by the appellant is to be supplied to the Board.

Bi-Partite arrangement: In order to provide the agreed power/ gas to the Board and for supply under such arrangement, Pioneer had entered into a bi-partite arrangement with Gas Authority of India Limited ("GAIL").

However, during the performance of the agreement, a shortage in supply of the gas was noted due to diversion of gas supply by GAIL, though the supply was continued.

Board refused to make complete payment citing that there was a shortage. Parties litigated in lower tribunals and reached the Apex Court, wherein, Pioneer filed a petition and sought its outstanding payments in nature of fixed and variable charges and all costs.

[8] CIVIL APPEAL NO(S). 706 OF 2014; March 15, 2023

The Court considered the facts in detail, and observed the following:

there is no clause in the PPA which provides for full fixed cost, even when appellant fails to meet the PLF. ... in terms of clause 4.3 of the said notification, the responsibility of the fuel linkage would be that of the independent power producer and any fuel supply risk would have to be shared between the power and fuel producer/supplier and not by the Board to indemnify[9]

As the Board was not privy to the arrangement between PIONEER and GAIL, Board is not supposed to indemnify Pioneer. Pioneer also could not produce material to record what action it had taken against GAIL.

"At the same time, the appellant has not been able to demonstrate **any provision either under the Act, 2003 or under the PPA** although has not been approved by the competent authority under the Act, 2003 which may protect the right and interest of the appellant. **That apart, no clause of the PPA has been pointed out indicating if there is a short supply of gas due to diversion of gas to the other generating station of the Board, the respondent Board has to indemnify the appellant."[10]**

Thus, in absence of the relevant provisions either in the PPA or in the notifications/ rules that governed the arrangement, no relief was granted to Pioneer. In light of the above judgement, it is important to review and negotiate these clauses specifically to ensure that the parties performing under PPA are protected and the main intent of a PPA is intact.

Conclusion :
It is thus clear that the provisions in PPA need to be carefully considered and deliberated so that they may be a real helping tool to protect the interest of the parties involved. Cogent provisions help in taking care of aspects when an unforeseen event or change in law occurs which may have a crucial impact on the performance of the PPA. So, it is essential to comprehensively check whether a provision for such arrangements has been made in the PPA being signed by the parties failing which the aggrieved party may not be entitled to any relief or compensation.

[9] Para 16
[10] Para 18

For any feedback or response on this article, the authors can be reached on gauri.joshi@ynzgroup.co.in and pranav.mane@ynzgroup.co.in

Author: Gauri Joshi

Gauri Joshi is an Associate at YNZ Legal. By qualification she is Bachelor of Commerce from Mumbai University and Bachelor of Law from SNDT University.

Co-author: Pranav Mane

Pranav is an Associate at YNZ Legal. By qualification he is Bachelor of commerce and Bachelor of Law from Mumbai University. He is also a member of Bar Council of Maharashtra & Goa.