

Power Tariff Scam Gets Bigger at Rs 50,000 crore

Did Adani and Essar Group Over-Invoice Power Plant Equipment?

PARANJOY GUHA THAKURTA

Vol. 51, Issue No. 20, 14 May, 2016

Paranjay Guha Thakurta (paranjay@epw.in) is the editor of the Economic and Political Weekly.

The dimension of the scam relating to inflation of power tariffs by, among other things, over-invoicing imported coal has become considerably bigger. It has now come to light that electricity generating companies are seeking to obtain compensatory tariffs from regulators. In addition, particular firms in the Adani and Essar Groups, have allegedly over-invoiced imports of equipment. The total size of the scam is currently estimated at Rs 50,000 crore, if not more.

The scale and scope of the scandal relating to the fraudulent inflation of power tariffs by over-invoicing coal imported from Indonesia, and passing on the costs to the consumer has acquired new dimensions (Guha Thakurta and Malik 2016). Over and above the investigations that are being carried out by the Directorate of Revenue Intelligence (DRI) in the Ministry of Finance on 40-odd companies for allegedly over-invoicing coal imported from Indonesia to the tune of Rs 29,000 crore, there have been certain unrelated developments.



Mundra Power Plant, Kutch, Gujarat, owned by an Adani Group company. Courtesy: Nizil Shah, from Wikimedia Commons.

It is now being claimed that power generating companies are attempting to make illicit gains through “compensatory tariffs” awarded by electricity regulators. On top of this, firms in the Adani and Essar Groups, have been accused of over-invoicing imported power plant equipment.

The cumulative size of this scam that has led to higher electricity tariffs is currently estimated at over Rs 50,000 crore and could rise further. Among the private and public sector companies that have allegedly benefitted illegally are firms in the Adani, Essar, and Anil Dhirubhai Ambani Groups, as well as the National Thermal Power Corporation and the Tamil Nadu Electricity Board. One of the persons being sought to be indicted in the scam is the brother of Gautam Adani, who is known to be close to Prime Minister Narendra Modi.

On 31 March 2016, a “general alert” was issued by the DRI to some 50 customs establishments across the country, directing them to investigate all imports of coal from Indonesia. Why was this done?

The [alert document mentions](#) that imported coal was being systematically over-invoiced and that this illegal practice was not just rampant but continues unabated. On condition of

anonymity, a customs officer in the Mundra port which has been set up by the Adani Group, told this writer that "All customs clearances for home consumption [of imported coal] are provisional and the bills of entry will be finalised only when all investigations in this regard are complete."

A week later, on 7 April 2016, in an apparently unrelated development, the Appellate Tribunal for Electricity (APTEL) set aside an order of the Central Electricity Regulatory Commission (CERC), granting compensatory tariffs to various companies, notably those in the Adani and Tata Groups (*Adani Group Appeal No 100 of 2013 and IA No 116 of 2013 et al 2016*) (*Coastal Gujarat Power Limited vs Gujarat Urja Vikas Limited et al 2013*).

Power Purchase Agreements

Adani Power Limited, a subsidiary of Adani Enterprises Limited (AEL), operates the Mundra power project in the Mundra special economic zone in Gujarat. The plant has a total installed capacity of 4,620 megawatt (MW) and supplies power to Gujarat Urja Vikas Nigam Limited (GUVNL), Uttar Haryana Bijli Vidyut Nigam Limited and Dakshin Haryana Bijli Vidyut Nigam Limited on the basis of power purchase agreements (PPAs) signed with these companies. Coastal Gujarat Power Limited (CGPL), a subsidiary of Tata Power, operates a 4,000 MW ultra mega power project at Mundra, which supplies power under PPAs signed with GUVNL, Maharashtra State Electricity Distribution Company Limited, Punjab State Power Corporation Limited, Haryana Power Generation Corporation Limited, as well as with the power distribution licensees for Ajmer, Jodhpur and Jaipur in Rajasthan.

In accordance with the terms of the PPAs, it was incumbent on Adani Power and CGPL to secure their supply of coal through fuel supply agreements (FSAs) which were to be submitted under the PPAs. CGPL signed an FSA with IndoCoal Resources (Cayman) Limited, a subsidiary of the Indonesian coal mining and exporting group Bumi Resources. Simultaneously, Tata Power, CGPL's parent company, acquired a 30% stake in two coal mines owned by Bumi Resources in Indonesia, effectively permitting it to supply fuel to its own subsidiary. This FSA provided coal to CGPL at discounted prices. Adani Power, entered into a similar FSA with its subsidiary AEL.

CGPL and Adani Power appealed to the CERC in 2013, claiming compensation for losses incurred because of an order passed by the Indonesian Minister of Energy and Mineral Resources in September 2010, which made it mandatory for coal exporters to claim rates from their buyers that were in line with international market prices for coal. This order, CGPL and Adani Power alleged, overruled their FSAs and resulted in a sudden rise in fuel costs. The CERC, in orders issued in February 2014, held that the "change in law" clause referred only to Indian laws and not foreign laws, and hence could not apply in this instance. It further held that conditions for *force majeure* were not satisfied by the facts of the case. (The doctrine of *force majeure* refers to a situation where it is impossible for a party in a contract to fulfil its obligations under the contract, due to events and

circumstances outside its control, such as a war or an "act of god.") In the relevant PPAs, a *force majeure* event permitted a revision of the agreed tariffs as did a "change in law" event. The CERC held that the increase in costs over those specified in the FSAs signed by Adani Power and CGPL were not admissible as *force majeure* events since this situation did not prohibit or delay the execution of the PPAs.

However, the CERC assumed for itself the power to revise the tariffs outside the terms of the PPA under Section 79 (1) of the Electricity Act, 2003, ostensibly keeping in mind the interests of not just the consumer, but the producer of electricity, as well as the supplier or the distribution companies (discoms). The CERC set up a committee to determine the value of compensatory tariffs to be awarded to the two companies in the Adani and Tata Groups. This committee, chaired by Deepak Parekh, the chairman of HDFC (formerly Housing Development and Finance Corporation), included representatives of the Tata and Adani Groups, the discoms, as well as Arundhati Bhattacharya, the then managing director and chief executive officer (CEO) of SBI Capital Markets Ltd (SBICML) as an independent financial analyst (Committee Report for CERC 2013) (Bhattacharya went on to become the chairperson of the State Bank of India, the country's largest public sector bank). The final reports were signed by Parekh and Bhattacharya, and subsequently adopted by the CERC in its final orders recommending compensatory tariffs to be awarded to the two companies (Disclaimer: Parekh is a trustee of the Sameeksha Trust which publishes *EPW*).

It is necessary to note that SBICML was the financial advisor and the mandated lead arranger for all power ventures of the Adani Group. The 2009-10 SBICML annual report included a mention of the total debt of Adani Power and Adani Power Maharashtra Limited as amounting to around Rs 10,000 crore (SBI Capital Markets Limited 2010; Thota 2009).

A confidential report submitted by KPMG, an independent consultant to the Parekh committee, detailed the structure of holdings of ten companies in the Adani Group, with Adani Enterprises Limited as the holding company and the rest as direct or indirect wholly-owned subsidiaries. The report, which is available with the author of this article, noted the presence of the Adani Group across the entire coal supply chain, from the mining company in Indonesia to various intermediaries (mainly in Singapore).

The bulk of the imported coal came to Mundra port (set up by the Adani Group). The report pointed out that all the Indonesian coal companies from which AEL imported coal were 100% subsidiaries of AEL. It reported the statement of the Adani Group that there was no "mark-up" on invoicing between the mining company and AEL and between AEL and Adani Power except for freight and insurance cost. Further, it stated that the gross calorific value (GCV) of the coal imported from Indonesia appeared to be 3,000 GCV or less, a fact that gains renewed significance in the light of the DRI investigation which found cases of misdeclaration of the GCV of imported coal to artificially inflate costs.

Verdict of APTEL

The CERC's orders came up for appeal before APTEL which issued its final order on 7 April 2016. In a 486-page judgment, dealing with Adani Power and CGPL in the Tata Group, as well as two other cases involving subsidiaries of the GMR Group and the Reliance Anil Dhirubhai Ambani Group, APTEL set aside the final orders of the CERC in the Adani and CGPL cases, arguing that the CERC's powers did not permit it to award compensatory tariffs under Section 79 (1) for tariffs that had been set through the price discovery mechanism of an international competitive bidding process under Section 63 of the Electricity Act. However, in re-evaluating the issues of "change in law" and *force majeure* under the relevant clauses in the PPAs, through which the CERC was empowered to revise tariffs in its capacity as a regulator, APTEL found that the change in Indonesian regulations did constitute a *force majeure* event, and directed the CERC to recalculate the necessary revisions in power tariffs.

[In view of the DRI investigations on over-invoicing imported coal from Indonesia](#), there will be a direct impact on the electricity tariff fixation process not only by the CERC but also by all the various state electricity regulatory commissions (SERCs) in the country. Public sector companies like the NTPC and various state electricity boards, whose tariffs are regulated by both the CERC and the SERCs, also stand to be affected.

According to a highly placed source in the CERC, who spoke off the record, the compensation due to the Adani Group could work out to about Rs 6,000 crore while that to CGPL would come to over Rs 3,000 crore. This amount will be collected by the various discoms (including the ones in Haryana and Gujarat) from consumers. There will also be a loss to the exchequer since power is highly subsidised. APTEL has asked the CERC to specify the exact amounts to be paid to the companies in the Adani and Tata Groups. The hearings before the CERC are scheduled to take place in late May 2016.

It must be emphasised at this juncture that representatives of discoms were part of the committee on fixation of compensatory tariffs but they have not signed the committee's final reports. Right through the proceedings before the CERC, these representatives of discoms opposed the award of any compensatory tariff to the company in the Adani Group. As stated, the reports were signed by Parekh and Bhattacharya and were accompanied by affidavits of "in principle" consent by the respective power distributors. The CERC's orders noted that representatives of discoms did not sign the final reports as they need the approval of the concerned state governments.

The CERC source told this writer that "the DRI has submitted a report on its investigations on the Indonesian coal import issue to the CERC, which had previously not taken *suo motu* cognisance of the case." The CERC will now be calculating the compensation to be paid to the Adani and CGPL Groups in light of the APTEL order. Time will tell as to how the discoms, which are supposed to represent the interests of the consumer before the CERC, will respond now, given that the report of the DRI's investigations are with the commission. It is likely that both the electricity producing companies as well as the discoms will appeal

against APTEL in the Supreme Court. The findings of the investigations by the DRI may then enter the public domain.

The compensatory tariff issue does not stop with the Adani and Tata Group companies. The CERC source says there is a long queue of petitions have come from various power generating companies making claims for compensatory tariffs. The significance of this legal process cannot be understated. The outcome of these proceedings is expected to set important precedents for the pricing of electricity.

Power Plant Equipment

The story of the scam does not end here. Two years ago, in 2014, the DRI issued show cause notices alleging over-invoicing of power plant equipment to the tune of Rs 6,000 crore by a number of companies in the Adani Group. The notices alleged that the Adani Group had over-valued capital goods imported by Adani Power Maharashtra Limited, Adani Power Rajasthan Limited and Maharashtra Power Eastern Grid Power Transmission Company Limited. These companies were alleged to have indulged in a “trade based money laundering scheme” by mispricing equipment and by routing invoices through an intermediary in the United Arab Emirates, which is allegedly a “front company” of the group.

It has been two years since the notices were issued but the cases have not yet been adjudicated by the competent customs authorities. The notification for adjudication of the case against the Adani Group, which is available in the public domain, was issued in 2015. A senior law officer in the government noted that

“The devil lies in the delay. The more you delay the adjudication process, the more the cases fade away from public memory and our collective consciousness. There is no accountability in the system. No one is held responsible if adjudication is not done in a timely manner. And this is an important reason why the government, in this case the Department of Revenue in the Ministry of Finance, ends up losing most of such cases.”

Companies in the Adani Group are not the only ones that have been sought to be implicated. In 2015, the DRI issued show cause notices to companies in the Essar Group as well, alleging over-invoicing of power plant equipment to the tune of Rs 3,000-odd crore. It has in fact seized power plant equipment valued at around Rs 2,000 crore under the Customs Act, 1962. In the case of the Adani Group, the value of the equipment seized is more than three times higher at around Rs 7,000 crore.

In both instances, the mode of operation appears to have been similar. The customs duty levied on power and infrastructure projects has been either at zero or a very low rate, that

is, 5% or a lower percentage of the value declared. If these companies are found to have inflated the value of the equipment imported, the equipment is not just liable for confiscation, the customs authorities can levy penalties on the firms. But this has not been done as yet.

Effect on Consumer Tariffs

How does over-invoicing power plant equipment lead to higher electricity tariffs for consumers? Electricity tariffs are arrived at by evaluating two sets of costs—fixed and variable. Fixed cost involves operations and maintenance together with servicing of equity and debt. Variable cost includes the fuel price and costs of fuel transportation and handling. Both the costs have a direct impact on tariff fixation. The fixed cost has a direct impact on tariff fixation, irrespective of whether a particular plant is operational (generates electricity) or otherwise as in the merit order dispatch, the plant with the lowest variable cost is placed on the top of the stack. As far as fixed cost is concerned, a plant's debt-equity ratio is a key determinant when the regulator fixes the tariff. The regulators normatively divide debt and equity in a ratio of 70:30 while calculating tariffs. The cost of land, which is the other component of the fixed cost, is a relatively smaller component of the fixed cost. The major item under this head is the cost of equipment. By artificially over-valuing power plant equipment, the producer obtains a higher tariff from the regulatory authorities.

The tariff is the per unit value that the electricity generating company can recover from distributors/consumers and is based on the cost that it incurs in generation of electricity. The electricity generation companies submit their fixed cost and variable cost figures to the regulator. The expenditure incurred in installation of capital goods is also taken into consideration while fixing the tariff. The higher the fixed cost by way of over valuation of imports, the greater the tariff and, by implication, greater will be the illegal profits which are siphoned outside the country. In the end, the consumer of electricity pays.

The not so surprising fact is that the CERC has not initiated any action, *suo motu* or otherwise, to analyse the tariff structures in the context of allegations of over-invoicing of imported coal and power generating equipment, as the law officer quoted earlier pointed out. "The CERC has the power to take *suo motu* cognisance to initiate necessary action which it has not done," the person remarked.

Skeletons in the Closet

[As the earlier EPW article on over-invoicing of coal imports suggested](#), there are skeletons in the closets of nearly every other major Indian power producer. The power plant equipment was obtained from original manufacturers in China or South Korea, which were directly transported to India. However, the invoices for these were routed through intermediary companies in Dubai. These intermediaries were raising inflated invoices against which money was remitted from India.

In other words, by allegedly violating the laws of the land, these companies have been apparently able to inflate costs and, what is worse, got electricity users to pay for their malfeasance. It has been estimated that ordinary consumers of power have been charged excess amounts, varying between 50 paise and Rs 2 per unit (or kilowatt hour). The entire process appears to be premeditated involving multiple layers of related transactions, according to a source in the Finance Ministry, and virtually identical to the method deployed to over-invoice coal imported from Indonesia.

The Adani Group currently operates four thermal power plants at Mundra (Gujarat), Kawai (Rajasthan), Tiroda (Maharashtra) and Udupi (Karnataka). The four plants have a combined installed capacity of 6,480 MW. The Essar group operates three thermal power plants at Salaya and Vadinar (both in Gujarat) and at Mahan (Madhya Pradesh). The combined installed capacity of these plants is 2,810 MW. These companies are in the process of expanding their capacities. Adani Power is in the process of installing two more thermal power plants at Chhindwara (Madhya Pradesh) with a capacity of 1,320 MW and at Dahej (Gujarat) with a capacity of 2,640 MW. In view of the investigations going on, it is not clear whether these expansion programmes will proceed on schedule.

The DRI notices issued to the Adani Group in the cases of over-invoicing of power plant equipment name Vinod Shantilal Adani alias Vinod Shantilal Shah, the brother of Gautam Adani, making him liable to penalties under the Customs Act. The notice, which has been viewed by this writer, states that Vinod Adani appears to have conspired with other employees, including Jatin Shah and Moreshwar Rabade, to “execute the planned conspiracy of siphoning foreign exchange abroad.” The notice records that despite repeated summons being served to Adani and Shah, seeking their presence with requisite documents, they “appear to have deliberately avoided presenting themselves before the DRI and did not cooperate with the ongoing investigations.”

It is interesting to note that Vinod Adani's name has appeared in the recently leaked Panama Papers. The records of Mossack Fonseca, the Panamanian law firm revealed that two months after incorporating a company in the Bahamas in 1994, Vinod Adani requested a correction in the “spelling” of his name, changing it from Adani to Shah. GA International Inc was set up a few months after the formation of the Adani Group's flagship company, Adani Exports Limited (now Adani Enterprises Limited) in 1993 (GA presumably stands for Gautam Adani). AEL is the single largest importer of Indonesian coal. The possible role played by these offshore entities in the alleged over-invoicing is being probed by the DRI.

If the allegations in the DRI notice are substantiated, the violations will far exceed the breach of customs and electricity tariff fixation laws and rules. The beneficiaries of the scam could possibly have violated provisions of the Income Tax Act, the Foreign Exchange Management Act and the Prevention of Money Laundering Act. It is not known if the DRI has referred its findings to the Income Tax Department, the Enforcement Directorate or the Central Bureau of Investigation.

Sources in the Ministry of Power told this writer on condition of anonymity that this could well be one of the biggest scandals in the country's power sector. The three methods through which electricity tariffs have been artificially inflated are—over-valuation of imported coal to the tune of Rs 29,000 crore, over-valuation of power plant equipment to the tune of Rs 9,000 crore and compensatory tariffs awarded to the tune of at least Rs 10,000 crore, or possibly higher. Sources in the government claimed that these are conservative figures and the total scam amount could very well go up as investigations are completed.

This scam could prove to be an acid test for the Ministry of Power and regulatory bodies such as the CERC, the SERCs and APTEL. In the government's replies to a number of questions raised in both the Lok Sabha and the Rajya Sabha by different members of parliament during the month of May, none of the coal importing companies accused of inflating costs have been named. The names of companies in the Adani Group, the largest importer of Indonesian coal to India, find no mention in any of these replies either, even though parliament has been informed of the ongoing DRI investigation, sources told this writer.

This is a scam that has affected millions of middle class and poor Indians. The government's actions, or inaction, in the coming months will tell their own tale.

References

[All URLs accessed on 16 May 2016]

Adani Group Appeal No 100 of 2013 and IA No 116 of 2013 et al (2016): New Delhi: Appellate Jurisdiction,
http://aptel.gov.in/judgements/Full%20Bench%20Judgment_07.04.16.pdf.

Coastal Gujarat Power Limited vs Gujarat Urja Vikas Limited et al (2013): Petition No 159/MP/2012, New Delhi: Central Electricity Regulatory Commission,
http://www.cercind.gov.in/2013/orders/159_mp_2012.pdf.

Committee Report for CERC (2013): "Committee Report on Compensatory Tariff for Mundra power plant of Coastal Gujarat Power Limited (CGPL)," August,
http://www.cercind.gov.in/2013/Reports/COMREP_CGPL.pdf.

Guha Thakurta, Paranjoy and Aman Malik (2016): "How Over-Invoicing of Imported Coal has Increased Power Tariffs: A Rs 29,000 crore Scam," *Economic and Political Weekly*, Vol 51, No 14,
<http://www.epw.in/journal/2016/14/web-exclusives/how-over-invoicing-imported-coal-has-increased-power-tariffs.html>.

SBI Capital Markets Limited (2010): "Annual Report 2009-2010," Mumbai: SBI Capital Markets Limited,

Economic & Political WEEKLY

ISSN (Online) - 2349-8846

<http://www.sbicaps.com/wp-content/uploads/2013/05/SBICAPs-Annual-Report-FY-10.pdf>.

Thota, Vijesh (2009): "Adani's Phased Approach," Project Finance International—India Report 2009, pp 9-12, http://www.sbicaps.com/uploads/apl_article_in_pfi.pdf.