Dabhol Power Company[1]

Introduction

In April 2003, power cuts and rolling blackouts were becoming regular occurrences in western India, and yet the ~$3 billion 2184 MW Dabhol Power Project in India's western coast lay idle; after having been shut down for close to two years (~ 22 months). The impasse related to the project is amply reflected in the headlines of two Indian financial dailies, *Business Standard* & *The Economic Times* on April 4th, 2003.

> ***Foreign Lenders Want to End Dabhol Pact (Business Standard – April 4th)***
> ***Slow progress in project restructuring forces lenders to take decision***
> *In a major blow to efforts by the domestic lenders to restart the first phase of the Dabhol power project, overseas lenders to the project have expressed their intention to terminate the power purchase agreement (PPA) with the Maharashtra State Electricity Board (MSEB).*
>
> ***FII Lenders to Terminate Dabhol PPA (The Economic Times – April 4th)***
> *A face-off between the offshore lenders and domestic lenders of Dabhol Power Company is now imminent. Even as discussions were on to restart phase-I of DPC, the foreign lenders have decided to terminate the power purchase agreement with MSEB.*

The Dabhol Power Project was originally conceptualised in 1992 as a show case project for India & for Enron (the main project sponsor). The project, which was identified as a fast-track project by the Government of India (GoI), was the largest gas based independent power project in the world and was also the largest foreign direct investment into India. It was also Enron's largest power venture.

Yet more than a decade later, the project, which is almost fully constructed and was partially operational, has run into numerous disputes among the various counter-parties and is on the verge of being junked. One cannot help but reflect on the chequered history of the project over the last decade.

Dabhol Power – A Brief History

The Early Years

The Dabhol Power Project was among the first of a series of independent power projects that were being developed in various Indian states as part of the Government of India's (GoI) liberalisation of the Indian Electricity Sector. The initial Memorandum of Understanding (MoU) for the project was signed in June 1992 between Enron and the Government of Maharashtra (GoM). The project was intended to be operated as a baseload gas-fired plant with a capacity of 2015 MW, and Dabhol, a village on India's western coast, located about 180 kms south of Mumbai was chosen as the project site.

Enron incorporated an unlimited liability partnership in India, Dabhol Power Company (DPC), to implement the project. The project was to be developed in two phases. Originally, Phase I was designed to have a capacity of 695 MW & Phase II was designed to have a capacity of 1420 MW. Liquefied Natural Gas (LNG) was to be used as the fuel for the power plant. The LNG was to be brought in from the Middle-East and accordingly, a regassification plant was also to be constructed at Dabhol. The Maharashtra State Electricity Board (MSEB) was to be the sole customer of DPC power. General Electric (GE) & Bechtel Corporation, two large American companies, were chosen by Enron to be the equipment suppliers and the turnkey Engineering Procurement & Construction (EPC) contractors. In return, both GE and Bechtel also took minority equity stakes of 10% each in the project company (DPC).

Enron Corp – A Snapshot

In the 1990s, Enron Corp. was very aggressively pursuing a two-pronged growth strategy under the chairmanship of Dr. Kenneth Lay. The Houston based company already had a significant presence in the natural gas markets in the US and was developing a significant energy trading platform, under the leadership of Jeffrey Skilling. A second arm of the company, Enron Development Corporation (EDC), was trying to develop large power projects in emerging economies, including India. EDC was being headed by Joe Sutton & Rebecca Mark, both very charismatic individuals, and their primary aim was to be the first to move into these emerging markets and set up large scale infrastructure projects. In return for the significant risks involved in such ventures, they were looking for high returns out of these investments. The projects were to be developed by Enron's development team, which would bring the project to financial closure and then hand over the project to an operating team, which would oversee the construction and the operations of the project.

Phase I Project Approvals

Following the signing of the MoU, DPC spent the next 18 months procuring a series of approvals from various government agencies, including the Foreign Investment Promotion Board (approval for foreign direct investment), the Central Electricity Authority (techno-economic clearance of the project & capital cost and tariff approval), Ministry of Environment & Forests (environmental clearance), etc.. During this period, the company and its sponsors were also involved in negotiations with the GoM and MSEB, on the Power Purchase Agreement (PPA), which was to form the contractual basis for the price and volume of power purchased. Finally, after obtaining the Central Electricity Authority (CEA) clearance for the project in November 1993, the original PPA was signed in December 1993.

After the initial PPA was signed, the company also signed a GoM guarantee and a GoI counter guarantee for Phase I of the project, thus enabling it to achieve financial closure of Phase I in March 1995. The financing was obtained from a variety of sources including OPIC, US-EXIM, domestic financial institutions and international commercial banks. However, the process of reaching financial closure was not without its share of controversies. MSEB had sought the World Bank's opinion on the Dabhol project soon after signing the MoU and the World bank in its report had averred that the Dabhol project was too large in scope for the state of Maharshtra. It also stated that LNG as a fuel may prove to be very expensive for a power plant in an emerging economy and given the extent of cross subsidies in the power sector, MSEB may not be able to bear the burden of paying for the power. The World Bank also observed that the agreement was one sided in favour of Enron. However, Enron's continued persistence and the willingness of the GoM and the GoI in seeing the project through ultimately resulted in the project achieving financial closure, despite objections from some quarters. While construction of Phase I of the project began in earnest soon after financial closure, storm clouds were beginning to gather.

Initial Setback

In March 1995, subsequent to the legislature elections for the state of Maharashtra, the incumbent govt. (led by the Congress party) was voted out of power and a new coalition government (led by BJP – Shiv Sena combine) was elected. The BJP (Bhartiya Janata Party – Indian People's Party) was a nationalist party, with economic nationalism as one of the key issues in its agenda and was also a champion of domestic companies as opposed to multinational companies. Similarly, the Shiv Sena, a state level party, had a stated objective of protecting the economic interest and identity of the people of Maharashtra.

Soon after being sworn in, the new government duly formed a committee (the "Munde Committee") to review the Dabhol deal. Based on the findings of the committee (which included, *inter alia*, allegations relating to extra commercial considerations, high capital cost of plant, high cost of power and potential environmental damage), in early August 1995, the GoM decided to cancel Phase II of the project and suspend construction of Phase I of the project. This was the first of many setbacks for the project.

Project Renegotiation

The sponsors (Enron, GE & Bechtel) at this point had an option to exit from the project. However, the sponsors filed for international arbitration and challenged the state government's actions. Given the arbitrariness of the state government's actions and the tight legal provision under the PPA, the international arbitration ruling was expected to be in favour of the sponsors. Simultaneously, the sponsors also launched into a series of meetings with senior GoI & GoM officials to convince them of the economic viability of the project, during which they also indicated a willingness to reduce the DPC power tariff.

Accordingly, in early 1996, a few months after the suspension of the project, GoM formed a "Renegotiating Committee" to restructure some aspects of the deal with Enron. The deal envisaged a reduction in the overall capital cost of the project and the unit power tariff and also a 30% equity stake for MSEB in the project. The sponsors in turn benefited from an increase in Phase I plant capacity and also the ability to sell regassified LNG to additional customers (other than MSEB) to make good some of the losses borne by the sponsors due to the project suspension and the reduction in the tariff. The revised PPA was finally signed in July 1996 and the financial closure was achieved in December 1996 after which Phase I construction recommenced.

As part of the renegotiated power purchase agreement, the Phase I capacity was enhanced to 740 MW, while Phase II capacity was 1444 MW, bringing the combined capacity of the power station to 2184 MW. At this stage, it was also agreed that the setting up of Phase II of the project would be conditional on the existence of sufficient demand for additional power in the state. An overview of Dabhol's project profile is provided in Exhibit 1.

Over the next 3-4 years, numerous lawsuits [mostly, public interest litigations (PILs)] were filed against the project in the Indian courts by various bodies and individuals, alleging corruption and protesting the high cost of power from the Dabhol Project. While none of the petitions found favour with the courts, in one instance, the Bombay High Court did ask DPC to construct a hospital and school for the local population at the project site and also to undertake other social development projects.

Phase II Financial Closure

During 1998, while Phase I construction was nearing completion, Enron was aggressively pursuing the financial closure of Phase II. While Rebecca Mark & Joe Sutton were still actively involved with the project, the activities in India were being spearheaded by Sanjay Bhatnagar, Managing Director of Enron India. The financing required for Phase II alone was projected to be ~ US$ 2 billion, which was huge especially in an emerging market context. In fact, the capital cost of the combined project along with the re-gassification facility was projected to be US$ 2.88 billion.

Finally after months of negotiations with MSEB, LNG suppliers, financial institutions (both domestic and international), GoM and GoI, Phase II of the project achieved financial closure in early May 1999. This was a tremendous achievement for Enron, given the size of the project and the numerous controversies and obstacles that the project had been mired in, especially given the fact that many other power projects of a much smaller size and investment had come nowhere close to reaching financial closure.

Buoyed by this success, Enron made even bigger business plans in India. Its plans included constructing a pipeline & selling regassified LNG to customers in the western India, setting up a power marketing venture and building a broadband network across India. To spearhead these businesses, there was a realignment of Enron's Management in India. Wade Cline, who had been Enron's in house general counsel for the Dabhol Project, took responsibility for DPC and Metropolitan Gas Pvt. Ltd. (Enron's pipeline venture in India), while Sanjay Bhatnagar began to oversee the development of Enron's broadband venture.

The Indian Economy & the Power Sector in the 1990s – A Glimpse

The Indian Economy

Since independence in 1947, the Indian economy had grown largely as a socialist economy till the 1980s. While the socialist oriented industrial policy served India well in the initial couple of decades after independence, in the subsequent decades, the protection of the domestic industry and the large bureaucracy resulted in increasing inefficiencies and the government itself became financially strapped. Things came to a head in July 1991, when the Indian foreign exchange reserves were down to US$ 1 bn. (equivalent to about 2 weeks of imports). Driven by its dire circumstances, the GoI decided to adopt certain bold measures in terms of liberalising the Indian economy and bringing an end to the so called "License Raj" which was an all pervading feature of the Indian economy. The economic reform did have a salutary effect on the Indian economy. Foreign Direct Investment (FDI) grew almost 20 times from the 1991 levels to reach US$2.4 bn in 1998. The country's foreign exchange reserves grew to over US$ 40 bn in 2001. It was an euphoric time in India, as this period saw significant economic growth. Large-scale capacity was being added to various infrastructure sectors such as cement and steel. For instance, in the cement industry, new capacity addition over a 5 year period between 1993-94 to 1998-99 amounted to as much as

40% of the original capacity. However, after the initial years of liberalisation, the pace of reforms slowed down. Further, the economy was still hampered by a lack of infrastructure, which was impeding future growth as well as detracting foreign investment. Among other things, India suffered from significant power shortages.

The Indian Power Sector - Structural Changes After Liberalization

In 1991, as part of India's liberalisation efforts, the power sector was identified as one of the key infrastructure sectors to be developed to spur economic growth. While the GoI's intent was to liberalise the entire sector, the generation sector was opened up first, since it was felt that this sector was more amenable to private sector participation. The transmission and distribution sectors were expected to be liberalised over a longer time frame, since it was considered to be a more complicated process. The government also envisaged the setting up of electricity regulatory commissions both at the central and the state level. While private interest in generation capacity was evinced as early as 1992 (Enron being one of the earliest entrants), broader scale reforms of the SEBs was occurring at a much slower pace. However, in the second half of the 1990s, at least a few SEBs had split up into separate generating, transmission and distribution entities. Further, electricity regulatory commissions were also being created, both at the central level and the state level. However, the power of these state electricity regulatory commissions (SERCs) have been significantly curtailed by the state governments in many instances. While the SERCs have, *inter-alia*, a mandate to rationalise the tariff structure, any attempts in this direction have met with stiff resistance from the consumers as well as the politicians in many instances. While the emergence of regulatory commissions is in principle a good development, the creation of partially empowered commissions has only served to further increase the element of bureaucracy in the sector. In summary, reform of the sector has been progressing at a much slower pace than anticipated and most of the SEBs are still in the red and the state governments still do have a substantial influence in the way most SEBs operate.

Structural Framework prior to Liberalisation

The Indian power sector infrastructure is owned both by the central utilities as well as the state utilities. While the central utilities mainly own large generating units (coal, hydel, nuclear) and inter-state transmission networks, the state utilities (also referred to as State Electricity Boards) are largely responsible for the electricity infrastructure within each state. Additionally, a central planning body, Central Electricity Authority (CEA), was responsible for overall development of the electricity infrastructure, whose approval was required for any significant capacity addition in the generation, transmission and distribution areas. The State Electricity Boards (SEBs) are fully vertically integrated and own generation assets, intra-state transmission assets and also distribution assets. Most of these SEBs were built in the late 1950s and early 1960s. They are owned by the respective state governments and were treated as cashcows by the governments till the eighties, when their operations were still profitable. However, over the years, the state governments resorted to populist decisions to increase levels of power subsidies to certain consumer categories (especially, the agricultural sector). These measures combined with the poor operational discipline of the SEB's themselves, led to the deterioration of the financial health of the SEBs. This negatively impacted much needed investments in the sector andas a consequence, the power industry has been inflicted by capacity constraints on all fronts (generation, transmission & distribution).

The Project Structure

The Dabhol project was envisaged as an integrated energy complex comprising a power station, constructed in 2 phases, and an LNG re-gassification plant. While the project company (DPC) had numerous contracts with various counterparties, for construction, financing and operation of the project, the key contracts were the power purchase agreement (PPA), LNG Sales & Purchase Agreement (LNG SPA), EPC agreement, common agreement (key financing agreement) and credit support (guarantee) agreements from GoM & GoI). A schematic of the contractual relationship between the various project counterparties is provided in Exhibit 2.

MSEB was the sole customer for DPC, with which it had a 20 yr. (extendable) power purchase agreement (PPA). For Phase I, DPC was to use Naphtha as the primary fuel, which was procured through international tendering on a yearly basis. After the commissioning of Phase II, LNG was to be used as a fuel for the entire power station. The LNG supply contracts were long term supply contracts with significant take-or-pay clauses and were contracted with Oman LNG LLC (1.6 mmtpa) and Abu Dhabi Liquefaction Gas Co. Ltd. (0.5 mmtpa). GE & Bechtel were the principal EPC contractors for the power plant, while a separate Enron company was the turnkey contractor for the LNG re-gassification facility.

DPC Tariff Structure

The tariff structure for DPC was very different to the tariff structure of most other Indian IPPs. While most IPPs had a "cost-plus" structure, which provided compensation for operating costs, fuel costs and debt servicing plus a fixed return on equity, DPC had proposed a levelised tariff structure over the life of the PPA in dollar terms. A schematic of the Phase I & II tariff structures is provided in Exhibit 3. The plant was meant to be operated as a baseload plant and full fixed charge recovery was possible only if the plant was avaliable for dispatch at least 90% of the time. Further, the contract provided for significant penalties on DPC, if it failed to achieve the target availability levels.

Financing Structure

The main lender groups were the domestic lenders (IDBI, ICICI, SBI, IFCI & Canara Bank), Export credit agencies (J-Exim/MITI, OND of Belgium, US Exim), OPIC and a consortium of foreign commercial lenders (led by ABN AMRO, Citibank, ANZ Grindlays, Bank of America). A schematic of DPC's financing structure is provided in Exhibit 4.

The sponsors were looking to develop the project with non-recourse project finance, which implied that their liability towards the project would be limited to their equity investments and other guarantees that they provided to the project. This, coupled with the fact that the project had only one customer with a weak credit quality, implied that the financing of the project was critically dependent on the credit support mechanism for the project. A multi-layered credit support mechanism was established for both monthly bill payments and termination related payments of the project comprising a letter of credit, a guarantee from GoM, a counter-guarantee from GoI and an escrow account consisting of MSEB's cash collections from selected regions. Of these, the GoI counter-guarantee was available as credit support only for obligations related to Phase

I, while the cashflows from the escrow account were only available for Phase II related obligations. A more detailed schematic of the Payment security mechanism is provided in Exhibit 5.

While the sponsors and the lenders had done a due diligence analysis of MSEB's future cashflow generating capability, they were relying heavily on the guarantees furnished by the GoM and the counter-guarantee given by the GoI. In fact, the GoI counter-guarantee was provided by the Central Government of India to only 8 fast track projects (of which DPC was one) as part of an effort to kick-start the development of IPPs in India. This was done in recognition of the fact that there were numerous imponderables and a high degree of risk in setting up large infrastructure projects in a developing economy, such as India.

Dispute Resolution Mechanism

Given the billions of dollars at stake, the PPA had also provided for a detailed dispute resolution mechanism between MSEB & DPC in the event of a disagreement in the implementation or the interpretation of the contract. A similar dispute resolution process was also provided for in all major project contracts including the credit support agreements. The process envisaged a conciliation process between the counter-parties, failing which an international arbitration procedure was provided for. Additionally, the PPA dispute resolution mechanism precluded the intervention of any other body (such as an Electricity Regulatory Commission) in resolving the disputes related to the project.

In summary, numerous safeguards were provided for in the project contractual structure for the project lenders, the sponsors and the fuel suppliers. This was partly a reflection of the fact that when Enron first came in to India in the early 1990s, the common perception was that there were significant risks with respect to the viability of private sector development of infrastructure projects in India. Accordingly, Enron and the project lenders demanded greater credit protection and higher returns to develop the project. On the Indian side, the economy was just liberalising and the negotiators for MSEB (notwithstanding their international advisors) were in un-chartered waters. They only had certain Ministry of Power guidelines as a frame of reference, which itself was in an evolutionary stage. However, with time, the Indian power policy evolved and there was significant learning on the Indian side. Accordingly, subsequent projects had significantly fewer safeguards. Accordingly, the DPC contracts were assumed to be very tight by the sponsors and the various project lenders, and had become a benchmark, in terms of contractual credit support, based on which the viability of other IPPs being developed in India were assessed.

However the effectiveness of this credit support mechanism and contractual structure was soon going to be tested to the limits.

Issues concerning the Project

Even before all concerned could congratulate themselves on the spectacular success of completing the largest project financing in Asia, the harsh realities of implementing an infrastructure project in an emerging economy were becoming all too evident.

Perceived high tariff

Given the fact that the project tariffs were arrived at through negotiations and not on a competitive basis, there was a feeling across the public at large that DPC tariffs were high, despite the tariff reduction achieved in the 1995 renegotiation process. This perception was further reinforced after Phase I became operational.

In May 1999, Phase I of the project was finally commissioned after some teething problems and MSEB started to draw power from DPC. However, the cost of the power from the brand new liquid fuel based DPC was proving to be significantly higher than the power costs of MSEB's own older coal based power plants. Aside from the significant dollar denomination of the DPC tariff, there were two additional factors, which were primarily responsible for this high tariff. First, MSEB was despatching the power plant at low plant load factors (~ about 60% of the plant's capacity in the 1st year) and there was a sharp increase in the price of Phase I fuel (Naphtha), during 1999–2000.

The low despatch of the power plant resulted in the total fixed costs being apportioned over a smaller number of units, leading to an increase in the unit fixed costs. Further, the increase in the fuel costs (which was completely passed through to MSEB), led to an increase in the unit variable cost as well. Accordingly, the total unit costs from DPC were significantly higher than projected. This tariff was regularly compared to the power costs of MSEB's old and depreciated plants and other centrally operated plants, which further increased the public's perception that the tariff was unusually high. The media also played its part in sensationalising these tariff comparisons.

It is true that DPC Phase I tariff was relatively higher than other liquid fuel power stations. However, after the commissioning of Phase II and the transition from liquid fuel to natural gas, the unit tariff was expected to come down. Another issue relating to the DPC tariff was its high level of dollar denomination (as much as 85% in Phase I & over 90% in Phase II). While the significant dollar denomination reflected the high proportion of dollar financing of the project (in terms of both equity investments & debt capital), this would increase MSEB's liability on an ongoing basis should the local currency (Indian Rupee) continue to depreciate vis-à-vis the dollar.

MSEB's poor operational performance & financial health

MSEB was one of the largest SEBs in India, with its own generating capacity of 9738 MW (as of 2001) and a total available capacity of ~12800 MW for its grid,. However, a combination of factors aside from DPC were impeding its performance. To start with, the policy of cross-subsidisation in which 90% of MSEB's consumers paid less than the cost of generation meant that industrial and commercial consumers paid the highest tariff, while agricultural consumers paid very low tariffs (Agricultural consumers paid as little as Rupees 0.50 per kwh, as compared to Industrial and commercial consumers, who paid tariffs of over Rupees 4 per kwh). This skewed tariff structure combined with an economic downturn, resulted in a decline in demand for power from the industrial customers. Further, the SEB was saddled with high transmission and distribution (T&D) losses (reported T&D levels shot up from 16% in 1996-97 to 36% in 2000-01) due to a combination of old equipment and high consumer theft. In addition, MSEB had poor collection efficiencies, which reflected in the very high level of gross receivables (Rs 64,830.2 mn. as of Mar 2001), which constituted about 55 % of MSEB's total income for the year.

In summary, MSEB's revenue base did not increase commensurately with its increase in purchased power and MSEB was soon having problems paying DPC's power bills.

MSEB's poor financial performance is reflected in losses amounting to Rupees 28,415 million for the financial year 2000-01. Thus MSEB's financial crunch was further exacerbated by the monthly payouts to DPC. From MSEB's and GoM's perspective, it was convenient to lay all the blame of MSEB's financial distress on DPC's high power cost.

A snapshot of MSEB's recent performance profile is given in Table I below:

Table I: MSEB Performance Highlights

	1996-97	1997-98	1998-99	1999-2000	2000-01
Net Generation & Purchase (in Mus)	50815	53353	56597	60459	62111
Sale of Energy (in Mus)	42698	43894	46328	41982	39994
T&D losses (in %)	**16.0%**	**17.7%**	**18.1%**	**30.6%**	**35.6%**
Total Revenue (Rs.mn.)	88,173.7	95,249.0	105,358.9	111,311.9	122,609.5
Average Revenue per unit (Rs/Kwh)	2.07	2.17	2.27	2.65	3.07

Source: MSEB Administration Report & Annual Accounts: 2000-01

(All figures in Rs. mn)	**1998-99**	**1999-2000**	**2000-01**
Revenue Receipts	105,359.3	111,311.9	122,615.5
Subsidy from GoM	3551	20841.9	-3738.5
Total Revenue	**108,910.3**	**132,153.8**	**118,877.0**
Revenue Expenditure	83211.9	101852.6	113728.6
Other appropriations & adjustments	21937	26270.1	33563.5
Net Surplus/(Deficit) before state subsidy	**210.4**	**(16,810.8)**	**(24,676.6)**
Net Surplus/(Deficit) after state subsidy	**3,761.4**	**4,031.1**	**(28,415.1)**
Return on Capital Employed (%)	8.9%	10.0%	-11.1%
Total Debtors to Revenue (%)	43.1%	49.7%	55.2%

Source: Annexure B of the MSEB Annual Accounts 2000-01

Emergence of MERC

MSEB's problems were further accentuated by the emergence of the Maharashtra Electricity Regulatory Authority (MERC) in 1999, as the regulatory body responsible for setting tariffs in the state of Maharashtra. MERC questioned MSEB's purchase of power from DPC and did not approve the end user tariff increases that MSEB sought.

DPC's PPA was signed prior to the emergence of MERC and accordingly, MERC did not have any power to decide on the tariff charged by DPC. However, in its first tariff ruling, MERC lay down certain 'merit order' based despatch guidelines regarding the extent of despatch of DPC by MSEB, which further exacerbated the problems. On this basis, MSEB reduced its despatch of DPC to as low as 33% in some months, which resulted in the unit power cost from DPC being exceptionally high for those months (given the fact the fixed charges had to be apportioned over a small number of units).

Managing Public Opinion

Right from the beginning, the project had been mired in controversies. In the early phase of the project, the high profile maintained by the lead developers of the project, Rebecca Mark & Joe Sutton, ensured that the project continued to receive extensive publicity. Enron developers' approach of aggressively pursuing the financial closure of the project was very different to the way business had traditionally been conducted in the Indian energy sector, which was characterised by red tapeism and bureaucracy. The Enron developers in their zeal to close the deal did exert immense pressure on bureaucrats and politicians, which may have worked in the short term, but came undone in the longer term. In a sense, there was a feeling that Enron officials had, by and large, failed to assimilate the Indian culture to way they conducted their business in India.

Enron didn't deem it necessary to pay enough attention to public opinion earlier on and eventually paid the price for its oversight. Further, the fact that the project was not competitively bid, but was awarded to Enron on a negotiated basis resulted in further criticism of the project. Enron was never able to successfully address the public perception of "DPC power being a high cost power". While the state government in power supported the project, there was significant opposition from the opposition parties. The situation was further complicated by Enron's/DPC's attempts to deflect some public criticism by awarding various smaller project contracts to local parties, backed by local politicians.

Downward Spiral

Given MSEB's deteriorating operating and financial condition, its ability to absorb and pay for DPC power (especially after the commissioning of Phase II) was highly questionable. In the meantime, in late1999 there was another legislature election for the state of Maharashtra, when the incumbent govt. (led by BJP – Shiv Sena combine) was voted out of power and a new coalition government (led by the Congress-I party) was elected into office. Certain political parties in the new coalition government were openly opposed to the project.

DPC and the sponsors were getting increasingly worried with the situation. In an attempt to pre-empt a major problem, DPC developed numerous workout plans with various restructuring options (including short term sale of DPC power to other states), which were discussed with MSEB, financial institutions, GoM & GoI. However, from MSEB's perspective, none of these plans significantly alleviated its burden and in its views, more drastic measures were needed. Further the problems related to the project had taken significant political overtones. A new chairman, Mr. Vinay Bansal, was appointed at MSEB, who had a mandate to get MSEB out of its current difficulties. The stage was set for MSEB to attempt to unwind the deal.

Invocation of GoM & GoI Guarantees by DPC

By the end of 2000, MSEB's deteriorating financial condition, the increasing public perception of the high cost of DPC's tariff and the imminent commissioning of Phase II in a few months (which would have increased MSEB's payment liabilities towards DPC two-fold) had set the stage for MSEB to attempt to take some drastic measures. MSEB had begun to delay its payments to DPC, until a stage was reached when DPC invoked the GoM guarantee for the first time in early 2001. When GoM failed to pay, DPC followed it up with an invocation of the GoI counter-guarantee. Following this, in Feb 2001, MSEB raised a technical dispute and imposed a claim of about $86 million (over 2.5 times the size of DPC's monthly bill), alleging a claim of misdeclaration of its plant's availability by DPC[2]. DPC disputed the claim stating that the timing of MSEB's actions and claims indicated MSEB's intention to extricate itself from having to make the monthly contractual payments. However, both the GoM and GoI failed to make payments of DPC's bill (for the months of December 2000 and Jan 2001) under their respective guarantee invocations, claiming the billed contractual amounts were disputed by MSEB.

Escalation of Legal wrangle

Once GoM & GoI failed to make payments under their respective guarantees, DPC upped the ante and initiated formal conciliation and dispute resolution process. An attempt by DPC to activate the escrow account, which was one of the available payment security mechanism was also blocked by MSEB, which sought an injunction from the High Court in Mumbai. When the conciliation process between the counter-parties failed, DPC continued to push for a legal route, by seeking an international arbitration process, as envisaged under the PPA (a step which DPC had resorted to during the project suspension in 1995 as well). As a further measure to increase pressure on MSEB & GoM, DPC also served a Preliminary Termination Notice (first of several steps to terminate the contract), citing non-payment of its monthly bills and also claiming Political Force Majeure. Additionally, with a view to further strengthen its legal stance of not recognising MSEB's protests, DPC also refused to receive monthly bill payments for the month of April by MSEB (While, MSEB didn't make the bill payments for December 2000 and Jan 2001, it started making payments for subsequent months under protest).

MSEB on its part disputed the arbitration process and in complete disregard of the PPA, wanted MERC to adjudicate on the dispute resolution process claiming that it was vested with quasi-judicial powers to adjudicate over all electricity related disputes within in the state of Maharashtra. Finally, on May 29th 2001, MSEB sent a letter to DPC rescinding the PPA and stopped despatching the power plant and all further payments. MSEB claimed that DPC had misrepresented the power plant's ramp up capability from cold start to full load, which entitled it to declare the PPA "null & void".

Energy Review Committee – Godbole Committee

Simultaneously, there was a separate drama unfolding. The new GoM had appointed an 'Energy Review Committee' headed by a retired bureaucrat, Dr. Madhavrao Godbole. This committee was given the responsibility of establishing whether or not the previous government had acted appropriately, when it gave the go ahead for Phase II of the project. The committee was also to consider the relevance of the project for the state of Maharashtra and to review the project tariff. The Energy Review Committee (also known as the Godbole Committee) included representatives from the GoM (Energy & Finance Department) and a representative from the GoI as well. It started its proceedings in Feb 2001. The committee came up with its first report in April 2001 and was highly critical of the manner in which the project was approved by the various authorities at the Central level and the State level. Some of the committee's key conclusions were:

---

[2] DPC had taken about 6 hrs. to restart the plant and bring it to full load after a plant shutdown for about a week's time, as opposed to the 3 hrs indicated in the PPA.

With respect to DPC, the Committee is concerned that there are numerous infirmities in the process of approvals granted in the project, which bring into question the propriety of decisions [Page 3, Chapter 1]

…even if DPC, especially Phase II, were to be attached to a MSEB without any problems of T&D loss, it would still manage to drag MSEB back down into financial sickness.

The Committee finds that while the initial demand projections for DPC were flawed in that they ignored different load types in their projections, the demand projection that was the basis for commencement of Phase II was based on patently untenably assumptions, given the information at that time; assumptions that have since proved to be completely unjustified.

The Committee also finds that the financial institutions showed poor judgement and lack of due diligence in accepting these projections without demur, as they indicated to the Committee during deliberations, and as is evidenced by the their agreement to disburse funds for Phase II of the project.

It is therefore imperative that the basic issues involved in this project are addressed up-front. These would call for financial re-engineering and restructuring of DPC so as to reduce the cost of its power substantially….DPC has emphasised the sanctity of the contracts entered into with it. However, it is well known that many commercial contracts are routinely renegotiated with major changes. In a sense, economic reality dominates technical legality in the commercial world. [Page 68, Chapter 7]

In a sense, the statement above highlights the committee's views that none of the contractual provisions were sacrosanct. The Godbole committee was also subsequently authorised to negotiate with DPC to restructure its tariff. The difference in the negotiations this time around (as opposed to the renegotiation process in 1995) was that Enron and the other sponsors had already invested all their equity capital in the project and the project was over 90% complete. Accordingly, their bargaining power was considerably lowered.

The Godbole committee's contention was that the current imbroglio was a consequence of a poor commercial decision and *'inept due diligence'* on the part of DPC's equity holders and the lenders. Accordingly, the committee proposed that equity holders to the project had to take the major hit in the restructuring process, followed by the lenders to the project, while MSEB and GoM would only have to make marginal sacrifices. The committee proposed significant changes and reductions in the tariff structure, including pegging the sponsors' equity returns in Indian rupee terms rather than dollar terms. With respect to the Payment Support Mechanism, the committee recommended cancellation of the Escrow Agreement, claiming that the presence of the escrow agreement, would impede MSEB's privatisation process.

The sponsors' however found these demands completely unacceptable, since the committee was attempting to blatantly restructure the contractual terms of the deal, after the sponsors and the lenders had sunk in over 90% of the capital in the project. Also, in the sponsors' view the elaborate payment support mechanism made available to the project was supposed to address precisely such a situation. As a consequence, the negotiations broke down without any viable solution being reached.

Equity Sale Option

Once the renegotiation efforts with the Godbole committee failed, the sponsors' tried to sell off their equity in the project. Ken Lay, Enron's CEO, made a visit to India in July 2001 and met with senior GoI officials and proposed that GoI or any of its arms buy out the offshore sponsors' equity stake in the company. However, while some efforts were made in this direction, this effort ultimately failed owing to a disagreement over the amount of the buyout payment. Further, Enron Corp's own financial problems in the US during October-November 2001 and its subsequent bankruptcy significantly impaired the company's ability to canvass support from the US Government for its claims, and thus it lost its leverage with GoI as well. Accordingly, Enron's initiatives for engineering a buyout of its equity stake lost steam.

While the equity sale option was being pursued, DPC and MSEB were also simultaneously locked in a legal battle in the Indian courts on a variety of issues, including the issue of MERC's jurisdictional powers, invocation of the letter of credit and the activation of the escrow account. The court process was taking its time and DPC and its sponsors were losing patience.

Termination of DPC Contracts

With DPC's disputes with MSEB escalating, the lenders stopped disbursing funds for Phase II of the project in March 2001. This in turn resulted in non-payments to the EPC contractors and consequently the EPC contractors terminated their contract in June 2001. Additionally, with no payments from MSEB since April 2001, DPC's cash reserves started dwindling and the company was forced to start laying off its employees. By the end of October 2001, DPC was preparing to issue the final termination notice to MSEB under the PPA, after procuring the appropriate consent from the lenders.

GoM's Perspective to the Dispute:
The new state government which took over in Maharashtra after the 1999 state elections, was a coalition government led by the Congress-I & the Nationalist Congress Party (a breakaway faction of the Congress-I party). This coalition also included the People's Party, which was completely opposed to DPC. In some sense, there was no champion for the project in the new GoM and in fact, Phase II was seen to be sponsored by the previous BJP - Shiv Sena led govt. Additionally, the GoM's finances were already stretched and it suspected that payments to DPC under the GoM guarantee may not be a one-off payment, but rather would have to be repeated. This problem was expected to become worse after the commissioning of Phase II.

GoI's Perspective to the Dispute:
GoI, at least initially, intended to maintain a hands-off position. Various reasons could be attributed to such an attitude: The project was being set up in the State of Maharashtra and as such, the GoM was primarily responsible for resolving the dispute. Governments led by different political parties at the Central and State level further complicated the issue. The GoI was more sensitive about its image as perceived both internationally & domestically and accordingly, didn't take a more proactive stance at the initial stages of the dispute. GoI also realised that guarantee invocation may be a regular feature and accordingly, was more interested in pursuing alternative routes, rather than just making a payment on the GoI guarantee invocation. GoI also failed to provide the necessary support for the equity sale option. This again could have been for political reasons as well as not wanting to set a precedent.

Rift between the Sponsors & Lenders

Of the various lender groups, the domestic lenders were the least amenable to an issuance of the final termination notice by DPC, since they had the most exposure to the project. The domestic financial institutions' had disbursed loans directly to the project and they had also guaranteed the loans that the ECAs had provided to the project. Further, the domestic lenders were also of the view that DPC and Enron's heavy reliance on legal recourse to resolve the issues at hand, had led to the escalation of the problems. Accordingly, in early November 2001, the Indian Financial Institutions (IFIs) filed a petition in the Mumbai high court seeking a court order to prevent DPC from issuing a final termination notice on MSEB. The foreign lenders did not join the IFIs on this court action. With this step, the relationship between the sponsors and lenders (especially the domestic institutions) started to deteriorate.

The lenders and sponsors did try to restart the process of sale of sponsors' equity and completion of the project in early 2002. However, disagreements regarding the treatment of the equity sale proceeds, resulted in the process being abandoned. Ultimately, in March-April 2002, with no immediate resolution of the problems in sight, the domestic lenders approached the Mumbai High Court and requested the appointment of a receiver by the court to ensure preservation of the project, while some form of restructuring package was worked out.

Rift between Domestic & Foreign Lenders

Since April 2002, while numerous attempts were made by the lenders to restart the project, a growing rift between DPC's domestic lenders and the foreign lenders prevented any viable solution being reached. Considering the significant liabilities incurred by DPC, the domestic lenders were in favour of acquiring the assets of the project (using their lenders' rights) and then proceed with an asset sale of the project to any interested buyers. However, the foreign lenders, led by OPIC, were in favour of an equity sale of the project. OPIC had provided a political insurance cover to the project sponsors and was accordingly not keen on asset sale of the project, since this would have strengthened the sponsors' political insurance claim (under the grounds of expropriation of the project[3]). Similarly, the Phase I foreign commercial lenders to the project were covered under the GoI counter guarantee, which they believed might lapse in the even of an asset sale. Owing to these conflicting interests, the lenders were never able to reach an agreement. In April 2003, nearly 2 years after the plant stopped operating and construction ceased, the stalemate continued. At this time, one section of the lenders, namely the foreign commercial lenders, lost patience and decided to terminate the DPC PPA.

---

[3] Although the majority of the domestic lenders are private institutions, there is a still a significant GoI ownership in these entities. Thus, any action by the IFIs to exercise their foreclosure rights would have been viewed as expropriation.

Exhibit 1: Dabhol Project Profile

◆ ***Location***	**Maharashtra, India**
◆ ***Power Station***	**2,184 MW** **3 x 9FA combined cycle units** **2 x HRSG** **1 x 38 MW Frame 6**
◆ ***Regasification Facility***	**3 LNG tanks, Vaporizers, Dredging, 2.3 km Breakwater, 1.7 km Fuel Jetty**
◆ ***Primary Fuel (Phase II)***	**Natural Gas (from LNG)**
◆ ***Primary Fuel (Phase I)***	**Naphtha or Distillate**
◆ ***Power Purchaser***	**Maharashtra State Electricity Board**
◆ ***Shareholders***	**Enron Corp., MSEB, General Electric Capital Corporation and Bechtel Enterprises Holdings Inc.**
◆ ***Fuel Suppliers***	
Phase I	**no contract - purchase locally**
Phase II	**Oman LNG and Abu Dhabi Gas Liquefaction Company**
◆ ***Shipper***	**Greenfield Shipping Co. Ltd.**

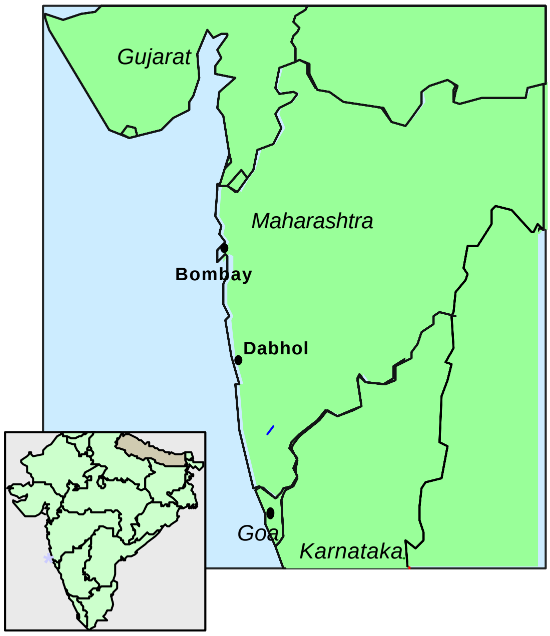


Exhibit 2: Dabhol Project Structure

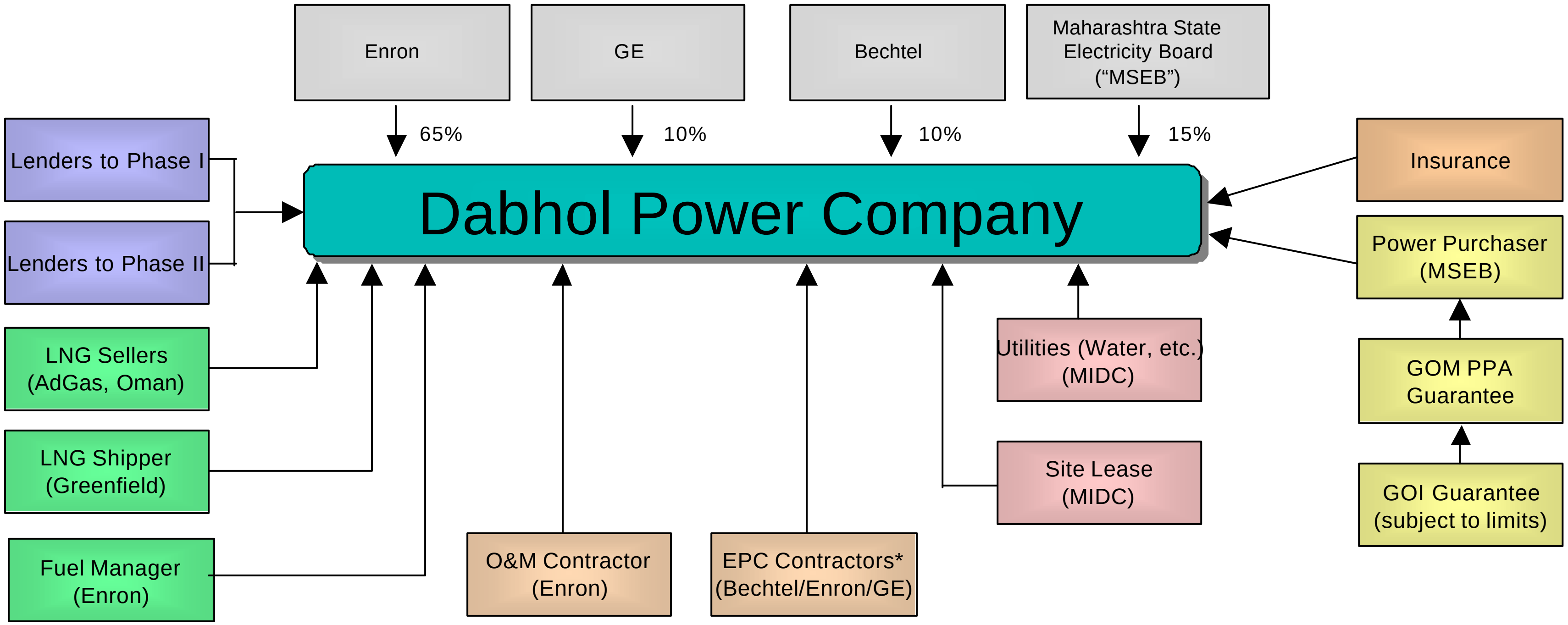
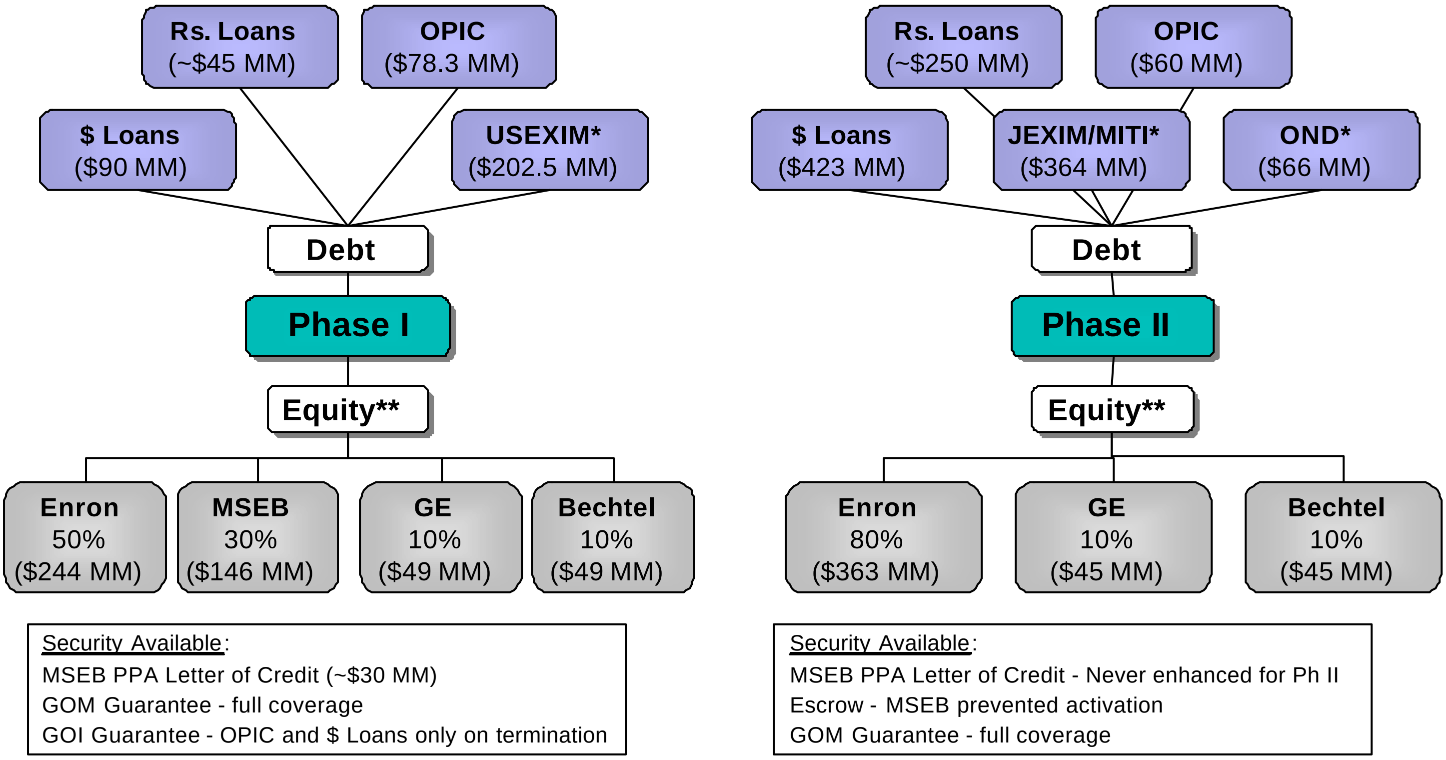


Exhibit 4: DPC Financing Structure



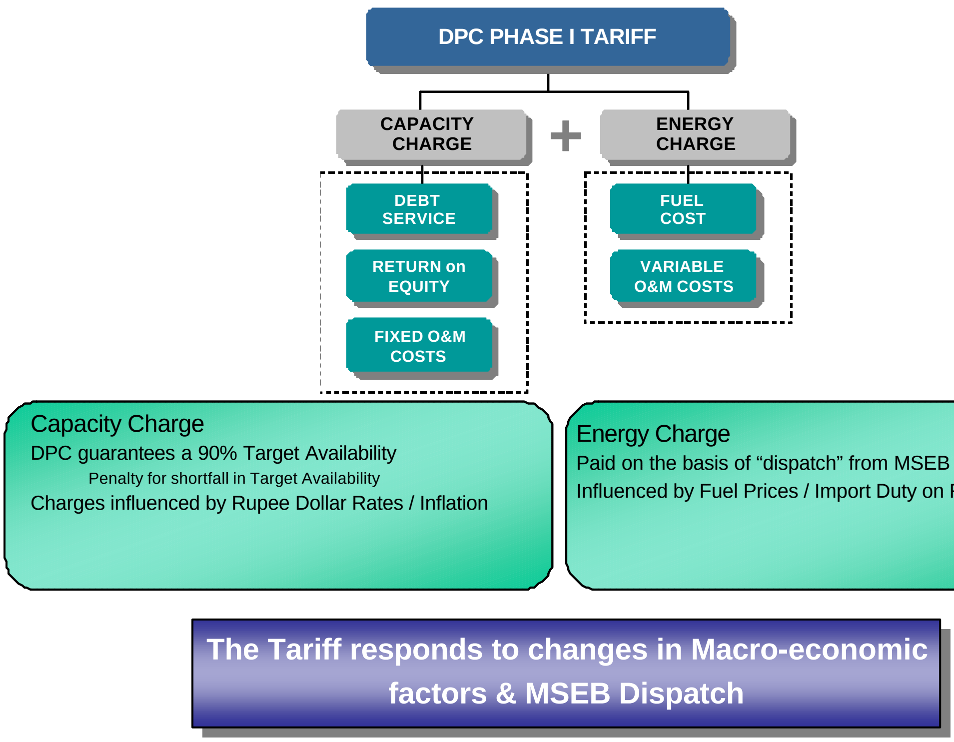
Means of Finance & Ownership Pattern

	Phase I	Phase II	Total
Debt	607	1400	2007
Sponsors' Funds			
Equity	**435**	**454**	**889**
Addl. Support	**95**	**228**	**323**
Total	1137	2082	3219

- *IFIs have an exposure ~ $ 1450 MM in the entire Project (~$ 400 MM as Rupee debt, $ 230 MM as $ debt and ~$ 820 MM (plus interest thereon) as guarantees to $ debt)*

	Phase I	Phase II	Total
• Enron	50%	80%	65%
• GE	10%	10%	10%
• Bechtel	10%	10%	10%
• MPDCL	30%	-	15%

Exhibit 3: DPC Tariff Structures – Phase I & II



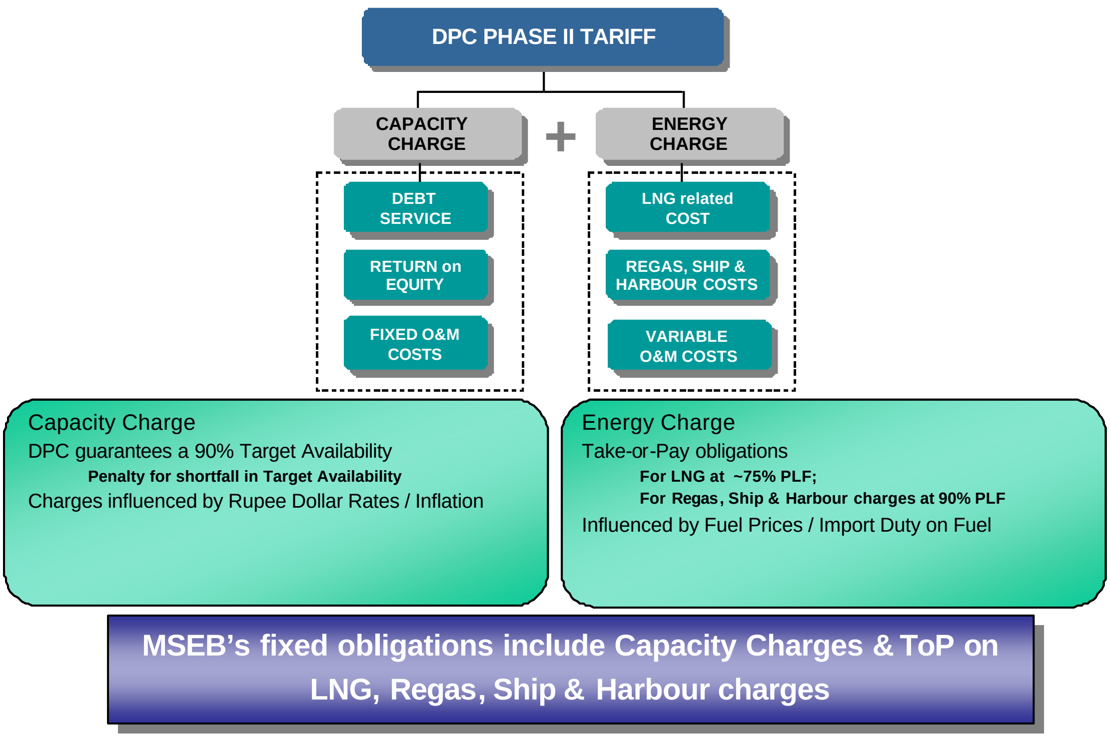


Exhibit 5: DPC's Payment Security Mechanism