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## Of RPL, & conflicting interests

Part 6

Aditi Roy Ghatak

There are serious questions about the interests of Reliance Power's controlling shareholders conflicting with its own interests or with the best interests of its other shareholders (Risk Factor 6). Post-issue Reliance Energy and AAA Project will own, directly and indirectly, around 45 per cent of RPL's outstanding equity shares.

Both companies are controlled by Mr Anil Ambani and there may be a conflict of interest with a common chairman for all three entities, says RPL. RPL's articles of association provide that Mr Anil Ambani shall be the non-retiring chairman of its board as long as he is willing to serve in such a position.

This means that Mr Anil Ambani, Reliance Energy and AAA Project "will continue to exercise significant control over us, including being able to determine decisions requiring a supermajority of the total voting power of our shareholders". "The interests of our controlling shareholders and our affiliates will cause significant conflicts of interest in the ordinary course of RPL's business" (Risk Factor 7).

RPL has entered into a number of non-binding MOUs with each of these affiliates and will face conflicts in negotiating definitive agreements between the affiliates and itself. Conflicts will also arise in the allocation of resources, including key personnel, contractors and intellectual property between REL and RPL, the company says.

Reliance Energy currently operates 941 MW of power generation projects and is one of the largest Indian private sector power generation companies. While the Reliance ADA group has stated that it intends Reliance Power to be its primary vehicle for investments in the power generation sector in the future, there is no non-compete agreement in place between other companies of the Reliance ADA group and RPL. This means that Reliance ADA may develop power generation projects in the future and compete with RPL.

There are critical feedstock issues for the projects and RPL may not be able to ensure the availability of fuel at competitive prices (Risk Factor 12). Eight RPL projects will be coal-fired or gas-fired thermal projects and need fuel at competitive prices. Some plants have assured captive fuel supplies or long-term coal allocations from the government. Others may not be able to obtain necessary coal or gas supplies on commercially acceptable terms, or at all.

Coal for Shahapur Coal and gas for Shahapur Gas and Dadri is expected to be routed through RNRL though there is no definitive agreement with RNRL. Nor does RNRL have any rights to coal resources of its own. Also, RNRL is involved in litigation over its gas reserves, which may impact the availability or the pricing of

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fuel for the two RPL gas-fired thermal projects.

Again, one of the three coal blocks allotted to the Sasan project is involved in litigation between the Ministry of Coal and third parties. "Failure to obtain sufficient fuel supplies for any of our thermal power projects may have a material adverse impact on our business, financial condition and results of operations. We cannot offer any assurance that RNRL itself will be to obtain gas or coal supplies, or that we will be able to obtain gas or coal from RNRL, either on commercially acceptable terms to us, or at all. We currently have not arranged alternative sources of coal or gas for our Shahapur Coal, Shahapur Gas and Dadri projects", says the draft red herring prospectus.

There are issues around conducting mining operations for the Sasan project. (Risk Factor 13) RPL has been allotted three coal blocks to source for Sasan for mining but has "no prior experience in mining". Moreover, the construction and operation of RPL power projects or mines may face opposition from local communities and other parties (Risk Factor 37). The company also says that it may not have sufficient insurance coverage to cover all possible economic losses (Risk Factor 36). RPL is a beneficiary of insurance coverage maintained by its EPC contractors for Rosa Phase I. It hopes to "purchase additional insurance coverage" to meet its obligations under the financing arrangements that it has entered into for Rosa Phase I prior to drawing funds as it believes to be commercially appropriate and for its other projects as they enter the construction and operation phases. "Nevertheless, the insurance we obtain may not be sufficient to protect us from all casualty losses. Losses suffered due to inadequate coverage may have a material adverse impact on our business, financial condition and results of operations".

The remaining important risk factors include the litigations against RPL, its subsidiaries, its directors, promoters and its promoter group companies. (Risk Factor 39) and criminal proceedings pending against Mr Anil Ambani, promoter and chairman (Risk Factor 40).

Besides, RPL says that two of its promoters, one of its five listed promoter group companies and some subsidiaries have incurred losses in the last three years. (Risk Factor 42) Significantly, a large portion of the net proceeds from the issue will be invested in the subsidiaries. Five of them - VIPL (developing the Butibori thermal power project), USHPPL and the three project companies for the Siyom, Tato II and Kalai II projects- will not be wholly owned by RPL in the future. Therefore, the company will not fully benefit from the investments made in such non-wholly owned subsidiaries.

'We expect investors to take note of risks'

KOLKATA, Oct. 29: The Statesman asked Reliance Power to comment on further aspects of its Draft Red Herring Prospectus forming part of the report published alongside. Our questions and RPL's answers are published below.

Q. Do you see conflict issues arising between RPL's controlling shareholders and the company and its other shareholders? (Risk Factor 6) Post issue Reliance Energy and AAA Project will own, directly and indirectly, around 45 per cent of RPL's outstanding equity shares. Would you agree that with both companies being controlled by Mr Anil Ambani, there may be a conflict with all three entities having the same chairman? Further, you admit in your DRHP that "the interests of our controlling shareholders and our affiliates will cause significant conflicts of interest in the ordinary course of RPL's business" (Risk Factor 7). Please explain what the impact of these conflicts will be on RPL's operations, especially with regard to services to be provided by affiliates, allocation of resources, including key personnel, contractors and intellectual property.

RPL says: This assertion relates to the Risk Factors 6 and 7 set out in the DRHP. In relation to this assertion, which only brings out matters already stated in the Risk Factors, you have sought our views on whether we see the Risks as actually arising as also as to the impact of these Risks if they were to arise. For reasons already

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stated, we cannot reply these questions. We may, however, draw attention to the Section of the MOUs entitled "Summary of our business, strengths and strategy and, in particular, to Part II thereof dealing with our "Our Competitive Strengths" and within that to the portion entitled "Reliance ADA group's Experience and Position in the Indian Power Sector" as also the portion entitled "The Reliance ADA group Brand". Also see the portion entitled "Reliance Power and the Reliance Anil Dhirubhai Ambani group" on Page 2 of the DRHP and various other reference in the DRHP to the Reliance ADA group. Reliance Power Limited is part of Reliance ADA group.

We would expect that investors will take these factors into account. They will also consider the track records of other companies of the Reliance ADA group as has been set out in the DRHP, in particular, in the Section entitled "Our Promoters and Promoter Group" at Page 138 of the DRHP. Q. While RPL is said to be the main vehicle for investments of the Reliance ADA group in the power sector, there is no non-compete agreement in place between other companies of the Reliance ADA group and RPL. How has RPL protected itself from the possibility that Reliance ADA may develop power generation projects in the future and compete with RPL? There are also potential conflict issues about the role of Mr. Anil Ambani and other RPL board members vis-à-vis Reliance ADA group companies, especially with some of them having common directorships. Please comment. RPL has appointed Mr K. H. Mankad as a manager with effect from March 12, 2007 but there is fear that key management personnel and employees will encounter conflicts of interest in certain situations. Many of them are on deputation from the promoter companies and RPL admits that its success will depend on its ability to attract and retain its key personnel (Risk Factor 43). Please comment.

RPL says: This assertion relates to Risk Factors 7 and 45 as set out in the DRHP as also the portion of the DRHP entitled "Reliance Power and the Reliance Anil Dhirubhai Ambani group" on Page 2 of the DRHP. We are further asked to comment upon measures taken for mitigation of these Risks which, for reason already indicated we cannot elaborate upon. However, we may reiterate that it is stated in the DRHP that "The Reliance ADA group intends Reliance Power to be its primary vehicle for investments in the power generation sector in the future." Risk Factors 6 and 7 set out in the DRHP clearly bring out that we are alive to the risks arising from possible conflicts of interests as also to the risks of our ability to attract and retain key personnel.

It is for the potential investors to judge whether we would take such action as is appropriate to mitigate risks of which we were aware and based thereon to take an informed view about their investment decision. We reiterate our inability to comment upon and enter into a debate on giving our evaluation of the Risk Factors and our ability to manage the risks of which we are aware as also those which are unknown to us.

Q. RPL may not be able to ensure the availability of fuel at competitive prices (Risk Factor 12). Eight RPL projects will be coal-fired or gas-fired thermal projects and need fuel at competitive prices. Some plants have assured captive fuel supplies or long-term coal allocations from the government. Others may not be able to obtain necessary coal or gas supplies on commercially acceptable terms, or at all. Coal for Shahapur Coal and gas for Shahapur Gas and Dadri is expected to be routed through RNRL though there is no definitive agreement with RNRL. Nor does RNRL have any rights to coal resources of its own. Also, RNRL is involved in litigation over its gas reserves, which may impact the availability or the pricing of fuel for the two RPL gas-fired thermal projects. Again, one of the three coal blocks allotted to the Sasan project is involved in litigation between the Ministry of Coal and third parties. Please comment on these risks, and how RPL proposes to deal with them. While RPL has been allotted three coal blocks at Sasan to source for mining, it has no prior experience in mining (Risk Factor 13). Moreover, the construction and operation of RPL power projects or mines may face opposition from local communities and other parties. (Risk Factor 37). Please explain how RPL

proposes to deal with these risks.

RPL says: This assertion summarises the risk set out in Risk Factor 12 of the DRHP and asks us to comment on how we propose to deal with risks, the strengths of our Company and our proposed business strategy have been set out in the DRHP at Pages 63 and 65.

We believe that DRHP provides sufficient information to the investors to be able to make an informed judgement on our ability to deal with the Risks set out in this assertion as also all other Risks set out in the DRHP.

Q. Other risk factors are around the government regulation (at both state and central levels), which could change and "disrupt" RPL's operations (Risk Factor 33) or environmental laws. "Failure to comply with new environmental laws could adversely affect our results of operations", you say (Risk Factor 34). You say further that there may be restrictions on your operations of a revenue limiting nature and that these could be "subject to substantial civil and criminal liability and other regulatory consequences in the event that an environmental hazard was to be found at the site of any of our power stations, or if the operation of any of our power stations results in material contamination of the environment". Please comment on how RPL plans to deal with these risks.

RPL says: Our comments in relation to the previous assertion would apply with equal force to this assertion which again refers to some of the Risks factors set out by us in the DRHP.

Q. You admit you may not have sufficient insurance coverage to cover all possible economic losses (Risk Factor 36) and state, "Nevertheless, the insurance we obtain may not be sufficient to protect us from all casualty losses. Losses suffered due to inadequate coverage may have a material adverse impact on our business, financial condition and results of operations". Please explain why you have insufficient coverage and whether this is prudent.

RPL says: This assertion refers to Risk Factors 36. While it is not permissible for us to elaborate upon the Risk Factor, we may mention that the assumption made that there is an admission that we may not have sufficient insurance coverage to cover all possible economic losses is not to be found in the Risk Factor as stated and that there is no such admission. The Risk Factor itself clearly inter alia states that "we will purchase such additional insurance coverage for ROSA - Phase-1 as we believe to be commercially appropriate and for other Projects as they enter the construction and operation phases".

We leave it to the investors to judge whether our actions are or are not prudent and accordingly to form their own view about the investment opportunity.

Q. The remaining important risk factors include the litigations against RPL, its subsidiaries, its directors, promoters and its promoter group companies, (Risk Factor 39) including one case for which no records are traceable.

There are also criminal proceedings pending against Mr Anil Ambani, promoter and chairman (Risk Factor 40). Please comment on how these risks could impact on profitability and endanger investor capital.

RPL says: Relevant facts relating to the litigations referred to in Risk Factors 39 and 40, to which this assertion relates, have been elaborated in the Section entitled "Outstanding Litigations and Material Developments" at Page 211 of the DRHP. We believe that the stated /said Risk Factors and the details set out in the aforesaid Section are self-explanatory and which enable investors to form a view about the possible impact of these Risks.

Q. RPL admits that two of its promoters, one of its five listed promoter group companies and some subsidiaries have incurred losses in the last three years (Risk Factor 42). Significantly, a large portion of the net proceeds from the issue will be invested in the subsidiaries. Five of them - VIPL (developing the Butibori thermal power project), USHPPL and the three project companies for the Siyom, Tato II and Kalai II projects- will not be wholly owned by RPL in the future. Therefore, the company will not fully benefit from the investments made in such non-wholly owned subsidiaries. Please comment.

RPL says: This assertion again calls for a comment on a Risk Factor listed

in the DRHP. The relevant information is set out in the Risk Factor and in the DRHP. The extent of the losses stated to have been suffered by certain companies have also been set out in the Risk Factors 42. Similarly, the fact that certain Subsidiaries will not be wholly owned Subsidiaries is also set out the Risk Factor 43. The details of the 5 Subsidiaries, which may not be wholly owned subsidiaries, are to be found in the Section titled "Our Subsidiaries" at Page 122 onwards of the DRHP.

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In our report yesterday, "RPL, its finances, its debt", we had commented on RPL depending on its affiliates in certain key business areas. RPL's response to our question on this point is published below:

Q: According to your DRHP, Reliance Power is relying on Reliance ADA group and its affiliates in certain key aspects of its business as well as ancillary support services. (Risk Factor 5). Are you in a position to assure investors that your affiliates will sign definite agreements on the basis of non-binding MoUs or that if they do, these will be on terms commercially acceptable to you? Please explain how failure to make alternative arrangements could impact on your business, financial condition and operations. Further would you agree that much of your development plans depend on the success of your affiliates? If so, what will be the impact of your affiliates not being successful in maintaining and expanding their own businesses?

RPL says: This assertion is stated to relate to Risk Factor 5 set out in the DRHP. All facts relevant to this Risk Factor have, in fact, been set out in the DRHP which also refers to the Section of the DRHP which throw further light on the matters referred to. In particular, it invites attention to the Section on arrangement with Reliance Anil Dhirubhai Ambani group (Reliance ADA group) at Page 85 of the DRHP wherein it is clearly stated that the non-binding MOUs "will form the basis for negotiations of the definitive agreements". The MOUs and Agreements are more fully described in the Section titled "About the Company - Description of certain Key Contracts" on Page 90 of the DRHP. It has also been stated at Page 85 that the relationships are essential to the business model of the Company and that the Company believes that "they will operate to the benefit of the Shareholders of Reliance Power". We hare sure, The Statesman will study and draw attention of the investors to all relevant parts of the DRHP so that they can make their own informed judgement. As indicated at the outset, it is not possible for us to give further comments upon the quality of the Risk, the possibility of the occurrence or consequences thereof, alternatives etc.

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