

# Regulatory Hotline

November 25, 2015

## DIRECTION FOR CAG AUDIT OF DISCOMS QUASHED: PRIVATE COMPANIES CAN BE SUBJECT TO CAG AUDIT

- High Court rules that a body that has been financed by grants from Consolidated Fund of India may be subject to CAG audit, irrespective of terms of such grant.
- Even private companies may be subject to CAG Audits – law makes no distinction between government and non-government bodies.
- In present case, principles of natural justice were not complied with and effective opportunity of being heard not granted to DISCOMs. Hence, directions were quashed.

### INTRODUCTION

The Aam Aadmi Party ('AAP') had directed that electricity distribution companies ('DISCOMs') be subject to audit by the Comptroller and Auditor General of India ('CAG'). DISCOMs had challenged this in a writ petition before the Delhi High Court ('High Court'). However, interim relief against this direction was not granted and a division bench of the High Court also refused to grant interim relief (i.e., audit not be carried out till the writ petition was finally adjudicated). The High Court has now allowed the writ petition and quashed the directions for subjecting DISCOMs to CAG audits.<sup>1</sup>

While this may be a relief to DISCOMs, the High Court has also ruled that there is no bar to private companies or PPPs being subjected to CAG audit in appropriate cases. Last year, the Supreme Court of India ('Supreme Court') held that telecom companies could be subject to CAG audits.<sup>2</sup> This clearly indicates a trend of governments trying to enforce measures of transparency and accountability which have been traditionally associated with public sector undertakings ('PSUs') against private companies. High Court has specifically said that there is no justification to curtail the powers of CAG in relation to companies other than PSUs.

### FACTS

In 2011 public interest litigations ('PILs') were filed in the High Court seeking an audit of DISCOMs on the ground that they were manipulating their records and showing losses. There were allegations of fraud and tariff rigging by DISCOMs and on these grounds, an audit of DISCOMs were sought. While these PILs were pending, in 2013, AAP which was elected to Delhi State Legislature directed that DISCOMs be audited by CAG. Earlier, in July 2010, Delhi Electricity Regulatory Commission ('DERC') too had requested the Government of National Capital Territory of Delhi ('Delhi Government') to subject DISCOMs to CAG audit. The Delhi Government gave the direction to CAG by invoking powers under Section 20 of the Comptroller and Auditor Generals' (Duties, Powers and Conditions of Service) Act, 1971 ('CAG Act'). Delhi Government had given 48 hours to DISCOMs to give a representation on the proposal for an audit. This was extended once. Ultimately, the direction was challenged in various writ petitions by DISCOMs.

### CONTENTION BEFORE THE HIGH COURT

#### DISCOMS

DISCOMs contended that they were not 'state' within the meaning of Article 12 of the Constitution of India, 1950 ('Constitution') and consequently, it was not permissible for CAG to audit its revenues and expenditure. Disputes relating to tariff were amenable to jurisdiction of the DERC and there was an independent dispute resolution mechanism and regulatory mechanism. Therefore it was not permissible to impose CAG audit on them.

DISCOMs also challenged the procedure by which CAG audit was directed to audit DISCOMS – they contended that Delhi Government could not give such a direction and only Parliament could give such a direction (Article 149 of the Constitution). In respect of Delhi, such an audit could have been directed if the Administrator under Section 41 of the Government of National Capital Territory of Delhi Act, 1991 ('Delhi Act') gave it and in the present case, there was no such direction from the Administrator. DISCOMs contended that section 20 of CAG Act mandated that the request for a CAG audit could only have been made by Administrator and could not have been initiated by Delhi Government. The approval granted by Administrator was mechanical and within independent analysis and hence, this decision was arbitrary. It was also argued that the Administrator was to act on his own (discretion) and was not to rely on the aid and advice of the Delhi Government Cabinet.

DISCOMs also contended that principles of natural justice were not complied as they were not granted an effective hearing prior to the issuance of the direction for CAG audit by the Administrator.

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Delhi Government submitted that serious allegations had been made against DISCOMs, which were also supported by DERC. Section 20 of CAG Act was complied with and the approval of Administrator was also obtained. Delhi Government held 49% shares in DISCOMs and therefore, it was justified and in public interest that accounts of DISCOMs be audited. Delhi Government rejected the mechanism under the Electricity Act, 2003 ('**Electricity Act**') and even DERC submitted that it did not have wherewithal to examine transactions of DISCOMs. Delhi Government also submitted that principles of natural justice were complied with and hence objections of DISCOMs were overruled.

## CAG

CAG relied on ruling of Supreme Court in *Association of Unified Tele Services Providers & Ors. v. Union of India*<sup>3</sup> and contended that based on this precedent, it was permissible for CAG to audit DISCOMs. Further, tariff collected would form part of Consolidated Fund of India ('**CFI**') and therefore, interest of Government was at stake and hence, CAG audit was permissible.<sup>4</sup> CAG also relied on principles of transparency and accountability based on various previous rulings of Supreme Court.

PIL litigants supported the submissions on CAG and Delhi Government.

## JUDGMENT

High Court ruled that Article 149 of the Constitution<sup>5</sup> was to be read as follows:

- CAG shall perform such duties and exercise such powers,
- In relation to the accounts of the Union and of the States and of any other authority or body,
- As may be prescribed by or under any law made by Parliament.

Consequently, there was no limit on what entities may be subjected to CAG audit. However, the duties and powers to be exercised by CAG, were to be those prescribed by Parliament. Sections 14 to 16 also set out various powers that may be exercised by CAG without limitation as to the entity that may be subject to CAG audit. High Court held that the expression 'body or authority' used in Article 149 or section 14 and 15 of the CAG Act made it clear that entities which have received grants or loans from CFI or State could be audited and there was no reason to limit the scope of CAG Act. Thus, section 14 to 16 set out parameters for the body or authority in respect of which CAG may exercise powers and section 20 sets out the circumstances when CAG may exercise powers in respect of circumstances beyond what is set out in sections 14 to 16. High Court therefore rejected the argument of DISCOMs that CAG audit was limited to entities that could be 'state' under the Constitution.

High Court also rejected the role of the Administrator and held that the Administrator did not act as a nominee of the Central Government and that the Administrator was to act only on advice of the Council of Ministers.

However, based on the sequence of events, High Court concluded that process under section 20 of the CAG Act was not followed because views of DISCOMs were sought before consultations with the Administrator. Section 20 contemplated that only after the request for audit was initiated by the Administrator, thereafter, the proposed auditees were to be given an opportunity of being heard. In the present case, even before Delhi Government had taken a view in accordance with the CAG Act, the views of DISCOMs were sought and this was not in accordance with the procedure prescribed under the CAG Act. Further, the details of the proposed audit was not disclosed to DISCOMs and it was also not disclosed why it was in public interest to in fact subject them to CAG audit. Thus, DISCOMs were not granted an effective opportunity to make a representation against CAG audit.

High Court, however, further examined the case and also held that even assuming a CAG audit were conducted, it would serve no purpose as Delhi Government would not be in a position to use such an audit report for any purpose. High Court ruled that a CAG report was not actionable and could not be enforced in judicial review and consequently, no purpose would be served by subjecting DISCOMs to CAG audit. Further, High Court held that regulation of tariff would not have any nexus with CFI and consequently, audit would not be justified in the present case. Thus, it distinguished this case from the case of Association of Unified Tele Services Providers.

## ANALYSIS

Enforceability of the CAG report is an interesting issue that has been raised by the High Court. However, there is precedent for courts relying on CAG reports.<sup>6</sup> High Court observed that it would be more expedient for the sectoral regulator to investigate rather than subjecting private companies to CAG audits. Executive powers should not be exercised for appeasement purposes. As the High Court observed, it is just and expedient that regulators have necessary powers to enable better regulation of market players. This would develop better jurisprudence and also make the market more mature. Resorting to drastic measures such as CAG audits can be counter-productive as this case has shown. Taking recourse to PILs rather than strengthening sectoral regulators is equally counter-productive. It places a burden on courts, weakens the relevant legislation and unfairly favors litigation against private companies - when there should in fact be better enforcement.

It must be noted that this ruling may be challenged in Supreme Court by Delhi Government or the PIL litigators. In such a case, it is hoped that Supreme Court strikes a balance between public interest, expediency and role of the sectoral regulator.

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<sup>1</sup> BSES Rajdhani Power Limited v. Government of NCT Delhi & Ors. WP (C) 529 of 2014.

<sup>2</sup> Association of Unified Tele Services Providers & Ors. v. Union of India, Civil Appeal No. 4591 of 2014.

<sup>3</sup> Civil Appeal No. 4591 of 2014, Note 2 above.

<sup>4</sup> See Nishith Desai Associates Hotline *Supreme Court: Private Telecom Service Providers Under CAG Scanner*, April 29, 2014, available [here](#).

<sup>5</sup> Duties and powers of the Comptroller and Auditor General.

The Comptroller and Auditor-General shall perform such duties and exercise such powers in relation to the accounts of the Union and of the States and of any other authority or body as may be prescribed by or under any law made by Parliament and, until provision in that behalf is so made, shall perform such duties and exercise such powers in relation to the accounts of the Union and of the States as were conferred on or exercisable by the Auditor General of India immediately before the commencement of this Constitution in relation to the accounts of the Dominion of India and of the Provinces respectively.

<sup>6</sup> Supreme Court of India relied on the same in the 2G scam case - Centre for Public Interest Litigation and Ors. v. Union of India and Ors. [(2011) 1 SCC 560]. Competition Commission of India too relied on a CAG report in In Re: Sheth & Co. and Ors., (Suo Moto Case No. 4 of 2013).

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