

NHPC Limited

Comments on draft First amendment to CERC (Terms & Conditions of Tariff) Regulations, 2019

1. Amendment to Regulation 30 (Return on Equity):

The proposed draft amendment provides as under:

*In the first proviso under Clause (2) of Regulation 30 of the Principal Regulations, the words **“excluding additional capitalization due to Change in Law,” shall be deleted** and at the end of the said proviso, the words and expressions **“or in the absence of actual loan portfolio of the generating station or the transmission system, the weighted average rate of interest of the generating company or the transmission licensee, as the case may be, as a whole, shall be considered;”** shall be added.*

In this context, the first proviso to Regulation 30(2) of principal Regulations reads as under:

*“Provided that **return on equity in respect of additional capitalization after cut-off date beyond the original scope excluding additional capitalization due to Change in Law,** shall be computed at the **weighted average rate of interest on actual loan portfolio** of the generating station or the transmission system;”*

It can be seen from above that in the principal Regulations, Return on Equity (ROE) is allowed on additional capitalization after cut-off date beyond original scope at the weighted average rate of interest on actual loan portfolio of the generating station, however an exception has been made for ‘Change in Law’ by which normal ROE (15.5%/16.5%) is permissible for the cases falling under the category ‘Additional Capitalization due to Change in Law’ even if it is beyond cut-off date & beyond original scope. However, in the draft amendment the dispensation for providing

ROE @ 15.5%/ 16.5% on 'add cap due to change in law' has been removed and ROE at the weighted average loan rate is proposed.

NHPC Comments:

Following points are submitted for kind consideration of the Hon'ble Commission:

- a. In the Tariff Regulations applicable for the previous control periods viz. 2001-04, 2004-09, 2009-14 & 2014-19, same rate of return was permissible on the invested equity either in the original project cost or in the subsequent additional capitalization as admitted by the Hon'ble Commission. The concept of differential return on equity was introduced first time by the Hon'ble Commission during the current control period 2019-24. Earlier, in the draft Tariff Regulations, 2019, Hon'ble Commission had proposed ROE @ weighted average rate of interest on loan for the entire additional capitalization beyond cut-off date irrespective of whether it is within or beyond the original scope. NHPC had submitted comments on the above broadly covering following aspects:
 - i) Additional capitalization beyond cut-off date is permitted under Regulation 25 & 26 so as to meet the liabilities of award of arbitration, change in law, force majeure events, higher security and safety of the plant or replacement of assets deployed under original scope of work. In any condition, this expenditure is an investment towards asset creation, which is unavoidable, and such investments should be allowed to earn a fair rate of return. Therefore, the equity investment on account of additional capitalization cannot be treated differently from the equity investment during construction.

ii) Moreover, the suggested changes in draft regulations, if implemented, would be a disincentive for efficient borrowers like NHPC since our rate of borrowing is very low on account of high credit rating.

Therefore, it was suggested by NHPC that the return on the entire equity, invested at any stage of the project should be allowed at the consistent rate of 15.5%/16.5%.

b. Subsequently, in the Final Tariff Regulations, Hon'ble Commission has specified ROE at the weighted average rate of interest on loan for the additional capitalization beyond cut-off date and beyond original scope of work with the exception that 'add cap due to change in law' will be entitled for full ROE. The elucidation given by the Hon'ble Commission on this issue as provided at para-10.1.2 of the Statement of Objects & Reasons (SOR) is reproduced below:

"The Commission has considered the stakeholders' comments / suggestions. The Commission is of the view that in cases where the additional capitalization has become necessary to comply with the 'Change in Law' event, normal rate of return of equity should be allowed instead of allowing rate of return on equity at the weighted average rate of interest on actual loan portfolio. Therefore, first proviso to clause (2) of Regulation 30 has been revised suitably."

c. Now, after one year of notification of the final Tariff Regulations for the period 2019-24, the Hon'ble Commission proposed that 'add cap due to change in law' will also be entitled for ROE at the weighted average rate of interest based on actual loan portfolio. In this regard, the para-3.15 of Explanatory Memorandum to draft Ist amendment to CERC Tariff Regulations, 2019 reads as under:

"Regulation 30: Return on Equity

3.15 Servicing of additional capital expenditure is to compensate the generating station for the additional cost incurred to comply with revised emission standards. The Commission is of the view that it would be reasonable to allow equity infused by the generating company for installing emission control system at the cost of borrowing from financial institution. The same principle is also applicable for additional capital expenditure required due to other Change in Law events. Accordingly, it is proposed to amend existing clause (2) and to add new clause (3) to Regulation 30.”

- d. From para-b & para-c above, it can be seen that Hon’ble Commission has taken two different views on the same issue within a span of one year in the same regulatory period. **NHPC is of the view that such frequent changes in the Regulations will create inconsistency and Regulatory Uncertainty.**
- e. On one side Hon’ble Commission has defined a debt:equity ratio of 70:30 for capital infusion (including additional capital expenditure), and on the other side Commission has specified a lower rate of return at the loan rates for the equity portion of add cap thus **forcing the generators to deploy equity at the loan rates.**
- f. The generating companies in any way have to incur expenditure on account of change in law, force majeure, arbitral awards etc. which are beyond their control and statutory in nature. Accordingly, **specifying a lower rate of return on these mandatory expenses** at the borrowing cost is not justified. Further, if this principle is applied, one generator will get a return say, @ MCLR and another say, @ MCLR + 400 basis points depending on their credit ratings thus **penalizing the GENCOs having superior credit ratings.**

- g.** Accordingly, it is to reiterate that any additional capitalization even if it is beyond original scope and beyond cut-off date required to meet the liabilities of award of arbitration, change in law, force majeure events & higher security and safety of the plant should be provided with **ROE at the normal rates**.
- h.** As stated at point 'g', the stand of NHPC on Return on Equity on additional capitalization is crystal clear. However, if the Hon'ble Commission still intends to provide return on equity (for additional capitalization after cut-off date beyond original scope) at weighted average rate of interest, then in order to avoid differential rate of return to different players i.e. to have a level playing field for all players (kindly refer para (f)), Hon'ble Commission may consider providing ROE on normative basis. i.e. at Bank Rate (SBI MCLR 1 year plus 350 basis points) as on 1st of April, 2019 for any additional capitalization beyond original scope and beyond cut-off date.