

# Haldia Energy Limited

## **Comments on Draft Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations, 2019 for the period 1.04.2019 to 31.03.2024**

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The draft tariff regulations circulated by the Hon'ble Commission is an extremely important piece of statutory document, as it will guide the Indian electricity sector over next five year period. A rather contentious observation can be made in the draft document on operational generation / transmission assets. Finalisation of the regulations, in its present form will discourage continuing operation of many such assets, which are otherwise efficient, cost-effective and are critical in maintaining cost of power affordable for end consumers. Regulatory framework implying wrap-up of such assets will not be in the interest of the consumers and the overall economy of the nation.

Our comments on few regulations / areas are given below for kind consideration of the Hon'ble Commission.

### **(A) Return on Equity (Regulation 17 and 30)**

#### **I. Appropriate level of Return on Equity:**

In the Consultation paper published by the Hon'ble Commission in May 2018, it was set out that return on equity ("RoE") may be determined on the basis of CAPM analysis. Such approach yields RoE of around 20% as compared to existing norm of 15.5% considering beta of listed electricity sector companies having generation business, and prevailing risk free return and historical market return. Therefore, it is essential that the return on equity is revised upward to attract investment in the sector, in preference to other sectors, as envisaged in Para 5.11 a) of the Tariff Policy.

"5.11.....

#### *a) Return on Investment*

*Balance needs to be maintained between the interests of consumers and the need for investments while laying down rate of return. Return should attract investments at par with, if not in preference to, other sectors so that the electricity sector is able to create adequate capacity. The rate of return should be such that it allows generation of reasonable surplus for growth of the sector.*

*The Central Commission would notify, from time to time, the rate of return on equity for generation and transmission projects keeping in view the assessment of overall risk and the prevalent cost of capital which shall be followed by the SERCs also. The rate of return notified by CERC for transmission may be adopted by the SERCs for distribution with appropriate modification taking into*

*view the risks involved. For uniform approach in this matter, it would be desirable to arrive at a consensus through the Forum of Regulators.*

*While allowing the total capital cost of the project, the Appropriate Commission would ensure that these are reasonable and to achieve this objective, requisite benchmarks on capital costs should be evolved by the Regulatory Commissions. The Central Commission may adopt either Return on Equity or Return on Capital approach whichever is considered better in the interest of the consumers.*

.....”

In view of various criticalities in the power sector e.g. non-availability of fuel, cancellation of coal blocks, projects without fuel linkages, lack of adequate long-term PPAs by states, contract / tariff-related disputes, issues related to banks / financial institutions etc., issues in financial and contractual matters affecting performance of the sector; existing approach should be continued with the necessary upward revision of return on equity figure as per CAPM method, for sustenance as well as desired development of the sector.

## II. Encouraging early commissioning of projects:

The draft regulations have done away with the provision of additional return for early commissioning of projects which was stipulated at 0.50% as per prevailing regulations. The Hon’ble Commission is kindly aware that various uncontrollable external factors such as delay in obtaining land clearances, RoW issues, environmental clearances and statutory / government clearances etc. affect the progress of the project. Therefore, without adequate financial incentive, it would not be possible to ensure timely completion of projects. The Hon’ble Commission is also aware that early commissioning saves a lot of cost in terms of IDC, IEDC etc. Moreover, principle of rewarding efficiency is a key guiding factor for tariff regulations in terms of section 61 of the Electricity Act, 2003.

## III. Return on additional capitalisation:

It has also been proposed that the additional capitalisation beyond the cut-off date would attract return at weighted average interest rate of actual loan portfolio of the generating station or the transmission system, as applicable. This would lead to curtailment of the allowable return for the generation / transmission companies. Additional capitalisation beyond cut-off date becomes necessary in order to comply with situations like change-in-law etc. Moreover, ratio for pass-through of capital costs in case of delay in project completion has been laid down by Hon’ble Appellate Tribunal for Electricity which has also been reflected in the draft regulations. As capital costs in such cases have been considered prudent, appropriate return on such costs should not be denied. The Hon’ble Commission, in these draft regulations, has specified several such provisions, e.g. additional capitalisation for

environmental compliance (Regulations 8(4), 9(3), 14(2), 16), renovation and modernisation (Regulation 26). In order to comply with the above provisions, additional investment beyond the cut-off date becomes incumbent on the generating or transmission company. Moreover as mentioned above, timely completion of a project is many times beyond the control of the developer due to external factors. Therefore, due consideration should be given before curtailment of legitimate return.

#### IV. Appropriate equity base

It has been proposed in the draft regulations to reduce the equity base for a generating station or a transmission system (including communication system), completing useful life on or after 1 April 2019, to the extent of excess accumulated depreciation over cumulative repayment of loan. Moreover, admissible depreciation post completion of useful life and balance depreciation, if any, would first be adjusted against the balance repayment of outstanding loan and thereafter would be utilised for reduction of equity till operating period of the generating station.

In this context, it is submitted that completion of useful life is not equivalent to closure of the business. Moreover, businesses are operated under the applicable statutes as going concern basis, and shareholders' money is not taken out from the business unless the same is wound up. Any unnecessary adjustment in the return base on completion of useful life of asset would be prejudicial to the shareholders' interest and would affect much needed investment in the sector.

It is worthwhile to mention in this context that for many of the operating generating stations and transmission system of the country, which are nearing end of their useful lives but capable of efficient operation for considerable period in future, cumulative depreciation surpasses the cumulative loan repayment amount. Therefore, proposed mechanism of computation of return for these projects on a reduced / net equity base would be detrimental for these efficient operating assets and the same may be forced to cease their operation. It is expected that any new investment in power assets will come with concomitant tariff burden on end consumers. Therefore, such an approach is certainly against the philosophy of encouraging good performance, optimum investment as enshrined in the Electricity Act, 2003.

#### **(B) Fuel – Quality (Regulation 52)**

The Hon'ble Commission is kindly aware that "as fired" heat value captures the true heat input into the boiler. It is a widely acknowledged fact that heat losses occur at multiple storage points before the actual firing point of the boiler. Moreover, such heat loss is more prominent for Indian coal. Therefore, heat value needs to be considered on "as fired" basis for determination of fuel cost.

As per the proposed regulations of the Hon'ble Commission, "as received" heat value has been considered for computation of fuel cost after taking into account margin of 85 kCal / Kg as loss in heat value due to storage. CEA, vide communications dated 17 October 2017 and 18 October 2017 to the Hon'ble Commission, recommended that a margin of 105-120 kCal / Kg may be considered as loss of heat value between wagon top at unloading point and point of firing of coal in the boiler. Accordingly, in case heat value is considered on "as received" basis, loss margin may be suitably modified to 120 kCal / Kg.

**(C) Operational norm – Station Heat Rate (Regulation 59(C))**

The draft regulations have revised the norm for gross station heat rate to 2410 kCal / kWh from 2450 kCal / kWh for 200/210/250 MW sets. It may kindly be noted that the recommendations of the Central Electricity Authority dated 10 December 2018 has not been adhered to while specifying the revised norm. It is also urged that adhering to constantly reducing operating norms is an infeasible task for electricity utilities. Improvement in efficiency is bound to get plateaued after certain point in time and resetting of norms for every control period provides a disturbing signal for the sector. Moreover, vintage, present level of operational efficiency etc. should also be considered while setting up norms. Therefore such downward modification of norms goes against the principle of encouragement of superior performance and should not be implemented.

In light of the above, it is urged that the Hon'ble Commission may continue with the existing norm for gross station heat rate.

Additionally, Gross Station Heat Rate ("GSHR") =  $1.05 \times \text{Design Heat Rate (kCal/kWh)}$  is very difficult to achieve in view of partial loading, temperature variation and coal quality. We request the Hon'ble Commission that 6.5% Design Heat Rate margin may be allowed i.e. =  $1.065 \times \text{Design Heat Rate (kCal/kWh)}$  due to the following reason:

With peak power and energy shortage coming down, it is expected that the new stations will not be able to achieve desired level of PLF. Additionally, there will be cases of frequent ramp-up / ramp-downs. These circumstances will have an adverse impact on station heat rate.

The effect of part loading for sub-critical and super-critical units on unit heat rate degradation should also be considered.

## **(D) Operation and Maintenance Expenses (Regulation 35)**

The Tariff Policy envisages setting of operational norms based on past performance and such norms should be achievable. Relevant provisions of the same are extracted below –

“5.11.....

### *f) Operating Norms*

*....The norms should be efficient, relatable to past performance, capable of achievement and progressively reflecting increased efficiencies and may also take into consideration the latest technological advancements, fuel, vintage of equipments, nature of operations, level of service to be provided to consumers etc.*

*.....”*

#### **I. Determination of the base (O&M norm for FY20):**

It is urged that constant reduction in operating expenses, on completion of every control period is an infeasible task for electricity utilities. Improvement in efficiency is bound to get plateaued after certain point in time and resetting of norms for every control period provides a disturbing signal to investors. Moreover, vintage, present level of operational efficiency etc. should also be considered while setting up norms. Under the prevailing inflationary regime over past few years, any abrupt reduction of norms would significantly affect the recovery of prudent and actually incurred expenditures by the generators.

The base year (FY20) norms for most of the capacity sizes have been reduced in the draft regulations even from the norms for FY19 as specified in the prevailing regulations, which is prejudicial for the economic sustainability and new investment in the power sector as a whole. The average Consumer Price Index for Industrial Workers (CPI-IW) over the past five year period 2014-2018 has been about 5%. CPI-IW is the true representative for the inflation level associated with O&M expenses of power sector, essentially an industrial activity. Therefore, the norm for FY20 should be set at a level after considering the escalation rate of 5% over the specified norms for FY19.

In consideration of our submissions, the base level of O&M norm for FY20 has been shown in the following table:

*Rs. Lakhs/MW*

Basis	<b>200 / 210 / 250 MW Series</b>	<b>300 / 330 / 350 MW Series</b>	<b>500 MW Series</b>	<b>600 MW Series</b>	<b>800 MW Series and above</b>
FY19	30.51	25.47	20.43	18.38	
FY20	30.59	24.22	20.38	17.39	15.65
FY20 over FY19 as per draft regulations	+0.08	-1.25	-0.05	-0.99	
Proposed FY20 over FY19 considering 5% escalation	32.04	26.74	21.45	19.30	Proposed to be suitably modified upward

## II. Providing appropriate escalation in O&M norm:

For generating stations:

The Hon'ble Commission has proposed O&M expense norms for the ensuing years considering annual escalation factor of 3.2% in the draft Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations (“**draft regulations**”). In light of our submissions above, 5% year-on-year escalation should be considered while fixing up the O&M norms. As per our submissions, the O&M norms for generating stations should be set at the level mentioned in the table below:

*Rs. Lakhs/ MW*

<b>Year</b>	<b>200 / 210 / 250 MW Series</b>	<b>300 / 330 / 350 MW Series</b>	<b>500 MW Series</b>	<b>600 MW Series</b>	<b>800 MW Series and above</b>
FY 2019-20	32.04	26.74	21.45	19.30	15.65

FY 2020-21	33.64	28.08	22.52	20.26	16.43
FY 2021-22	35.32	29.48	23.65	21.28	17.25
FY 2022-23	37.09	30.96	24.83	22.34	18.12
FY 2023-24	38.94	32.51	26.07	23.46	19.02

Further, the impact of Goods & Service Tax (“GST”) on the O&M contracts needs to be incorporated additionally over the above figures. GST had become effective from 01.07.2017 due to which the tax on O&M contracts went up from 15% to 18%. The impact due to the change in law including GST needs to be considered separately (over the figures mentioned in the above table) while arriving at the base O&M expenses for the next tariff period FY 2019-24.

For transmission systems:

For transmission system, the norms are not adequate enough to cover all types of O & M expenses. It is our submission that inflationary pressure must be considered, while framing the norms. Average inflation rate of about 5% (CPI-IW) over the period 2014-2018 should be considered while determining the norms for the base year (2019-20) as well as the remaining years of the next control period. The norms for transmission has been broken down in multiple components, however, recovery of adequate O&M expenditure, necessary for proper upkeep of costly assets remains to be an issue, which needs to be addressed in the regulations. Impact of GST should also be suitably considered while fixing the norms.

#### **(E) Recovery of Fixed Cost (Regulation 59)**

Under the present mechanism of prevailing regulations, recovery of entire fixed cost is ensured on achievement of normative annual plant availability factor by the generating stations. The proposed approach as set out in the draft regulations consider achievement of normative quarterly plant availability factor as a pre-requisite condition for recovery of full fixed cost. Such change in the methodology would increase the accountability of the generating companies to maintain the desired level of availability for each quarter and might therefore result in incurrence of higher operational expenditure. Thus, it would be essential to suitably revise the normative O&M expenses upward in order to protect the interest of the generating companies.

#### **(F) Working Capital (Regulation 34)**

The present regulations mention the specific components for recovery of expenses required for sustaining daily operations and the existing methodology of determination of normative working capital is best suited for the generating stations as it provides a clear projection of working capital to be provided for the tariff period.

The draft regulations consider 20 days of coal stock for non-pit head generating stations from the existing level of 30 days. The draft regulations also propose to reduce the receivables on account of capacity charges and energy charges for sale of electricity for the generators from 2 months to 45 days. Such curtailment in working capital base and consequent reduction in interest thereof clearly goes against the interest of the generating companies in the form of lower recovery of justified claims. Any adverse impact on the generating companies will also affect the operational creditors and other stakeholders, which will not be in the best interest of the industry and the overall economy.

#### **(G) Sharing of gains (Regulation 70)**

The draft regulations stipulate sharing of gains on account of controllable parameters in the ratio of 50:50 between generating stations and the beneficiaries from the prevailing ratio of 60:40. The proportion of gain realised by the generating companies may be retained at the existing level in order to encourage better and efficient performance. The Hon'ble Commission is kindly aware that the principle of rewarding efficiency in performance has been recognised in the Electricity Act, 2003 and the same has been echoed in the National Electricity Policy and Tariff Policy.

#### **(H) Deviations from ceiling tariff (Regulation 76)**

The draft regulations provide for an option for charging of lower than ceiling tariff by the generating company or the transmission licensee if mutually agreed with the beneficiary on account of reduced claim under certain expense-heads subject to approval of the Hon'ble Commission. The power procurement by beneficiaries from generating stations covered under the Hon'ble Commission's tariff regulations are bound by section 62 (1) of the Electricity Act, 2003, and there is no provision of negotiation for any discount under section 62 (1). This section of the Electricity Act, 2003 allows charging of lower tariff than ceiling fixed by the Appropriate Commissions only under specific condition where multiple distribution licensees exist in the same area, which is applicable only for retail tariff. As the tariff regulations cannot go beyond the Electricity Act, 2003, the provision of providing discount in tariff determined by the Hon'ble Commission should be deleted.



## **(I) Special provisions for thermal generating station (Regulation 28)**

The draft regulations provide for an arrangement with the beneficiaries and the generating stations completing 25 years of operation to have single part tariff covering fixed and variable costs instead of existing arrangement of recovery of costs through two-part tariff. Such stations shall be free to sell to third parties subject to the first right of refusal by the beneficiary. The proposed provision is tantamount to reneging the fixed cost responsibility of requisitioned power in an indirect manner. The Tariff Policy also specifies that for sale of un-requisitioned power, fixed cost responsibility is on beneficiary only. Relevant provision is extracted below:

“6.2

*....The developer and the procurers signing the PPA would share the gains realized from sale, if any, of such un-requisitioned power in market in the ratio of 50:50, if not already provided in the PPA. Such gain will be calculated as the difference between selling price of such power and fuel charge.....”*

Moreover, it might not be in the interest of end consumers considering increasing demand, slow capacity addition and firming up of spot-power price. It is submitted that such uncertainty in recovery of fixed costs would make the future operation of the generating stations difficult. Operation of older stations must be encouraged as these stations provide power at a much cheaper rate, as compared to necessary new investments.