

## Comments on CERC Approach Paper

### **INTRODUCTION**

The CERC has recently published an Approach Paper regarding the Terms and Conditions of Tariff regulations for the Tariff Period of 1.04.2024 to 31.03.2029. CERC has invited comments and suggestions from stakeholders on the same.

One section of the Approach Paper focusses on the consideration of capital costs for determination of Tariff of projects acquired post NCLT Proceedings and wherein tariff is determined under Section 62.

As per the approach paper, it is perceived that the tariff under Section 62 needs to be determined on the cost-plus principle. Therefore, the acquisition value should be considered. Furthermore, if the acquisition price is higher than the historical value, the same may be capped at the historical value of such assets, as consumers should not be burdened with the asset premium quoted.

In addition to the above, it is observed that considerable time is exhausted when the entities are under CIRP. Further, before finalisation of Resolution Plan, wherein no debt servicing was done by the utilities, the tariff allowed included such debt servicing and therefore appropriate provisions may be required to be incorporated in the Regulations to govern the determination of tariff for such entities during that period.

Accordingly, in view of the above Comments and suggestions were sought from stakeholders on the following issues:

- 1. Historical Cost or Acquisition Value whichever is lower should be considered for the determination of tariff post approval of Resolution Plan.*
- 2. Tariff provisions to be included to address the issue of the cost of debt servicing, including repayment that were allowed as a part of the tariff during the CIRP process.”*

### **Submission of Prospective Resolution Applicant (PRA) i.e. Bidders in the CIRP:**

PPL-REC Consortium (i.e. SJVN, PPL, REC and DVC) is declared as Successful Resolution Applicant (“SRA”) under Corporate Insolvency Resolution Process (CIRP) of Lanco Amarkantak Power Limited (LAPL). The Resolution Professional (RP) of LAPL has already submitted the Resolution Plan of PPL-REC Consortium to NCLT, Hyderabad for approval. NCLT approval is awaited. Accordingly, in response to the recently published CERC Approach as brought out above, we would like to submit the following:

### **1. Our Submission: Acquisition Value should not be considered for the determination of tariff post approval of resolution plan.**

It is proposed that while determining the tariff on the cost-plus principle, **the historical cost should be taken into account, regardless of whether the operational power projects are being sold at a premium or discount.** The tariff is determined in accordance with the capital cost incurred by the power projects. In an IBC process, it is observed that the acquisition value of the asset is lower than the Historical Value of the asset as the lenders take significant haircuts. Therefore capping of tariff on basis of Historical cost shall never arise.

In case the tariff is determined based on acquisition value, then in most cases the tariff determined for the power projects (*which have been already revived through the CIRPs*) will reduce significantly. The tariff rates play pivotal role in determining the resolution value offered by a resolution applicant. A Resolution Applicant, after detailed due-diligence, submits a proposal for successful resolution of the assets of the corporate debtor. A reduction in tariff, post-acquisition by the bidder, will not only make the approved resolution plan commercially unviable for the successful resolution applicants (i.e. “SRA”) but will also deter such bidders from participating in the CIRPs of power projects with tariff determination under Section-62. This will adversely impact the ongoing CIRPs in the power sector. In the cases where Successful Resolution Applicant has already been declared, the determination of tariff based on acquisition cost (as suggested in approach paper) will impose difficulties in implementation of the approved resolution plan and increase likelihood of further default in a power sector asset already resolved vide IBC at NCLT.

The following points from a Resolution Applicant’s perspective may kindly be taken into cognizance before considering acquisition value of asset for tariff determination:

**a. Capital Expenditure of the project:**

The capital expenditure of the project is financed by the company through a combination of debt and equity. In the event of any project delays or cost overruns caused by project related issues or clearances related matters, the company secures additional funding to complete the project, resulting in additional debt obligations. However, the increased project cost is not fully approved by the respective DISCOM under the CERC regulations for Tariff under Sec. 62, citing various reasons. Consequently, this situation increases the risk of default of the company due to the additional financial burden it entails.

It is evident that the Company and its lenders assume the entire risk of financing without any undue liability on the part of the DISCOM. The project cost is approved by the regulator after considering various aspects of the project cost. Additionally, the DISCOM is also safeguarded through penal provisions or liquidated damages in case of project delays etc. A combination of non-remunerative tariff on such count and delayed receipts of the same is among the reasons for default by such Power projects and their admission under CIRPs.

Furthermore, under NCLT regulations, the bid value is offered by Bidders to financial creditors after substantial reductions to address the above. Further, Bid Value and further capital expenditure is also tied through funding and internal sources. Therefore, it would be advisable not to make changes to the project cost once the project is resolved through NCLT proceeding/resolution plan under approval with NCLT (*presently, successful resolution plan of LAPL is under approval with NCLT, Hyderabad*). Not only existing financial creditors, it would also negatively impact the recovery for lenders funding the transaction and increase likelihood of further default in a NCLT resolved asset vide IBC.

**b. Additional cost for implementation of Resolution Plan by Resolution Applicant:**

It has been observed in various cases that due to delays in implementation of Resolution Plan on account of various factors, there is deterioration of assets, underutilization of assets due to liquidity challenges etc. Compliance related cost such as FGD installation, additional capital expenditure required for asset upgrades and completion of incomplete projects and any other unforeseen costs shall also need to be factored and funded additionally. Accordingly, Resolution Applicant has to consider various factors in its Resolution Plan to operate the assets at optimal capacity utilization. Hence, Acquisition Cost may not portray complete picture at time of acquisition of power sector assets.

**c. Determination of Resolution Amount by Resolution Applicant:**

During the review process of projects for acquisition under NCLT, Resolution Applicants (RA) carefully assess all the significant contractual terms associated with the project. Among these contracts, the Power Purchase Agreement (PPA) holds importance as it plays critical role in determining the baseline revenue projections for the project.

- i.** It may be noted that the present contractual terms for the project were not viable which has resulted in the project defaulting and getting referred to the NCLT. Considering the same, Resolution Applicant would submit a bid as per the overall viability and sustainability in terms of servicing of payment obligations towards creditors. If the contractual arrangements undergo further downward changes following the acquisition, it will eventually lead to non-implementation of the resolution plan, as commercial viability and sustainability of plan is negatively impacted.
- ii.** *Assets with multiple units:* In most cases, there are assets comprising of multiple units with distinct PPAs (even within individual unit level) with different tariff mechanisms and at different stages of implementation. RA typically submit a single bid value in such scenarios. Apportionment of acquisition cost across the PPAs duly factoring the residual life of corresponding assets/ units to implement a redetermination of tariff is impractical as tariff adoption process which was concluded and had reached finality has to be revisited. Consequently, it becomes impractical to determine the acquisition cost for each individual unit and should be avoided.
- iii.** **Dependence of Cost of Acquisition on tariff:** Valuation of a power project by a Resolution Applicant (i.e. basis of bid value) is based on the future revenues of the project on the basis of the tariff in the PPA. The proposed modification in CERC norms states that this tariff in turn will be determined on the basis of the acquisition cost (i.e. bid value). Thus, the valuation and tariff in this case becomes a factor of each other. This in turn creates an infinite loop of probable scenarios thereby forming a vicious cycle that puts into jeopardy the very outcome of a Resolution Process. Such uncertainty could result in failure of the CIRPs since a bidder will be unable to submit a definitive unconditional bid under such circumstances.

- iv. **Value for other instruments:** It is noteworthy that sometimes part of the lenders settlement involves instruments in the form of Compulsorily Convertible Debentures (CCDs), Redeemable Preference Shares (RPS) or any other instruments. At the time of acquisition the value of such instruments may be lower to its value post acquisition. However, the approach paper does not cover the methodology for valuing such instruments at the time of acquisition.

**d. Risk Perception and Return Expectations of a Resolution Applicant:**

Investor appetite for thermal stressed assets is generally limited with majority of investors now focusing on the renewable space, accompanied by higher return expectations. The heightened return expectations arise due to various costs associated with bringing the stressed asset into operational state. Consequently, developers anticipate a higher return on their investments compared to industry norms.

If the return is capped under Sec. 62, investors would either adjust their valuation of the remaining capacity toward a lower side or do not bid for the project entirely, leading to lower recovery for the lenders. This could possibly lead to failure of CIRPs in case of power projects with PPAs under Sec.62.

Additionally, with the focus on renewable energy, there is a limited number of buyers interested in acquiring stressed thermal power plants. Such additional uncertainties may only curtail investor interest and may lead to projects ending up in liquidation.

**2. Our Submission: Tariff provisions should remain unchanged.**

**The tariff provisions should remain unchanged irrespective of the fact that the cost of debt servicing stops during the moratorium.** The inclusion of these tariff provisions will negatively impact the commercial considerations provided by a resolution applicant in the resolution plan submitted for a corporate debtor. It is understood that debt servicing is not performed by a corporate debtor as per the moratorium imposed in accordance with the provisions of IBC and therefore the cost of debt servicing becomes NIL.

CIRP envisages that the existing contractual commitments of the power project shall continue. If the above-said cost of debt servicing during the moratorium period is considered while determination of tariff, the same will adversely impact tariff and go against the objectives laid out in IBC as it will make the revival process doubtful and entirely negate the principle of value maximization for the power projects undergoing CIRP.

Also, such tariff provisions are not in the overall interest of power sector since it creates an incentive to the power procurers to intentionally push projects into default and insolvency at the slightest instance of liquidity constraint (for which they themselves could be responsible), so as they shall be benefited by the interest moratorium and the resultant tariff reduction.

**Conclusion:**

To summarise, it is submitted that clear visibility on tariff is a critical input for the successful formulation of a resolution plan and the successful resolution of a stressed power asset.

DISCOMs are not impeded since there is no modification in their prevailing tariff arrangement. Also, bidders like PPL-REC consortium always have the option to opt out and not participate further in the bidding process of the CIRPs, in case tariff structure is unattractive or uncertain. In all cases, the lenders, who have funded the development of project, shall end up with major losses on account of the proposed tariff proposal, with adverse impact on public funds held with the lenders. In worse case, CIRPs of operational stressed assets may fail and such power plants will stop operation and go into liquidation with erosion of capital and power capacity, causing great loss to the nation.

Therefore in the overall interest of power sector, it is submitted that

1. Prevailing PPAs under Section-62 shall need to be continued for operational power projects.
2. Prevailing Tariff structure like Change in Law provisions, additional tariff on account of FGD implementation, spares etc. shall continue to apply for operational power projects.
3. Only change in Promoter on account of the CIRP shall need to be acknowledged for operational power projects.