



**Federation of
Indian Chambers
of Commerce and Industry**

Federation House
Tansen Marg
New Delhi 110001
T +91 11 23738760 (11 lines)
F +91 11 23320714 / 23721504
E ficci@ficci.com
www.ficci.com

Mr. Dinesh Batra
Co- Chair
FICCI Power Committee

August 2, 2024

Sh. Harpreet Singh Pruthi
Secretary,
Central Electricity Regulatory Commission
Government of India

Subject: Industry Suggestions on CERC Draft Order dated 3rd July 2024 revising the mechanism of compensation on account of installation of Emission Control System

Dear Sir,

We are writing with regards to the CERC Draft Order dated 3rd July 2024 revising the mechanism for recovery through tariff of the expenditure incurred on account of installation of emission control system by the generating companies as set out in its Suo Moto Order dated 13th Aug 2021.

At the outset, we convey our sincere thanks to CERC for considering the requests made by the industry for providing parity in the treatment of recovery of depreciation and O&M expenses between Sec 62 and Sec 63 PPAs.

However, the industry would like to submit the suggestions for the challenges faced by the Section 63 PPAs in terms of treatment of debt & equity.

We would request the Commission to consider these aspects in the interest of strengthening and improving the compensation mechanism for Sec 63 PPAs.

We request for your favourable consideration on the enclosed suggestions.

Thanking you,

With best regards,

Dinesh Batra



Note on

CERC Draft Order dt. July 3, 2024 for revision of mechanism for recovery through tariff of the expenditure incurred on account of installation of emission control system by the generating companies.

Submitted to CERC

BACKGROUND

- Ministry of Environment, Forest & Climate Change (“MoEF&CC”), vide its Notification dated 7th Dec 2015, has **revised the emission norms for existing as well as upcoming thermal power plants**. To comply with revised norms, the existing as well as upcoming thermal power plants must upgrade or install Emission Control Systems (“ECS”) like Flue Gas Desulphurization systems (“FGD”), upgraded Electro-Static Precipitators (“ESP”) etc.
- Ministry of Power (“MoP”) vide its letter dated 30th May 2018 has directed the Central Electricity Regulatory Commission (“CERC/Commission”) under Sec 107 of the Electricity Act 2003 (“EA 2003”) to **consider the implementation of ECS by thermal power plants as “Change in Law” event for all PPAs (for both Sec 62 & Sec 63)** signed before the date of Change in Law event (i.e.7th Dec 2015). The relevant excerpts of the MoP Letter dated 30th May 2018 are as follows:

*“5.1 The MoEFCC Notification requiring compliance of Environment (Protection) Amendment Rules, 2015 dated 7th December 2015, is **of the nature of Change in Law event**.....*

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*5.2 The **additional cost implication due to installation or upgradation of various emission control systems** and its operational cost to meet the new environment norms, after award of bid or signing of PPA, as the case may be, **shall be considered for being made pass through in tariff by Commission in accordance with law.***

*5.3 The respective TPPs may approach the Appropriate Commission for approval of additional capital expenditure and **compensation for additional cost on account of this Change in Law** event in **respect of the Power Purchase Agreement entered under Section 62 or Section 63 of the Electricity Act, 2003.***

*5.4 For the TPPs that are under the purview of the Central Commission, the Commission shall develop appropriate regulatory mechanism **to address the impact on tariff**, and **the certainty in cost recovery on account of additional capital** and operational cost, under concluded long term and medium term PPAs for this purpose.”*

- The industry **appreciates the MoP directive dated 30th May 2018 to CERC which clearly depicts the MoP’s understanding of requirement of huge capital funds in terms of debt & equity by thermal generators to comply with MoEF&CC Notification dated 7th Dec 2015 & the thermal generators should be adequately compensated for all parameters which impacts the tariff.**
- In pursuance of MoP directives as above, CERC issued a Suo Moto Order dated 13th Aug 2021 providing a mechanism for compensation for installation of ECS by thermal generators with Sec 63 PPAs with the beneficiaries. In parallel, CERC issued Tariff Regulations 2024 including compensation for installation of ECS for Sec 62 PPAs.
- In line with treatment of depreciation under Tariff Regulations 2024, CERC has now proposed a revision of the mechanism of compensation vide Draft Order dated 3rd July 2024 (“Order” or “instant Order”) as set out its Suo Moto Order dated 13th Aug 2021 & sought comments/suggestions/objections on the same by 4th Aug 2024.
- In this draft order, four aspects have been revisited – (i) Recovery of Depreciation, (ii) O&M expenses, (iii) Cost of debt and equity, and (iv) interim relief in the form of provisional tariff.

- The industry thanks CERC for considering the requests made by the industry for providing parity in the treatment of recovery of depreciation and O&M expenses between Sec 62 and Sec 63 PPAs.
- It is further submitted that the Commission, **while proposing this revised mechanism, may have overlooked & not considered the challenges faced by the Section 63 PPAs in terms of treatment of debt & equity.** In para 3 of the instant Order, CERC has recognized that these kinds of mechanisms need to be evolved & regularly strengthened to achieve the greater accuracy, based on practical experience.
- The industry, hereby, is submitting its comments/suggestions/submissions & request the Commission to consider these aspects **in the interest of strengthening and improving the compensation mechanism.**

COMMENTS / SUGGESTIONS / SUBMISSIONS ON THE PROPOSED REVISION

REQUEST # 1 - COMPENSATION MECHANISM SHOULD FOLLOW PRINCIPLE OF RESTITUTION IN LETTER & SPIRIT

A. Principle of Restitution

- The Hon'ble Commission, while determining the mechanism of compensation ECS, has relied on the **Principle of Restitution** laid down in PPAs.
- As per the Principle of Restitution, the affected party is to be restored to the same economic position as if no Change in Law had occurred. Restitution is therefore inherent to compensation on account of Change in Law
 - Hence, to ensure that the affected party is adequately restored to the same economic position, **the Commission should factor in all parameters of tariff that increases the cost or expenses & decreases the revenue.**
 - **Non consideration or Part consideration of any tariff parameter would result in inadequate compensation & consequently, the affected party would not be able to restore itself to the same economic position.**

APTEL Judgement dated 13.04.2018 in Appeal No. 217 of 2017

- The Article 13.2 of the model PPA in respect of Case-2 bidding (similar provisions exist in Case-1 bidding PPA) provides that the parties affected by Change in Law should be restored to the same economic position as if the Change in Law had not occurred. While interpreting this provision, the Appellate Tribunal for Electricity in its judgement dated 13.4.2018 in Appeal No. 210 of 2017, held as under:

“..... Further, the provisions of Article 13.2 i.e. restoring the Appellant to the same economic position as if Change in Law has not occurred is in consonance with the principle of ‘restitution’ i.e. restoration of some specific thing to its rightful status.”

Supreme Court Judgement dated 25.02.2019 in the matter of Uttar Haryana Bijli Vitran Nigam Ltd & ...vs Adani Power (Mundra) Limited & Ors

- Subsequently, the Hon'ble Supreme Court upheld the above judgment of APTEL vide its judgment dated 25.02.2019 as under:

“7. Article 13.2 is an in-built restitutionary principle which compensates the party affected by such change in law and which must restore, through monthly tariff payments, the affected party to the same economic position as if such change in law has not occurred. ..., i.e., the party must be given the benefit of restitution as understood in civil law.”

Supreme Court Judgement dated 03.11.2020 in the matter of Uttar Haryana Bijli Vitran Nigam Ltd & ...vs Adani Power (Mundra) Limited & Ors

“5.16. Hon'ble Supreme Court in Energy Watchdog Judgment has held that the purpose of compensating the party affected by shortfall in supply of coal by Coal

India Ltd. is to restore the affected party to the same economic position as if such change in law has not occurred. For such restitution, compensation is not pegged at

or limited to any particular ceiling but premised on 'actual' increase in cost of selling power. ..."

- The industry reiterates that installation of ECS is a “Change in Law” event for generators having signed Sec 62 & Sec 63 PPAs before the date of event i.e. 7th Dec 2015 & henceforth, the mechanisms formulated & issued by the Commission for compensation under either Sec 62 or Sec 63, in light of above judgements by APTEL & Supreme Court, **should be in consonance with the Principle of Restitution i.e. restoration of some specific thing to its rightful status”.**

B. Principle of Restitution vs Principle of Compensation

- The industry further submits that the Commission, while applying the **principle of restitution**, has unilaterally **been drawn to the principle of compensation**. The difference between Restitution and Compensation can be drawn from the **Restitutionary damage** and **Compensatory damage** under the law. In case of **Compensatory damage**, there is a need to **assess the loss (linked to decrease of revenue)** whereas the **Restitutionary damage** requires the assessment of profits also.

Madras High Court Judgement dated 15.12.2021 in Civil Suit No. 258 of 2020

- The Hon'ble Madras High Court vide its judgement dated 15.12.2021 in Civil Suit No. 258 of 2020 in the matter of ***E-merge Tech Global Services Pvt. Ltd. vs. M.R. Vindhyasagar & Anr.*** elucidates the difference between **Compensatory damages** and **Restitutionary damages**. Accordingly, we request the Hon'ble Commission not to consider the principle of compensation as an alternative to the principle of restitution and **apply the principle of restitution as per the power purchase agreement (PPA)**.

C. Restitution for Sec 63 PPA with underlying principles of Regulated Tariff Mechanism

- It is further submitted that for the purpose of granting compensation for additional cost of ECS for Sec 63 PPA by applying Principle of Restitution, the CERC itself recognizes to consider the underlying principles of regulated tariff mechanism for Sec 62 PPA or **at least to factor in all tariff parameters under Tariff Regulations for Sec 62 PPA**.

Supreme Court Judgement dated 02.07.2019 in CA No. 11133 of 2011

- The consideration of parameters of Section 62 for the purpose of compensation is accepted by the Supreme Court judgment dated 02.07.2019 in the matter of *M/s. Adani Power (Mundra) Ltd. vs. Gujarat Electricity Regulatory Commission* wherein it was held that the in case of termination of PPA, **the generating company is compensated for the power supplied during the interim period by applying principle of regulated tariff mechanism under Section 62 project.**
- The relevant extracts of the judgements are as under:

“50. Section 62 of the Electricity Act, 2003, provides entire mechanism for determination of the tariff by the CERC. It will also be relevant to note that the CERC (Terms and Conditions of Tariff) Regulations 2009 also consider various factors which

are required to be taken into consideration by the CERC while determining the compensatory tariff. ...”

D. Distinction from the CERC Order dated 20th August 2021

- In several orders related to the renewable energy projects, wherein the Commission (CERC) has allowed the relief on account of change in law event, relying on its initial order dated 20.08.2021 in the Petition No. 536/MP/2020 & Ors. In the said order, CERC decided the methodology of the compensation & allowed the compensation at the rate of interest rate or return. Relevant Para of the order is as under:

“64. Further, in the tariff determined through a competitive bidding process under Section 63 of the Electricity Act, 2003, the individual tariff elements, such as capital cost, cost of capital etc. are not known. Similarly, the expected return of equity is also unknown. In the absence of such details, it is neither possible nor appropriate to engage in detailed computation of the weighted average cost of capital based on the 2017 RE Tariff Regulations. Therefore, we are not inclined to consider the contention of the SPDs for discount factor of 12.9% or 13.14% or that of Respondent Discoms for a discount factor of 9.36%.

*65. We find that in Petition No. 536/MP/2020, SECI and the Respondents (SPDs as well as the Discoms) are on the same page in so far as the rate of interest on loan is considered. This is evident from the computation of the weighted average cost of capital advanced by the contending parties. Majority of the parties have used 10.41% (as mentioned in the CERC RE Tariff Order dated 19.03.2019) as the reference rate of interest for building their arguments for the rate of annuity payment. In other words, the parties have accepted this rate as the appropriate normative rate of interest for any debt that they might have taken. Given the fact that it is not possible in case of competitive bidding projects to ascertain either the capital structuring (extent of debt and equity) of the projects, or the actual rate of interest of the debt component or the expected rate of return on equity, we consider it appropriate to use the normative rate of 10.41% as reference for the purpose of annuity payment. **As the actual deployment of capital by way of debt or equity and their cost in terms of rate of interest or return, respectively, is unknown, the rate 10.41% can be taken as the uniform rate of compensation for the entire expenditure incurred on account of GST Laws or Safeguard Duty. The Commission is of the view that the compensation for change in law cannot be a source for earning profit, and therefore, there cannot be any higher rate of return than the prevailing normative cost of debt.** Accordingly, we hold that 10.41% shall be the discount rate of annuity payments towards the expenditure incurred on GST or Safeguard Duty (as the case may be) by the Respondent SPDs on account of ‘Change in Law’.*

- In this regard, it is to be submitted that **in case of renewable projects wherein the compensation mechanism-based annuity method was itself agreed into the PPA & there is no clear principle of restitution in case of renewable PPA, unlike the competitive bidding-based projects.** It is observed that CERC, while issuing various orders of compensation, unanimously got into mixing the compensation principle followed for renewable cases with restitution. However, **in case of competitive bidding based thermal projects, the principle of restitution is clearly laid down in PPAs.**
- The industry has a view that while drafting the CERC Suo moto Order for ECS, the restitution mechanism to be followed got diluted with compensation mechanism, as has been followed in case of renewable projects. In view of the above, **the industry earnestly requests the Commission to consider the clear demarcation between the**

- **compensation mechanism followed under Sec 63 Renewable PPAs & the restitution mechanism followed under Sec 63 thermal PPAs.**

Request: The industry hereby requests the Hon’ble CERC, while finalizing the Order for compensation mechanism for installation of FGD under Sec 63 PPA,

- a. to apply the **Principle of Restitution strictly as per the PPA** and not to consider the principle of compensation as an alternative to the principle of restitution.
- b. to **adopt all the parameters of Tariff Regulations, 2024 applicable for Section 62 projects to comply with the principle of restitution.** The mechanism or procedure of determination of tariff may be different but the resultant tariff awarded by the Commission should be equitable.

REQUEST # 2 – ADEQUACY OF RESTITUTION FOR ECS UNDER SEC 63 PPA – COST OF DEBT & EQUITY OF EMISSION CONTROL SYSTEM

- In order to compensate the returns on capital cost of Emission Control System (“ECS”), CERC Draft Order continues **with the approach of net fixed assets & cost of capital employed** as specified in its earlier Suo Moto Order dated 13th Aug 2021.
- The **normative rate of interest**, (which is also termed as Weighted Average Cost of Capital (“WACC”)) has allowed at 1 Year SBI MCLR + 250 basis points, for which the Hon’ble Commission is of the view that will balance the interest of the generating company & procurer. However, **the Hon’ble Commission has not substantiated the basis of allowing the margin of 250 basis points over the prevailing 1-Yr SBI MCLR while allowing the normative rate of interest for Sec 63 PPA.**
- The industry welcomes the CERC’s stand/approach of NFA/ RoCE for compensation of ECS for Sec 63 PPAs in view of Tariff Policy 2005 & its amendment thereof. However, **while implementing the same, the Hon’ble Commission has not considered the Principle of Restitution in true spirit, for the capital investments made by the stressed IPPs/generators in compliance with MoEF&CC Notification dated 7th Dec 2015, thus penalizing the IPPs indirectly for participating in competitive biddings & signing PPAs under Sec 63 in comparison to those signing PPAs under Sec 62.**

	Sec 62 PPA	Sec 63 PPA
Sectors	Mostly CPSU, State Generating Companies, Few IPPs	Mostly IPPs
Category of Plant	Existing	Existing
FGD type (mostly)	Wet Limestone Technology	Wet Limestone Technology
Compliance	MoEF&CC Revised Emission Norms “Change in Law”	MoEF&CC Revised Emission Norms “Change in Law”
Benefit to Environment - Contribution	Equal	Equal
Timelines	Dec 24 – Dec 26	Dec 24 – Dec 26
Capitalization	Additional beyond Original Scope	Additional beyond Original Scope
Gestation period	~ 33-36 months	~ 33-36 months
Normative D/E	70:30	70:30
Interest on Debt	Actuals	Cost of Capital on NFA basis @ 1-Yr SBI MCLR + 250 basis points No consideration of tax
Return on Equity	1 Yr SBI MCLR + 350 basis points (subject to ceiling of 14 %)	
Taxation impact	Grossing up of RoE with tax allowed	

- It is clear from above, **despite of all similarities in terms of technology, compliance, basic capital cost, timelines, gestation period & same contribution for environmental benefits**, the plants having Sec 63 PPAs are differentiated from Sec 62 PPAs in terms of treatment of debt & equity and indirectly be given lesser appreciation for their efforts & contribution to environment on installation of ECS in their respective plants.
- To encourage the private sector for timely compliance of MoEF&CC revised emission norms & safeguard their interests, the industry requests the Hon'ble Commission to take into considerations/suggestions in its final Order as follows:

Ground # 1: Equitable return in terms of Sec 62 (GFA approach) vis-à-vis Sec 63 (NFA approach)

- For a Change in Law event of complying with MoEF&CC revised emission norms, as recognized by Ministry of Power, **the principle of restitution is uniformly applicable & should be worked out in such a way that aggregate level of returns on debt & equity should be same for Sec 63 & Sec 62 PPAs.**
- The rate of return for ECS for Sec 62 project is 1-Yr SBI MCLR + 350 basis points under Tariff Regulations, 2024 on GFA approach i.e. say 12.15% at prevailing MCLR. **However, for the same aggregate level of returns as on GFA approach, the rate of return should be higher in case of NFA approach owing to reduction in asset base.**
- As per the industry assessment, the return to be allowed for ECS under Sec 63 PPAs should be ~ 1.5 – 2.0 % higher for the initial five years on an average basis to arrive at the same level of return for Sec 62 PPAs i.e. **14.15% vis-à-vis 12.15% on prevailing MCLR (Annexure A enclosed). It is requested that the above differentiation in commercial aspects of GFA & NFA approach may be taken on cognizance before arriving at the decision for normative rate of return.**

Ground #2: Consideration of impact of tax on cost of capital

- It is submitted that the **payment of taxes to tax authorities is treated as an expense for the purpose of accounting, as well as, the tariff determination purpose, by the Hon'ble Commission.** The tax component is passed through to the buyer as an expense which is an accepted commercial principle for all the transactions, except if it is specifically agreed by the buyer and seller.
- For Sec 62 PPAs, the Tariff Regulations (formulated by Central or State Commissions) always allow the pass through of the tax component for Sec 62 PPAs through grossing up of the Return on Equity with actual tax paid.
- Further, as **per Para 6.2(4) of the Tariff Policy, 2016**, the Ministry of Power has specifically **considered the tax as change in law and pass through.** The para is mentioned below for reference:

“6.2. (4) After the award of bids, if there is any change in domestic duties, levies, cess and taxes imposed by Central Government, State Governments/Union

*Territories or by any Government instrumentality leading to corresponding changes in the cost, the **same may be treated as “Change in Law”** and may*

unless provided otherwise in the PPA, be allowed as pass through subject to approval of Appropriate Commission.”

- Accordingly, in case of change in law event as in the case of ECS for competitively bid projects, the **pass through of tax component should also be acceptable and undisputable**. We humbly request the Commission that the tax on the servicing of capital cost employed for ECS should be allowed for Sec 63 PPA. **This is consistent with the sound commercial practice, accounting standards, the principles laid down by the Commission and the Tariff Policy, 2016.**

Industry Recommendation/Suggestion:

- Considering the above grounds for the impact of taxes on returns & equitable returns for NFA approach vis-à-vis GFA approach, the industry submits as follows:

	Notation	Sec 62 PPA under CERC Tariff Regulations 2024-29	Proposed for Sec 63 PPA with grossing up of tax & equitable returns
Debt Equity Ratio [D/E]	a	70:30	70:30
1 Yr SBI MCLR as on 1st April 2024	b	8.65%	8.65%
Actual Rate of Interest on Debt	c	10.50%	10.50%
Margin allowed by CERC	d	3.50%	-
Rate of Interest for Compensation	e	10.50%	10.50%
Rate of Return on Equity (post tax)	f = b +d	12.15%	12.15%
Margins for Equitable Returns under NFA approach vis-à-vis GFA approach	g	-	2.00%
Effective Return on Equity (post tax)	h = f +g	12.15%	14.15%
Applicable Tax Rate	i	34.94%	34.94%
Grossed up Rate of Return on Equity	j = h/[1-i]	18.68%	21.75%
WACC	k = [D*e + E*j]	12.95%	~13.85%
Margin over prevailing MCLR (%)	l = k - b	4.30%	~5.20%
Margin over prevailing MCLR (bps)		MCLR + 430	MCLR + 520

- Under the Principle of Restitution for the aforesaid change in law event & considering the Commission's view towards NFA approach throughout the life of ECS, **the industry strongly suggests that**
 - **Adequate margins (~1.5-2%) should be considered under the NFA approach for equitable returns for Sec 63 PPA vis-à-vis GFA approach for Sec 62 PPA.**
 - **Adequate treatment of impact of tax (as an expense) should be considered while calculating Normative cost of capital for Sec 63 PPA.**
 - **Accordingly, Normative cost of capital for Sec 63 PPA should be allowed at ~13.85% (i.e. margin of ~ 520 basis points above the prevailing 1 Yr SBI MCLR) to service the debt & equity throughout the PPA tenure.**