

COMMENTS ON CERC DRAFT ORDER FOR RECOVERY OF TARIFF OF EMISSION CONTROL SYSTEM

Clause	MSEDCL Comments
<p>10. It is observed from the above table that the Commission, in the 2024 Tariff Regulations, has revised the period of recovery of 70% depreciation (after adjusting the salvage value) of the emission control system to 12 years for all the generating stations where the operation of emission control system commences within the 20th year of the commercial operation of the generating station or unit thereof and the balance depreciation is graded over 13 years or the balance operational life of the generating station, whichever is lower. This is a change from the 2019 Tariff Regulations, where the 90% depreciation was to be recovered within 25 years from the date of installation of an emission control system for projects that have completed fifteen years or less of their useful life. Further, in the 2024 Tariff Regulations, the Commission introduced the concept of “operational life” of the coal-based thermal generating stations and fixed it at 35 years. Hence, the emission control system installed before the completion of 20 years of the generating station’s useful life has a balance operational life of more than 15 years.</p> <p>11. In the case of competitively bid projects, the PPAs do not define the useful life, but the PPAs provide for the term of the agreements for the supply of power, the highest being 25 years. For the purpose of determining the period of recovery of depreciation for the emission control system, the operational life can be assumed to be 35 years commensurate with the period specified in the 2024 Tariff Regulations. A perusal of the data with regard to competitively bid projects reveals that very few projects have completed a life of 15 years from the dates of their commercial operation. If we consider the operational life of 35 years, there will be a balance of life of 20 years to repay the loan raised for the emission control system over a period of 12-15 years. Therefore, it is</p>	<p>The Commission in the Order dated August 13, 2021, in 6/SM/2021 had made the following observations <i>“The Commission observes that as on today, there are no thermal generating stations with competitively bid tariff which have completed more than 15 years of life after COD. Therefore, based on 40 years of life of thermal generating stations, 25 years of life of emission control system would be available for recovery of depreciation”</i></p> <p>As per the above submission, the Commission had considered the life of thermal generating stations equal to forty years and therefore had agreed that the cost of emission control system can be easily recovered within 25 years since no generating station under Section 63 had completed the useful life of 15 years.</p> <p>The Commission recently introduced the concept of ‘operational life’ of generating station which is different than the ‘useful life’ of the plant. Since the Commission has already established that the life of thermal generating station is equivalent to 40 years, the Commission may consider the ‘operational life’ of thermal generating station equivalent to 40 years.</p> <p>Therefore, it is submitted that once the recovery of 70% of the depreciation (adjustment of salvage value) of emission control system is done by the thermal generating station in the first 12 years of operation of emission control system, the balance 30% (adjustment of salvage value) shall be spread over the balance operational life of the plant, which is to be extended up to 40 years instead of the proposed 35 years.</p> <p>For instance, in most cases of thermal generators operating under Section 63 which have completed 10-12 years of operation, the 70% may be recovered within a period of 12 years as proposed extending the operational life up to 22-</p>

<p><i>pragmatic to consider the operational life of the generating plant to be 35 years and the loan tenor of an emission control system for competitively bid projects to be 12 years in line with the 2024 Tariff Regulations</i></p>	<p>24 years and the balance 30% may be recovered within 18-16 years proposed extending the operational life up to 40 years.</p>
<p><i>15. The Commission, vide order dated August 13, 2021, in Suo-Motu Petition No. 6/SM/2021, decided the O&M expense as 2.5% of the additional expenditure on account of the emission control system to be escalated @ 3.5% per annum up to 31.3.2024. The Commission further decided that after 31.3.2024, norms would be decided based on actual data. While framing the 2024 Tariff Regulations, the Commission sought data from the various generating companies. In order to determine the norms of operation & maintenance expenses, data from a longer horizon (3-5 years) is required. It is observed that some of the generating stations have installed the emission control system recently, and hence, adequate operational data is still not available. In view of the limitation of data availability, the Commission reiterated the earlier provision in the 2024 Tariff Regulations by specifying the Operation & Maintenance expenses as a percentage of additional capital expenditure on account of the emission control system, to be escalated at the annual escalation rate of 5.25%. This escalation rate of 5.25% has been worked out based on the inflation indices</i></p> <p><i>16. The Commission, in its order dated August 13, 2021, provided for operation & maintenance expenses of the emission control system for competitively bid projects @ 2.5%, which was 0.5% higher than the norm specified in the 2019 Tariff Regulations on account of gypsum and water handling. However, while framing the 2024 Tariff Regulations, the Commission considered the O&M expenses @ 2% of the additional capital expenditure as adequate to meet the expenses. Accordingly, the operation & maintenance expenses of an emission control system for the competitively bid projects are proposed @ 2% of the additional capital expenditure on account of the emission control system (excluding IDC & IEDC) as on the date of commissioning to be escalated at the rate of 5.25% per annum till 31st March 2029 or revision by the Commission</i></p>	<p>It is submitted that the clause only specifies that the escalation rate of 5.25% has been derived based on the inflation indices. However, there is no detailed calculation provided for computation of 5.25% as a benchmark for inflation indices.</p> <p>It is submitted that the inflation rate within the country depends on the economic conditions prevailing and therefore keeps on varying constantly during a year. During a financial year the inflation rate may be very high in a particular month and may be very low in subsequent months. The inflation rate depends on the economic policies implemented by the government. Therefore, for no particular period the inflation rate remains at a constant.</p> <p>It is therefore submitted that the Commission may not arrive at constant number for allowing inflationary increase of O&M expenses for emission control system. The escalation in O&M expenses may be allowed to an index which is a benchmark index which shows the inflationary increase in the Country. Therefore, the escalation may be allowed in line with the increase/decrease in Wholesale Price Index (WPI) observed in each month rather than fixing it to 5.25%. The clause may be modified accordingly.</p>

<p><i>based on the availability of data, whichever is earlier. All the generating companies shall maintain the operation & maintenance expenses of the emission control system separately and submit to the Commission as and when so directed by the Commission</i></p>	
<p><i>27. The Commission has already recorded in its order dated August 13, 2021, in Suo-Motu Petition No. 6/SM/2021, that the emission control system requires significant additional capital expenditure. The financing of large amounts of capital expenditure may require equity infusion by the generating companies. But, as per the tariff-based bidding guidelines issued under Section 63 of the Act, the debt: equity ratio of a competitively bid project is not required to be submitted by the generating company. In view of the above, and with due regard to the consideration of the principle of restitution, the servicing of capital employed during each year of the contract period is proposed to be delinked from the actual weighted average rate of interest, and it shall be worked out based on net fixed asset (derived by adjusting cumulative depreciation of emission control system) and 1 year MCLR of State Bank of India (for one-year tenor as on 1st April of the financial year) plus 250 bps.</i></p> <p><i>28. The objective of the reduced normative rate of interest is to provide flexibility to the generating company and not to create an extra surplus. We have removed the provision for an actual weighted average rate of interest for servicing capital and introduced a normative rate, which, in our view, will balance the interests of the generating company and procurer(s)</i></p>	<p>It is submitted that the CERC Tariff Regulations 2024 provides for servicing of debt at actual rate of interest and the rate of equity equivalent to 1-year MCLR + 350 bps. In view of the above, the Commission has decided to fix the weighted average rate of interest for capital employed equivalent to 1 year MCLR of State Bank of India (for one-year tenor as on 1st April of the financial year) plus 250 bps.</p> <p>It is submitted that the benchmark decided to allow weighted average rate on capital employed is still on the higher side as compared to the benchmark decided for rate of interest and return on equity separately in CERC Tariff Regulations 2024.</p> <p>The above point is explained through the following example.</p> <p>A generating company has taken a long term loan at 8.5% per anum for financing of FGD with 70% financing through debt and 30% financing through equity.</p> <p>Weighted Average rate worked out based on CERC Tariff Regulations 2024 = 8.5% * 70% + 12.15%(SBI MCLR +350 bps) *30% = 9.60%</p> <p>Weighted Average rate worked out based on Proposed Mechanism = SBI MCLR + 250 bps = 11.15%</p> <p>Therefore, the weighted average rate of capital employed worked out as per proposed mechanism is significantly higher than the interest cost of servicing debt and cost of employing equity worked out separately as per CERC Tariff Regulations, 2024.</p>

	<p>It is requested that the proposed mechanism of considering weighted average rate of capital employed in this Draft Order shall be such that it shall be equivalent to the weighted average rate of capital employed worked out separately for serving equity and debt as per CERC Tariff Regulations 2024 and there shall be no undue benefit to generators merely due to shifting of mechanism from considering debt and equity separately to combined capital employed approach. The Commission may accordingly revise the clause of considering 1 year MCLR of State Bank of India plus 250 bps as weighted average rate of capital employed and lower the same to match the debt and equity approach as per CERC Tariff Regulations 2024.</p>
<p><i>30. The Commission, in the existing compensation mechanism, held that the provisional tariff needs to be mutually agreed between the procurer and seller, taking into account the compensation mechanism. In the absence of any mutual agreement, the generating company may file the application for determination of supplementary tariff after the actual Operational Date of the emission control system (ODe). Thus, the generating company will not be able to bill after the operational date of the emission control system till the determination of the supplementary tariff by the Commission. This would create difficulties for the generating company as well as the procurers. The procurers have to pay the additional carrying cost, whereas the generating companies have to raise the finance for the interim period to meet the debt service obligations and working capital requirements. Considering the above, the Commission is of the view that after the emission control system is installed, the generating company shall approach the Commission for determination of compensation. The Commission may consider granting interim compensation during the preliminary hearing subject to the determination of final compensation</i></p>	<p>It is submitted that the in case the interim relief of provisional tariff is not mutually agreed by the generator with the beneficiary then in that case, the generator may approach the Commission for providing the provisional tariff 2-3 months prior to the CoD of emission control system with the provisional numbers available with the generator. The Commission may accordingly allow a provisional tariff based on the provisional cost incurred by the generator. On the installation of emission control system, the generator may again approach the Commission for determination of final tariff against the emission control system to be allowed to generator. In such scenario, the provisional tariff may be levied from the date of commercial operation of emission control system and the generator would start getting the compensation from the CoD itself. On the issuance of final tariff order the final tariff may be accordingly adjusted in the provisional tariff resulting into minimum impact of any carrying or holding cost.</p>