

SEIL Energy's Comments/suggestions on Draft Order on Revision in compensation mechanism of recovery of expenditure for installation of ECS

Sr no.	Draft Order	Comments/Suggestions
1.	<p>Proposal for Recovery of Depreciation</p> <p>“31. The Commission has specified the operational life of a thermal generating station as 35 years in the 2024 Tariff Regulations. Further, the Commission, in light of the operational life of 35 years, has specified the period of recovery of 70% of depreciation of the emission control system as 12 years in the 2024 Tariff Regulations, which is commensurate with the standard loan tenor. There are very few thermal generating stations under competitively bid tariffs that have completed 15 years of life after their COD, and their loan tenors are in the range of 12-15 years. The Commission considers it appropriate to provide for the recovery of 70% of the depreciation of the emission control system over a period of 12 years from the date of operation of the emission control system commensurate with the loan tenor in order to enable the generating companies of competitively bid projects to meet their debt service obligations and the balance depreciation shall be spread over the remaining operational life of the generating stations.</p> <p>32. Accordingly, 70% of additional capital expenditure on account of the installation of the ECS (considering a salvage value of 10%) shall be recovered by the generating company in 12 years. The depreciation shall be computed from the date of operation of the emission control system after meeting all applicable technical and environmental standards, certified through the Management Certificate duly signed by an authorized person. The value base for the purpose of depreciation shall be the additional capital expenditure of the emission control</p>	<p>We appreciate that the Commission has considered the loan repayment period as 12 years, this is commensurate with the industry practice as financial institutes / banks are also sanctioning the loans for ECS/FGD with a duration only up to 12 years.</p> <p>However, if 12 years of repayment is considered with the normative debt of 70% (of the ECS cost), the annual loan repayment works out to be 5.83%. But as per the draft Order, the depreciation (which is used for repayment of loan) is allowed only at 5.25% (63%/12, post adjustment of 10% salvage value). We request the Commission to duly address the following issues on recovery of depreciation:</p> <ol style="list-style-type: none"> 1) The salvage value of any asset would always be recovered only at the end of useful life of the project, considering only 63% of asset for depreciation implies that the developer will start recovering the remaining 7% (i.e. 10% of 70%) by selling the salvage. This is not practical and is conceptually a wrong treatment for recovery of salvage value. 2) Further, as the loan repayment period is considered as 12 years, the entire 70% of the project cost (i.e. the debt amount) is to be paid by end of 12 year. Whereas the total depreciation (for 1st 12 years) being allowed is only 63%, which means there is a shortfall of 7%. Such shortfall in cashflow to make the debt repayment is therefore to be funded through additional equity infusion. Practicality this additional equity infusion can be recovered back only from the salvage value, but this will happen only post the project life is completed.

Sr no.	Draft Order	Comments/Suggestions
	<p>system as admitted by the Commission. The computation of depreciation during each year of the contract period shall be worked out by the parties directly based on admitted capital cost and the depreciation rate as follows:-</p> <p>a) Up to 31st March of the financial year, completing the 12th year from the date of operation of the emission control system:</p> $DEPe(n) = 5.25\% \times ACEe.$ <p>b) 13th year onwards from the date of operation of emission control system:-</p> $DEPe(m) = (0.30 \times 0.90 \times ACEe) / (\text{Balance operational life} - 12)$ <p>Where, ACEe is the gross capital cost (in Rupees) of emission control system as admitted by the Commission; DEPe(n) is annual depreciation (in Rupees) up to the 12th year, where n=1,2....12. DEPe(m) is annual depreciation (in Rupees) from the 13th year onwards where m=13,14,..... Balance operational life is balance operational life of the generating station as on the date of installation of the emission control system.”</p>	<p>3) Further the additional equity infusion by developer will again have the cost of equity which will not be passed on in the tariff and therefore has to be borne by developer, hence the principle of restitution does not hold good with such an approach.</p> <p>4) Also, the deficit in cashflow will also reduce the DSCR for the project, and hence the Fis/Banks will get reluctant to sanction the loans.</p> <p>In view of the above explained issues, we request the Commission to allow the depreciation for the first 12 years considering the normative debt of 70% and modify the depreciation rate to 5.83% instead of the proposed 5.25%. And in such case, only the remaining 20% (30%-10%, adjustment of salvage value) should be allowed to be depreciated in remaining useful life of the project.</p>
2.	<p>Operation & Maintenance Expenses</p> <p>44. Accordingly, the Commission is of the view that operation and maintenance expenses shall be allowed @2.0% of the additional capital</p>	<p>It is suggested that for the coastal plants which use seawater, there is an additional cost towards desalination, thus an additional 0.5% of ACEe may be retained for the coastal plants.</p>

Sr no.	Draft Order	Comments/Suggestions
	<p>expenditure (ACEe) for installation of ECS (excluding IDC, IEDC, and FERV) as admitted by the Commission and to be escalated at the rate of 5.25% per annum till 31st March 2029 or revision by the Commission based on availability of data, whichever is earlier. Till 31.03.2029, the additional O&M expenses (O&Me) shall be worked out as follows:-</p> <p>First Year: 2.0% of ACEe excluding IDC, IEDC, and FERV (to be allowed proportionately if the operation of the ECS is for part of the year) Second Year onwards: 2.0% of ACEe escalated annually at the rate of 5.25%.</p> <p>The additional O&M expenses payable shall be worked out by reducing the income generated from the sale of gypsum or other by-products from the operation and maintenance expenses.</p> <p>44A. All generating companies are directed to maintain the operation & maintenance expenses of the emission control system separately and submit them to the Commission as and when directed.</p>	
3.	<p>C. Cost of debt & equity of emission control system</p> <p>“37. The servicing of capital employed during each year of the contract period shall be worked out based on net fixed asset (derived by adjusting cumulative depreciation of emission control system) and normative rate of 1 year Marginal Cost of Lending Rate of State Bank of India (for one year tenor) plus 250 basis points. The generating companies shall work out the cost of capital employed towards the emission control system as follows:-</p> $COCe(y) = [NFA(y) \times RI(y) / 100]$ <p>Where,</p>	<p>It is essential to note that the cost of equity significantly exceeds the cost of debt. The ROCE approach fails to differentiate between these components.</p> <p>While we acknowledge the Commission's stance that compensation under change in law cannot be a mechanism to improve financial position of generators, it's equally crucial to prevent any undue financial burdens.</p> <p>Although competitively bid projects have flexibility in debt-equity ratios, practical considerations and industry practice indicate most of such projects are still financed at debt/equity ratio of 70:30. Also, as the point</p>

Sr no.	Draft Order	Comments/Suggestions
	<p> $NFA(y) = ACEe - \sum_{n=1}^y DEPe(n) \dots \text{where } y \text{ is less than or equal to 12 years}$ </p> <p> $NFA(y) = ACEe - \sum_{n=1}^{12} (DEPe(n)) - \sum_{m=13}^z (DEPe(m)) \dots \text{where } y \text{ is more than 12 years}$ </p> <p>COCe Servicing cost of Additional Capital Expenditure in Rupees per annum;</p> <p>NFA(y) is the net fixed asset of the of the year “y”;</p> <p>RI(y) is the rate of Marginal Cost of Funds based Lending Rate (MCLR) of State Bank of India (for one year tenor) as on 1st April of the financial year plus 250 bps.</p> <p>y represents the year starting from the date of operation of emission control system.</p> <p>z represents the balance operational life of the plant on the date of installation of the emission control system</p> <p>DEPe(n) is annual depreciation (in Rupees) up to the 12th year where n=1, 2,.....12.</p> <p>DEPe(m) is annual depreciation (in Rupees) from the 13th year onward where m=13,14,.....</p> <p>ACEe is the gross capital cost (in Rupees) of the emission control system as admitted by the Commission;</p>	<p>of discussion here is cost capital for ECS, the funding structure of thermal projects is irrelevant.</p> <p>The funding structure for capital investment for ESC/FGD would vary from one project to another. Say, a project which is 100% tied-up may get higher debt component and others may require to infuse higher proportion of equity component. Thus, it is important to first separate out the debt and equity component of the capital invested.</p> <p>We therefore request the Commission replacing ROCE with following two separate components:</p> <ol style="list-style-type: none"> 1) Interest on loan 2) Return on Equity <p>Instead of assuming same structure for all the projects, the debt equity component can vary well be validated and audited from accounts and thus actual debt/equity ratio should be allowed. This will ensure only the actual cost is passed through to hold the principle of restitution.</p> <p>RoE should be allowed on the equity component @ 15.5% post-tax on the lower of actual or normative equity.</p> <p>Rate of interest for debt should be allowed at weighted average rate of interest of actual loan portfolio of the emission control system or in the absence of actual loan portfolio, the weighted average rate of interest of the generating company as a whole should be considered.</p>