Ref: /PTC/Strategy/Tariff Reg/Comments/Feb-01 **Date:** February 20, 2024

To
The Secretary
Central Electricity Regulatory Commission (CERC)
3rd & 4th Floor, Chanderlok Building,
36, Janpath, New Delhi - 110001

Subject: Comments on the Draft Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations, 2024 for the tariff period from 1.4.2024 to 31.3.2029

Dear Sir,

This is with reference to your letter (No. L-1/268/2022/CERC dated. 4 January 2024) regarding seeking comments on "**Draft Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations, 2024 for the tariff period from 1.4.2024 to 31.3.2029**.".

You are requested to kindly consider the enclosed annexure (Annexure-A) of our comments for your kind reference and perusal. If deemed appropriate, we are also available for an in-person interaction to clarify any aspect.

Thanking you,

Yours faithfully,
For **PTC India Ltd.**

(Rajesh Cherayil)
Chief Strategy Officer

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(Annexure-A)

PTC India

Comments on the Draft Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations, 2024 for the tariff period from 1.4.2024 to 31.3.2029

1. **Force Majeure:**

   We welcome the expansion of the ambit of the Force Majeure to include the "operating period" and not just construction. Given our recent experience with a worldwide pandemic i.e. Covid 19, it might be worthwhile to consider such a pandemic also as a Force Majeure event as it is beyond the control of the entity in the electricity value chain.

2. **Additional Capex:**

   The recent draft of the Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations, 2024, includes a proposal to consider additions to the capital cost of an existing power project. This cost now encompasses expenses necessary for enabling the power station to operate flexibly at lower loads, as well as costs related to biomass handling and co-firing facilities. This initiative aligns well with the current policy framework in the country. Nonetheless, the proposed CERC Regulations 2024 are poised to approve only those Additional Capital Expenditures that are within the original project scope and are paid for after the cut-off date. This approach, however, neglects to account for additional capital expenditures approved before the cut-off date but paid after it. Consequently, it would be advisable to also recognize liabilities settled after the cut-off date as part of the Additional Capital Expenditure, along with the actual payments made subsequent to this date.

3. **Return on Equity:**

   Capital injections prompted by unforeseen events or legislative changes are essential for sustaining the progress of projects. Additional capital expenses caused by force majeure events, which are beyond the control of power generation companies, should not lead to diminished returns. Lower returns on such expenses unfairly penalize these utilities and could dissuade future equity investments. Therefore, it's advisable that all

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equity investments, regardless of when they are made, should earn a consistent rate of return, suggested to be at 15.5%. The higher ROE for pumped storage plants at 16.5% is a welcome measure.

The Honorable Commission, in the Draft Regulations, has proposed to continue with a Return on Equity (ROE) of 15.50% for existing projects. This rate has been maintained historically in past Tariff Regulations. However, the Draft Regulations propose a different approach for the Return on Equity for emission control systems and additional capital expenditures due to changes in law and force majeure events. These are suggested to be allowed at the SBI MCLR + 350 basis points, but with a maximum limit of 14%. This approach might not favor developers who are investing in the creation of assets. Furthermore, earlier sections of the Draft Regulations propose considering the interest rate for debt towards the installation of emission control systems at the weighted average interest rate for the entire generating company, capped at 14%. This is especially pertinent given the recent upward trend in both risk and interest costs. Consequently, it would be more equitable to align the ROE for these specific expenditures with the ROE rate applicable to existing projects.

4. **Interest on Loan, Interest During Construction (IDC) and Incidental Expenditure during Construction (IEDC)- (Regulation 21):**

In the proposed draft regulations, a method is outlined for calculating loan interest based on the weighted average interest rate of a company managing multiple projects. This approach might result in the redistribution of benefits from low-cost, project-specific debt or financial arrangements to other projects, potentially impacting their effectiveness. To better reflect each project's financial reality, it's advisable to apply the weighted average interest rate specifically to individual projects when their loans are distinctly identifiable. Furthermore, the standard loan amount set for new projects, instead of the actual debt in cases where projects often have longer development times and higher costs, might not accurately represent the true financial requirements.

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The Draft Regulations (under Clause 5) suggest that if project construction delays are due to late clearances from statutory authorities like forest, NHAI, railway approvals, or government land acquisition, a maximum condonation is allowed up to 90% of the delay. This proposal may be disadvantageous to generating companies or licensees, as they bear the financial burden of delays caused by external approval, over which they have no control. This could lead to increased risks and higher debt costs for such projects, ultimately deterring new investments in a sector crucial for the nation's economic growth. Therefore, it may be prudent to consider eliminating the 90% limit and allow full condonation for delays in calculating IDC and IEDC, provided these delays are clearly established as not caused by the project-developer.

5. **O&M Expenses:**

The Draft Regulations suggest that additional Operation and Maintenance (O&M) expenses, resulting from force majeure or changes in the law, would only be considered for adjustment during the true-up process if they exceed 5% of the normative O&M expenses. Given that force majeure events or legal changes are beyond the control of generating or licensee companies, the costs incurred due to such events are unforeseen. Therefore, to maintain the company's financial stability as if such events had not occurred, it's reasonable to allow for the recovery of these expenses at their actual value. Delaying the recovery of these expenses imposes an additional financial strain on the company due to increased financing costs. Hence, it's advisable to revise this clause to facilitate the recovery of such expenses through tariffs for generating companies and licensees.

The Honorable Commission, following the Tariff Policy, has consistently adhered to the principle that entitlements should be based on established norms and not be lesser than the actual or normative costs. However, allowing actual expenses to be claimed, especially if they are lower than the norm, could be beneficial for the beneficiaries.

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Regarding the Draft Regulations' proposed escalation rate for O&M expenses at a hybrid inflation rate of 5.89% (based on a CPI:WPI ratio of 60:40 over the last 5 years), it's worth considering that India's rapidly growing economy and its inflation trends might be better reflected in more recent data, such as an average from the past 2-3 years. This period would also account for the atypical economic conditions during the Covid-19 pandemic, providing a more accurate representation of the current inflationary environment.

6. **Working Capital (Regulation 34):**

The Honorable Commission has suggested setting the interest rate on working capital at the Reference Rate of Interest as of April 1, 2024. This Reference Rate is defined as the MCLR (Marginal Cost of funds-based Lending Rate) plus 325 basis points, a reduction from the previous MCLR plus 350 basis points. In light of the current liquidity conditions for short-term debt facilities and the prevailing interest rates, with the repo rate at 6.5%, it is respectfully proposed that the Reference Rate should be maintained at the former level of MCLR plus 350 basis points.

7. **Treatment of Capital Spares (Regulation 36):**

The Draft Regulations propose incorporating capital spares worth up to INR 20 Lakhs into the existing normative Operation and Maintenance (O&M) expenses. However, it is recommended that the current practice of accounting for capital spares on an actual cost basis may be a better approach. The reason for this is that capital spares are typically non-recurring expenses. Given their role in ensuring the reliable operation of major plant equipment, capital spares should be considered for additional capitalization. Hence, the existing method of allowing all capital spares to be accounted for based on actual costs should be maintained, while maintenance spares can remain part of the O&M expenses.

However, if the Honorable Commission decides to go ahead with the proposed method of including lower-value spares under Rs 20 Lakhs within O&M expenses, it may be

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prudent to allow that this amount be compensated by an increase in the normative O&M expenses as determined by the Commission.

8. **Plant Availability Factor for peak and off-peak period (Regulation 62):**

   The Draft Regulations suggest eliminating the differentiation between peak and off-peak periods. This is crucial because a standardized approach to low and high demand seasons across the country might not accurately represent actual demand patterns and could result in extra administrative work for load dispatch centers. Additionally, calculating the overall plant availability factor by combining data from both peak and off-peak periods helps mitigate the risk of under-recovering Capacity Charges. This risk arises from potential shortfalls due to planned or scheduled outages, which was previously constrained by the recognition of distinct high and low demand seasons.

9. **Blending of primary alternate fuel (Regulation 64):**

   The Draft Regulations propose to remove the need for prior approval from beneficiaries and the limitation on the percentage increase in Energy Charge Rate when blending coal. This change is significant because blending imported coal is primarily guided by mandates or policy directives from the Ministry of Power, aimed at addressing power shortages. Basing such decisions solely on cost considerations could be harmful both to the system's stability and the fulfilment of electricity demand. Additionally, the proposed requirement for prior consultation with beneficiaries when blending exceeds the normative ratio (6%) is a positive step. This ensures that any concerns of the stakeholders are addressed and mitigated effectively.

10. **Sharing of Gains (Regulation 81 and 82):**

    The Draft Regulations propose that any benefits arising from enhanced performance in areas such as normative station heat rate, auxiliary consumption, specific oil rate, and interest savings due to restructuring or refinancing of existing loans, should be shared equally between the generating companies and the beneficiaries. This sharing ratio of

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1:1 is a positive measure that evenly distributes incentives and interests between both parties involved.

11. **Procurement through competitive bidding (Regulation 100):**

The Draft Regulations' stipulation that equipment or services for developing projects should be acquired through a transparent competitive bidding process is a sound strategy. This method aligns with market dynamics, fostering efficiency and ensuring the discovery of the most cost-effective options. The Regulations also allow for procurement through alternative methods as per general financial rules in exceptional situations. However, to prevent future disputes about what constitutes 'exceptional circumstances' or the procurement process in general, it would be beneficial to provide a more detailed explanation of these conditions or scenarios.

12. **Rate of Interest for Carrying Cost:**

It is noted that the proposed rate of interest for carrying costs in cases of receivables by the licensee or generating company is set at SBI MCLR+100 basis points. Conversely, for refunds (in instances of excess tariff determination by more than 10% or during the truing up of excess capital cost), the rate is proposed at 1.20 times the SBI MCLR+100 basis points. We respectfully suggest that this asymmetric approach to carrying costs—lower for receivables and higher for refunds—may not be in the best interest of the stakeholders involved. It is a well-recognized legal principle to ensure equitable treatment in comparable situations. Therefore, we kindly request that the interest rate multiplier for refunds be aligned with the rate used for recovery purposes. This is also required because the carrying cost of receivables does not follow the principle of compound interest but an entity funding the receivable from a financing institution is subject to the same. Additionally, the proposed rate of interest for carrying costs is considerably lower than that for interest on working capital. This discrepancy could potentially be disadvantageous for the stakeholders.

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