

**CENTRAL ELECTRICITY REGULATORY COMMISSION
NEW DELHI**

Coram:

- 1. Shri Ashok Basu, Chairman**
- 2. Shri K.N. Sinha, Member**
- 3. Shri Bhanu Bhushan,
Member**
- 4. Shri A.H. Jung, Member**

**Petition No. 67/2003
(Suo motu)**

In the matter of
Terms and Conditions of Tariff

STATEMENT OF REASONS

The Commission has notified the terms and conditions for determination of tariff under the Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations, 2004, applicable from 1.4.2004 to 31.3.2009. These regulations, *inter alia*, provide that the actual expenditure incurred on completion of the project is to form the basis for determination of final tariff, subject to prudence check by the Commission. Under these regulations, the final tariff is to be determined based on the admitted capital expenditure actually incurred up to the date of commercial operation of the generating station or the transmission system, as the case may be. Where power purchase agreement entered into by the generating company or the transmission licensee, and the beneficiaries provides a ceiling of actual expenditure, the capital expenditure for the purpose of determination of tariff should not exceed such ceiling.

2. It is seen that the existing regulations contemplate tariff determination on actual completion of the generating station or the transmission system, as the case may be. In the meanwhile, Central Government have issued guidelines for competitive bidding on 19.1.2005 under Section 63 of the Electricity Act, 2003. These guidelines do not stipulate that all future projects will come through the competitive bidding route. The projects can continue to come under cost plus regime. Accordingly, the applications have been made before the Commission by IPPs for determination of tariff prior to commencement of construction of the generating station since it would give them some level of comfort before actually undertaking the construction of generating station. The matter was considered by the Commission who felt that the existing regulations should be suitably amended to provide for 'in principle' acceptance of capital cost of the project before commencement of construction. The Commission accordingly published the proposals for amendment of the existing regulation as applicable to the thermal generating stations. In the draft amendment published, it was proposed that a person intending to set up a project could seek 'in principle' acceptance of the project capital cost and financing plan, through an appropriate application and where the Commission has given 'in principle' acceptance to the estimated completion cost and financing plan, such acceptance shall be the guiding factor for applying prudence check on actual expenditure.

3. In response to the draft amendment published, WBSEB, NLC, Asian Development Bank, NHPC and one Shri K.M. Manoj have submitted their comments and suggestions.

4. WBSEB has suggested that more details regarding fuel and fuel-linkage should be obtained by the Commission before giving its 'in principle' acceptance. In our opinion, it is not necessary to go into the details of fuel-linkage while accepting the estimated completion cost of the project. Similarly, another suggestion made by WBSEB in regard to allocation of corporate office expenses is also not relevant for the present amendment.

5. NLC has suggested that the concept of 'in principle' acceptance should be extended to the proposals for additional capitalization since similar level of confidence is needed by the investor before undertaking expenditure on running projects. The proposal made in the draft regulations was to address the concern of investors intending to set up new projects. The proposals for capitalization of additional expenditure on existing projects are being considered on merits, after a detailed cost-benefit analysis. Therefore, there is no need for 'in principle' approval on this account as needed for setting up of new projects.

6. Asian Development Bank has sought a clarification as to whether the cost accepted by the Commission 'in principle' would be treated as the ceiling cost and there would be no objections to its incorporation in the tariff formula at the time of determination of final tariff. It is clarified that in the draft amendment, it was proposed that the cost accepted while according 'in principle' approval shall be the guiding factor for applying the prudence check on the actual expenditure. In other words, at the time of determination of final tariff, the actual audited expenditure for

the project shall be subjected to prudence check before deciding the capital cost to be considered for the purpose of tariff. However, the estimated completion cost which forms the basis for 'in principle' approval of the Commission shall be the guiding factor.

7. According to NHPC, under sub-section (1) of Section 8 of the Electricity Act, 2003 a generating company intending to set up a hydro generating station, has to approach CEA for its concurrence to the detailed project report which includes cost estimates wherever the estimated capital expenditure exceeds the specified limits. Further, the hydro generating companies owned or controlled by the Central Government shall also have to obtain the approval of the Central Government where the proposal involves the budgetary support from that Government. NHPC feels that 'in principle' acceptance by the Commission may not be necessary for hydro electric projects though the proposal made in the draft amendment may prove useful for setting up hydro generating stations which do not involve clearance from CEA. However, it feels that the concept of 'in principle' acceptance may be useful for taking up R&M scheme of existing hydro generating stations. We may clarify that proposal made in the draft amendment is only an enabling provision and is to be implemented in conformity with other applicable laws.

8. Shri K.M Manoj has suggested that the Commission should not go into the break-up of the project cost at the time of grant of 'in principle' acceptance. We may point out that before according the 'in principle' approval to the estimated completion cost, the Commission has to broadly satisfy itself on this aspect and therefore, in

order to assess the reasonableness of the estimated completion cost, the break-up of different elements of the project cost is considered necessary.

9. The amendment was proposed essentially with the intention to promote private participation in power sector. Such a procedure also became desirable in view of the fact that the Electricity Act, 2003 has dispensed with the techno-economic clearance of CEA. It was felt that the regulatory comfort in the form of 'in principle' acceptance would help the future investors including the companies owned or controlled by the Government to achieve the financial closure expeditiously.

10. On consideration of the issues raised, we are satisfied that there is no serious objection to the proposal made in the draft amendment. Accordingly, we direct that Regulation 17 of the Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations, 2004 be suitably amended.

**Sd/-
(A.H.JUNG)
MEMBER**

**Sd/-
(BHANU BHUSHAN)
MEMBER**

**Sd/-
(K.N. SINHA)
MEMBER**

**Sd/-
(ASHOK BASU)
MEMBER**

New Delhi dated the 11th August, 2005