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SHAKTI: Short term gains, long term pains

On May 17, 2017, the Union Cabinet took two important decisions aimed at streamlining coal allocation to the power sector and making it more transparent and objective. How would these decisions play out and would they be able to address the needs of the fast evolving sector? Our analysis suggests that while they address some near-term issues, but are unlikely to cater to the future needs of the sector.

The first decision was to approve the signing of Fuel Supply Agreements (FSAs) by power plants holding Letters of Assurance (LoAs) and likely to be commissioned by March 31, 2022. This assures such plants of firm coal supply and will address the curious case of many power plants not having firm fuel supply in spite of 'excess' coal availability. The reason for this paradoxical situation was that the extant policy only ensured FSAs to plants commissioned by March 31, 2015 and plants that did not meet this deadline for whatever reason had to rely to on other mechanisms such as various kinds of e-auctions or imports to access coal.

The second decision was to approve a policy called SHAKTI (Scheme for Harnessing and Allocating Koyala Transparently in India) to allocate coal to power plants without LoAs. Who will SHAKTI be applicable to, and what would it mean to them? While firm numbers are hard to come by, estimates suggest that about 44 gigawatts (GW) of coal-fired capacity that already has LoAs can now sign FSAs, and about 27 GW of this may already be commissioned. Since this 44 GW will fall under the old regime, SHAKTI is likely to be applicable to the roughly 50 GW of capacity that is in the pipeline and expected to be commissioned by 2022 according to the draft National Electricity Plan (NEP) from the Central Electricity Authority.

According to the SHAKTI architecture, there is no change in how central and state owned generators would get LoAs. They would continue to be based on recommendations from the Ministry of Power (MoP). When they are converted to FSAs, they would still get coal at Coal India Ltd. (CIL) notified prices. Since about 70% of the capacity in the pipeline is state or centre owned, and no additional coal-fired capacity would be required until 2027 according to the draft NEP, the changes suggested by SHAKTI are applicable to only about 15 to 18 GW over a decade.

SHAKTI also appears to be in conflict with some pro-competition initiatives of both coal and power ministries. In the power sector, rapidly falling prices of renewables and changing market dynamics require long-term open access, by which large consumers can identify their own suppliers in a competitive market, to be promoted. This is in line with the policy thrust of the MoP. But SHAKTI mandates long- or medium-term power purchase agreements (PPAs) only with distribution utilities (discoms) for all capacity that gets LoAs, thus discouraging creation of merchant capacity. As a result, the burden of base load capacity addition will continue to fall on discoms. This is likely to saddle discoms with capacity that may be under-utilised because large consumers may prefer to use captive renewables when possible due to prevailing economics and tariff structure. This would leave small consumers to effectively bear this cost.

On the coal side, the ministry has issued an approach paper to introduce commercial mining for coal and has been making statements to this effect. Since most of the upcoming capacity is

public-sector owned which will continue to get coal at notified prices from CIL under SHAKTI, CIL would be shielded from competition. Indeed, the expectation that CIL would continue to 'notify a price' seems to suggest that it would not be competing with commercial miners. This is at odds with the intention of introducing commercial mining.

SHAKTI's architecture is also skewed against private generation capacity as they have to bid for coal at a premium above the CIL notified price unless they are willing to take a chance on other routes such as participating in tariff-based bidding against linkages earmarked for discoms, bidding to acquire a captive coal block, or buying coal from a commercial miner (if it exists). Given this distortion, discoms would find it easier to continue signing 'cost-plus' PPAs with public-sector generators. Since small consumers will continue to rely on discoms for their power supply, the inefficiencies of the public-sector value chain shielded from competition will be passed on to their electricity tariffs. Effectively, under SHAKTI, the coal and power generation sectors would be fragmented along public and private sector lines with no competition between the two.

Finally, given the built-in advantage to public sector generators, most coal linkages will continue to be allocated to public-sector generators based on 'recommendations from the MoP'. This would go against the grain of making the allocations transparent, unless the entire process is fully transparent and backed by published objective criteria for the recommendations.

To conclude, rather than powering the future of the electricity sector, SHAKTI is likely to hinder competition and discourage private-sector participation, thus not meeting the needs of the future power sector which requires efficient thermal generation and flexible electricity markets in light of increasing competition from renewables and supply and demand uncertainties.

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