Comments and Suggestions on Scheme to enable DISCOMs to continue/exit from PPA after 25 years for cost-plus, inter-state generating stations.

Prayas (Energy Group) 23rd December 2020

It is our understanding that the Ministry of Power has circulated a proposal intended for public consultation to enable DISCOMs to exit from cost-plus PPAs with inter-state generating stations after 25 years, allowing the generators to sell power in any mode, post exit. The proposal primarily seems to be in response to repeated representations from states to surrender CGS capacity and de-allocate CGS capacity which has completed 25 years. However, the first right to power even beyond the PPA is envisaged to be retained by the DISCOM exiting the PPA.

A clear proposal with terms outlined to surrender PPAs after 25 years will increase flexibility for states to manage power procurement and will also increase liquidity in India’s growing electricity markets. However, there are several potential issues or challenges that need to be addressed and clarified in the circulated proposal. This is especially the case as deallocation/ relinquishing capacity should be seen in lieu of possible alternatives to meet demand including addition of new thermal capacity to replace existing capacity. Such strategies need to be avoided given the high risk of stranded assets, low utilisation, high fixed cost burden and resource lock-ins in the future which could adversely affect DISCOM finances. In such a scenario, many of the envisioned benefits from the scheme especially from increased power procurement optimisation by use of short-term instruments by DISCOMs may not be realised.

In this context, some comments and suggestions for the Ministry of Power to consider are detailed below:

1. **Focus on cost-optimisation of the DISCOMs’ power procurement basket**

   As a condition of the scheme, any new medium/long-term base load capacity should not be contracted by the DISCOM for a period of 5 years after surrendering its share under the scheme, given the high risk of potential lock-in and future cost burden. This is especially the case given the increasing viability of renewable energy, storage options and the development of market going forward. The cost of meeting intermittent/ medium-term demand from market or other alternative sources would be much lesser than the cost of managing surplus power of long term PPAs when power from alternative sources becomes more and more viable. This is especially the case with coal-based capacity addition. To avoid overcapacity risks, participation in the scheme must be contingent on the fact that the state/DISCOM shall commit to not adding or contracting any fresh coal thermal capacity for at least 5 years from the date of relinquishing capacity.

2. **Surrender after assessment of cost savings via regulatory process at the state level**

   The proposal highlights that the intention of the mechanism is to help rationalise the cost of power procurement. In a cost-plus, regulated business, this rationalisation is not only important for the distribution licensees, but also the consumers who bear cost impacts. To understand cost impacts of the proposed surrender of such capacity, it is important to take into account the distribution licensees’ demand growth and capacity addition plan. The benefits need to be seen in relation to alternate power
procurement strategies being undertaken in lieu of the proposed surrender. Therefore, surrender should be initiated under this mechanism only after:

- The surrender is approved by the State Electricity Regulatory Commission based on a public process.
- The process should include detailed demand supply analysis from all possible sources, proposal for alternate procurement planned in lieu of surrender to meet demand. The surrender should be approved only if the benefit from surrendering the capacity is higher than the cost of alternate power source.

3. **Retention of bulk supply agreement necessary for scheme to be effective**

The bulk power supply agreement between a generator and a distribution utility typically has contracts for multiple stations or units with varying vintages, variable costs and efficiencies. From a cost and capacity rationalisation perspective, states might want to relinquish power from only one unit which is part of the PPA. However, one of the conditions of the scheme specifies that the state would need to exit from the BPSA in entirety to participate in the scheme. Since the BPSA could also include capacity whose age is less than 25 years and could also include capacity with lower variable cost, the states would necessarily have to give up all the contracted capacity which is a significant risk. This would particularly be the case for states where there is considerable dependence on CGS capacity.

It is suggested that states/DISCOMs are given flexibility to choose the unit/station, which has completed 25 years, from which they would like to relinquish capacity and that the BPSA be amended to that affect. MSEDCL and MSPGCL in Maharashtra have amended their PPAs in the past to remove or add specific units with regulatory approval. Similarly, the amendment of the BPSA for the specific units should take place with CERC approval after a public process.

4. **Lack of clarity on coal allocation for these projects**

Currently, coal linkages to thermal capacity are contingent on existing PPAs. If the DISCOMs are to surrender their shares in inter-state generating stations, it is not clear if:

- the generating stations or units will have to relinquish its existing coal linkage and obtain coal linkages under B viii (a) of the SHAKTI Policy or
- the generating stations or units will retain the coal linkages

Thus,

- The proposal should explicitly mention that linkages are continue for capacity that has been retained by any DISCOMs beyond 25 years.
- For capacity that has been relinquished under this scheme, clarity needs to be provided with respect to the coal linkage as there are implications for not just the generators but also future off-takers of the power.

5. **Treatment of nuclear and hydro power**

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1 Please refer order in Case 42 of 2017 for more details.
As the scheme applies to all inter-state generating stations, the proposal should clarify if there are any specific mechanisms for nuclear and hydro power. This is specifically the case as tariff determination for these capacities are different under the cost-plus regime. Similarly, some inter-state generating stations are owned by joint venture companies with state-owned/ private utilities or wholly owned by state governments. Whether the scheme is voluntary for such companies currently and going forward is not clear.

6. Need for wider public consultation of revised version of proposed scheme

To ensure clarity in scheme provisions, streamlined and cost-optimal implementation and to address potential legal/contractual issues, it is vital that the proposal be uploaded on the Ministry of Power’s website for public consultation as it could have significant impacts on various stakeholders such as consumers, DISCOMs, generators, coal companies and financers.

As per the letter (No.23/23/2020-R&R) dated 4th December 2020, comments are to be provided by 24.12.2020. Further, the letter explicitly mentions that the proposal should be uploaded on the Ministry of Power website under current notices for public consultation. However, as on 22.12.2020, the letter has not been uploaded on the website of the Ministry of Power.

Given the potential impact on power procurement cost and consequently consumer tariffs with this scheme, adequate time for public consultation should be provided.

Since many states, regulatory commissions and utilities would have already provided comments on the mechanism, it is suggested that a revised version of the proposal, after addressing many of the potential issues is uploaded on the Ministry of Power’s website with at least 21 days for public consultation.

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