CRISIL Ratings released a report titled *Current Worries* at its Investor Discussion Forum (IDF) on July 28, 2015, which said 46,000 mw of power projects are facing viability issues due to lack of long-term buyers for electricity, inadequate fuel supply, and aggressive bidding to win projects and coal blocks. Apart from capacities, CRISIL said Rs 75,000 crore of debt to the projects was at risk.

As part of the IDF, a panel discussion (details of panelists on Page 5) between industry leaders was conducted. Here is the gist of the discussions and recommendations:

- **Medium term is the new long term in the electricity market…**
  While supply of coal has improved, raising tariffs, amending the Electricity Act and its implementation thereon will take another 3-5 years, which means the industry has to work towards a medium-term market for electricity. That’s just what many states agreed to 2-3 years back. When PTC India started power trading with Bangladesh in 2013, it was suggested to them – and they accepted – that the electricity supplied will be for a 3-year cycle. Next year, Bangladesh is going to take a call on whether it wants to renew the contract because prices are now discovered.

  … where contracts are for 5-7 years instead of 25 years
  The medium term market is going to be very interesting. Internationally, what is called long-term is actually a period of 5 to 7 years. Similarly, India should see a huge shift from the long-term as we know it to a medium-term market in the next couple of years.

- **Futures trading in electricity mulled, will give lenders clarity**
  PTC India is working with a stock exchange to see whether it can provide an electronic platform so that futures prices can be discovered anonymously – such as for the next three months, six months, nine months and one year. Once this happens, there will be greater clarity and revenue visibility for lenders as well as equity investors.

- **Current troubles began with competitive bidding to purchase power**
  In 2006, the government announced a tariff regime change where power could be sold only on a competitive bidding basis. Clearly, the risks on fuel, financing and transmission were not thought through when making this shift, which led to challenges in compensatory tariff. This is the reason why so many power plants are bleeding today. Ultimately, it’s better to leave these things to the state utilities and the state regulator. They will become independent if they are allowed to decide whether they want to procure power on a cost-plus or a competitive bidding basis.

- **End politicisation of tariff setting process and avoid build-up in regulatory assets**
  Today, politicisation of the tariff process has put regulatory assets of Rs 30,000 crore at risk. This has to be paid by somebody – obviously the consumer – with carrying cost. How can this be done? Only by depoliticising tariff. Regulatory assets should not be created except in cases of *force majeure*.

- **Pass on any variation in purchase cost vis-à-vis tariff in the same year**
  Variations in the purchase cost of power from the approved tariff should be passed on by the distribution company in the same year with no recourse to regulator. This will take care of 80% of the cost problems or under-recoveries of distribution companies.
● Ensure bankability of power purchase agreements
Bankability of power purchase agreements (PPAs) has become the biggest stumbling block in the sector. As is the lack of a market-making mechanism which helps discover prices that are a fair reflection of cost structure for merchant power even when there is no PPA. This will keep projects viable till such time the various issues – including the lack of a market for imported coal -- are sorted out. In projects where coal supply is the only bottleneck, a solution could be imports, but then imported coal cannot be used in isolation since blending of domestic coal is mandatory. This means projects where the easy solution of coal import is available are also put in the same basket as other projects with more difficult problems. The upshot is that there is a cloud on the bankability of the sector.

● Clear and present danger of losing investments to overseas markets
The situation in the sector is such that some promoters are weighing relocating their plants to Bangladesh where they can be run on imported liquefied natural gas, based on a PPA approved by the regulator there.

● Three modifications needed to make the 5/25 scheme more effective
The Reserve Bank of India (RBI) has been requested to consider 2-3 modifications to the 5/25 scheme. One is that the scheme, which is applicable only to the projects completed, be extended to those under construction. Second is that it should be considered even for smaller projects; at present it is considered only for projects where the loan amount is more than Rs 1,000 crore. And the third -- and the biggest issue -- is that the 5/25 guidelines say net present value must be protected, which is a very difficult thing to do. After various representations, the RBI has only partly resolved the issue. It has come out with a circular where it is allowing discounting at a lower rate.

● Stability of policies, reducing litigation imperative as India competes for capital
Long-term stability in policies is critical to the well-being of the power sector. The amount of litigation India sees on each and every issue -- be it land, interpretation of PPA, or receivables -- is just too much. This puts domestic projects at a disadvantage when competing for global capital.

● Foreign exchange seen as a risk not worth taking for power projects
Fixed cost does not have the same meaning in the electricity sector, for it also includes the cost of mining. Variable cost, on the other hand, is only about consumables and labour. Then there is also levelised tariff. As for foreign exchange, it has been clearly stated that this is up to investor, so the refrain is that don’t go for anything involving foreign exchange -- simply remove that risk. Today, projects can be run only by insulating them that way.

● Consumers are willing to pay for reliable power
The story about Pune is instructive. Maharashtra was suffering from load shedding and industries in Pune said that they will draw power only during peak hours to avoid load shedding. Their cost of running a diesel generation set was Rs 11 per unit, while they were paying Rs 7-8 per unit otherwise. The industries then said the difference should be shared by all consumers. So at a public hearing, a large part of the consumers agreed to share the higher cost, so a consumption watermark of 300 units per month was set above which consumers were to share this cost. And that is how the Pune model began, and it has been extended now. Basically the message there is that if you are willing to pay you will get electricity. So what can be done today? Privatisation is out of question because of the monies involved. The solution is moving to the model where, as per the old PPA, cheaper power is distributed equitably. And give meters to small consumers, telling them clearly how much more they will have to pay if they
exceed the consumption limit. This will make the regulator’s task easy. Consumers must pay if they want more power.

**Better forecasting key to use greater renewable power**
The key question in renewable power is forecasting. Without forecasting for wind and solar, grid integration is difficult. The other question is, who is going to pay for the costlier power? And what will be paid by the consumer? This then comes to the extent to which state governments can come on board because just saying that the renewable purchase obligation is fixed by the regulator has no meaning – it has to be fixed actually by the state. Only if the state agrees is it possible to fulfil the obligation.

**Suggested solutions**

- **Reduction of AT&C losses equally important for distribution sector reforms**
  Reducing AT&C losses and hiking tariff are critical. Feeder separation under the Deendayal Upadhyaya Gram Jyoti Yojana will enable stakeholders to assess the exact AT&C losses and thus take steps to reduce them.

- **Public ownership, but private franchisees**
  A government utility cannot reduce AT&C losses beyond a point so the solution lies in the franchise model. Bhiwandi near Mumbai is a very good example of this approach. The area used to have 69% AT&C losses but after the franchisee came in, this was reduced to 34% and today power supply has improved a lot. So there are solutions available that will be politically acceptable and that is what stakeholders have to move towards.

- **Embedding dispute resolution mechanism in law will be of huge help**
  As for disputes, it will be better if resolution mechanisms are incorporated into the Electricity Act. Till that is done, stakeholders will be prone to seeking legal recourse, which increases viability risks. Given the experience of past, it will be pragmatic for the government to embed dispute resolution mechanisms into law. The reality is that nobody can run a power project by making losses every month. So the best thing to do is for both parties to sit together along with some neutral observers and work out a formula for compensatory tariff. Making mitigation mechanisms a part of law is absolutely necessary to avoid unending litigation, and to take the sector forward.

- **Pragmatic redrawing of contracts critical**
  How pragmatically contracts can be redrawn to survive the contract period is the critical point. For example, in the case of the Mundra project, the regulator took such a pragmatic view that it is very difficult to find fault with its logic. Businesses can’t be run by shuttering all risks by closing all avenues. A two-way approach is an imperative: pass the risk, and ensure that the industry does not suffer for reasons completely beyond its control.

- **Mandate regular tariff setting in law**
  There is a need to mandate regular tariff setting within the Electricity Act to ensure timely cost recovery for the distribution companies. Only this will force the regulator’s hand. Things done for short-term political gains only end up hurting consumers in the long run.
Consider creating and legislating a ‘Power Cost Index’ to enable tariff setting
An independent agency can create a Power Cost Index, which will indicate the changes in the cost of both generation and purchase of power. This will have to be built into the regulation as an automatic increase that must be mandated by state distribution companies.

Key conclusions in Current Worries

Heightening risks for generators, discoms staring at liquidity stress
- 46,000 mw of thermal capacities face viability risks of lower offtake, fuel shortage and after-effects of aggressive bidding
  - Lower energy requirement of discoms and their weak health impacting power procurement
  - Fuel shortage persists despite positive steps taken to improve availability
  - Significant capacities impacted by aggression on tariff bids and also to bag coal blocks
- Discoms of 6 states face liquidity pressure as financial restructuring package (FRP) moratorium ends
  - Discom debt-trap continues on account of inadequate tariff hikes and high AT&C losses
  - Annual tariff hikes of 10% and greater efficiencies can help them break-even by fiscal 2018
- Critical measures needed going forward
  - Distribution sector reforms, including ability to procure power in the near term
  - Addressing generation-side risks by augmenting domestic coal production

Lending to power sector: risks rising again
- Growth in lending to power sector to decline over the medium term
  - Exposure to reach ~Rs 16 lakh crore by March 2018; growth set to fall to 14% from 16% between 2015 and 2018
  - Commissioning of capacities expected to be subdued in the medium-term
  - Banks and financial institutions turning more cautious given increasing risks
- Debt to weak power generation projects is at Rs 2.1 lakh crore (46,000 mw)
  - Entire debt not at risk; promoter support and 5/25 structuring can provide some respite
  - Strong promoter support available to projects with Rs 35,000 crore of debt
  - Likely 5/25 structuring for another Rs1 lakh crore debt can make related projects viable
  - Net-net, projects with Rs 75,000 crore of debt at risk
- Outstanding debt to discoms has touched a high of Rs 4.4 lakh crore
  - Till date, central/state government support has prevented discoms from turning weak
  - However, FRP commitments by discoms and state governments yet to be fulfilled
  - Visibility on fresh government support necessary
  - Sans tangible progress, Rs.1.9 lakh crore of debt of weak discoms of 6 states at risk
The discussion brought together distinguished industry leaders as panellists.

(Left to right)

Mr. Deepak Amitabh, Chairman & Managing Director, PTC India Limited,

Mr. Lalit Jalan, Group Director, Strategy and Corporate Affairs, Reliance Group,

Mr. Samir Ashta, Director - Finance and Chief Financial officer, CLP India,

Mr. Pawan Agrawal, Chief Analytical Officer, CRISIL Ratings, (Panel moderator),

Mr. Pramod Deo, Former Chairman, Central Electricity Regulatory Commission,

Mr. Ramesh Subramanyam, Chief Financial officer, Tata Power Ltd.,

Mr. Subroto Gupta, Chief General Manager, IDBI Bank