POWER SECTOR

Signs of financial brownout

Flexibility on the tariff issue is critical to investor interest

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TODAY India faces an acute energy scarcity that hampers its industrial growth and economic progress. In the next five years, India requires about 100 GW or 100,000 MW of capacity addition. The power sector, traditionally a capital-intensive industry, requires significant investments to develop capacity additions. While the Indian financial bodies have reached sectoral lending limits, there is a need to attract sustained foreign investment in the sector.

A pressing concern facing the power generators is the shortage of available fuel (coal and gas) coupled with unresolved pricing issues. The domestic coal supply shortage and the need for faster capacity addition have forced India to increasingly depend on coal, primarily imported from Indonesia, Australia and South Africa. However, recent policy changes in Indonesia and Australia have driven up the prices of imported coal, making India's coal-based power projects non-viable, especially the ones having long-term power purchase agreements (PPAs).

The issue gets complicated since the long-term PPAs do not permit a price increase due to any change in law to be passed on to the procurer, thus, threatening project viability. This holds true especially for the flagship ultra mega power project (UMPP) scheme of the ministry of power, which envisaged 16 large-scale capacity addition of 4000 MW each to meet India's growing demand for power within a short time span.

Under the existing framework, no imported-coal-based large project would be viable. Investments would be at perpetual risk with a negative return on investments. Investors and lenders, who fund up to 70% of the project cost, would face the prospects of debt not getting serviced. Non-performing assets of this size would shatter the confidence of the financial institutions in India's power sector projects.

Instead of looking at the larger issue concerning the power shortage and the possibility of capacity becoming idle, the country has chosen to argue around the issue. The government needs to look into the larger issue of dealing with imported fuels and evolve a mechanism to compensate producers for losses arising from imports of coal and gas (following price fluctuations), and also plan a more flexible tariff structure, or face the flight of investors who see more risk than reward in India.

Testing times

Without such flexible mechanisms, projects could become non-viable in a fast moving energy scenario. One such example of a power project that has been pushed to the edge of becoming non-viable is the Coastal Gujarat Pvt Ltd (CGPL)-owned UMPP in the Mundra district of Gujarat. Like the other UMPPs planned, the land, water, choice of fuel (imported coal), environmental clearances and tie-up for power sale was provided by the government. Project winner Tata Power's responsibility was to arrange funds, technological tie-ups and key equipment, besides executing and operating the project. Built at a cost of ₹20,000 crore, this UMPP is now fully commissioned. The project, based on super-critical technology, meets 2% of the country's power needs and caters to the states of Haryana, Punjab, Rajasthan, Gujarat and Maharashtra. But the project's viability is now threatened.

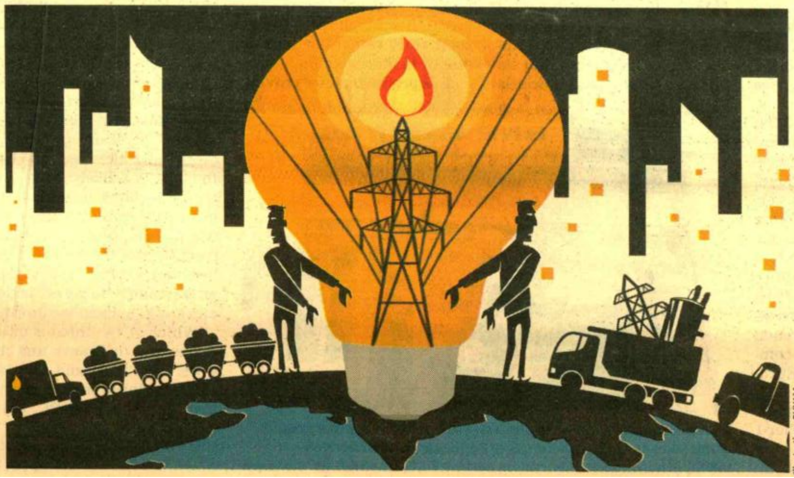
CGPL and other developers of similar large format projects filed a petition with the Central Electricity Regulatory Authority, seeking its intervention to establish an appropriate mechanism to offset in tariff the impact of the unforeseen and unprecedented escalation in the imported coal price, following a change of law in Indonesia. But the issue is caught in legalities.

But legal wrangles on the issue have to be avoided as they only add costs to an already costly and risk-filled process. Investors, both in India and abroad are closely watching the unfurling developments; and the way the government responds to the persisting issues in the power sector will determine the extent of investor confidence in this sector.

It must be borne in mind that the concept of UMPPs was designed to promote the public-private partnership (PPP) model under which the government conceptualises and carries out the pre-developmental activities and the private sector brings in the finances and managerial capabilities. If flagship government policies succumb to unresolved problems, then the belief in the government resolve is at stake. Investors and other stakeholders will, without exception, doubt the mettle of the government in resolution of issues.

Since the coal price paradigm has changed due to factors beyond the control or influence of the project developers, it is a normal expectation that the government of India or the concerned states intervene to restore the long-term viability of such projects.

The experience of the Dabhol Power Company—where valuable newly created assets were allowed to lie unused for several years—is a reminder to why such policy attentions are crucial. Without government sensitivity and support in changing situations, investors and power producers cannot hope to continue in business in a sustainable manner.



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