The case for longterm Power Purchase Agreements

What is the issue?

\n\n

India’s generation glut in electricity has been exacerbated due to stunted demand, which has brought down prices & left investors in the lurch.

\n\n

What is the background?

\n\n

\n
- With a pan-India thrust on electrification, the nation has become flush with power generation capacity in the last six to eight months.
\n
- This was further aided by the generation sector delicensing under the Electricity Act, 2003.
\n
- The spurt in “Merchant Market Prices” between 2008 and 2011 led power generation investors to enter the market.
\n
- Now, with excess production, merchant market prices have crashed, which has resulted in power generation companies have leaving their assets stranded.
\n
- Discoms have also become hesitant to undertake long-term power generation contracts that span a five to seven-year period.
\n
- This pricing dichotomy raises several questions.
\n

\n\n

What is the case for long term agreements?

\n\n

\n
- **Production -** Of the total electricity generation of 997 GWH (October 2016), over 90 per cent was sold through long-term contracts, which clearly

indicates that merchant prices do not represent correct power prices.
\n
- Power plants have always been set up to meet consumers needs for the long term & therefore, investors have aligned resources for the long term (typically 4 to 5 decades).
\n
- Financial institutions too, assess long-term revenue visibility before lending to investors.
\n
- **Transmission -**Power transmission is also designed for longevity.
\n
- Transmission networks planned by the CTU and STU are developed to transmit power for 25 years, if not more, to buyers.
\n
- **Agreements -** Long term agreements make it possible to finance new coal mines, essential for regular fuel access.
\n
- For this, PPAs of long duration are the only win-win solution for both generating companies and consumers.
\n
- This was echoed by the Maharashtra Electricity Regulatory Commission order.
\n

\n\n

How does the landscape look?

\n\n

\n
- Historically, power generation has been price-regulated in India.
\n
- The electricity sector received new impetus under the Electricity Act-2003, Competitive Bidding Guidelines-2005, the National Tariff Policy-2006, and other government notifications.
\n
- With the establishment of merchant power plants, investors were expected to shoulder the market risk of volatile selling prices.
\n
- However, not all investors followed this business model and many preferred the regulated route of tariff determination, as it ensures a revenue stream for the duration of the PPA.
\n

\n\n

What are the concerns of the investors?

\n\n

\n
- Power Plants need to recover their investments over their economic life.
\n
- This require tariffs to be determined after considering the operating costs, investment and depreciation.
\n
- Owing to short duration of the PPA, there is sizeable investment, which is yet to be recovered.
\n
- Hence, if the “initial” PPA period is less than its economic life, then the remaining period’s tariff should also be based on tariff regulation norms.
\n

\n\n

\n
- It would be unfair to leave the regulated tariff plants after the initial tariff period “in the lurch”, and expect them to participate in the merchant market for their remaining lifetime.
\n
- This is the only was to protect investor sentiment in the sector and enhance production to meet the growing demand for power.
\n

\n\n

How will this affesct the consumer?

\n\n

\n
- The consumer will also benefit from extending the regulated tariff to the balance period, as regulated tariffs are stable.
\n
- At present, merchant tariffs are low due to “suppressed” demand but price fluctuation in future can’t be ruled out.
\n
- While India is trying to move towards more developed international merchant markets, it must avoid compromising the health of the ‘power generation business’.
\n
- One of the ways of ensuring this stability is for the PPA period to match the economic life, that is, 25 years for thermal and 35 years for hydro.
\n

- PPAs can be constructed either through ‘Competitive bidding’ for a 25 year period that ensures predictability or through the regulated route that ensures a viable tariff.
\n

\n\n

\n\n

Source: Business Standard

\n

