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The case for longterm Power Purchase Agreements

What is the issue?

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

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What is the background?

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

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- **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.
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- 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).
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- Financial institutions too, assess long-term revenue visibility before lending to investors.
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- **Transmission -**Power transmission is also designed for longevity.
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- Transmission networks planned by the CTU and STU are developed to transmit power for 25 years, if not more, to buyers.
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- **Agreements -** Long term agreements make it possible to finance new coal mines, essential for regular fuel access.
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- For this, PPAs of long duration are the only win-win solution for both generating companies and consumers.
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- This was echoed by the Maharashtra Electricity Regulatory Commission order.
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How does the landscape look?

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- Historically, power generation has been price-regulated in India.
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- The electricity sector received new impetus under the Electricity Act-2003, Competitive Bidding Guidelines-2005, the National Tariff Policy-2006, and other government notifications.
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- With the establishment of merchant power plants, investors were expected to shoulder the market risk of volatile selling prices.
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- 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.

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What are the concerns of the investors?

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- Power Plants need to recover their investments over their economic life.
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- This require tariffs to be determined after considering the operating costs, investment and depreciation.
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- Owing to short duration of the PPA, there is sizeable investment, which is yet to be recovered.
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- 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.
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- 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.
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- This is the only was to protect investor sentiment in the sector and enhance production to meet the growing demand for power.
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How will this affesct the consumer?

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- The consumer will also benefit from extending the regulated tariff to the balance period, as regulated tariffs are stable.
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- At present, merchant tariffs are low due to “suppressed” demand but price fluctuation in future can’t be ruled out.
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- While India is trying to move towards more developed international merchant markets, it must avoid compromising the health of the ‘power generation business’.
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- 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.
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- 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.
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Source: Business Standard

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