Prayas (Energy Group)'s Comments and Suggestions on

Draft Electricity (Late Payment Surcharge and related matters) Rules, 2021

13th January 2022

The Ministry of Power has published the Draft Late Payment Surcharge Rules for public comments on the 20th of December 2021. The draft is proposed to replace the Electricity (Late Payment Surcharge and related matters) Rules, 2021 notified in February last year. The major change in the current draft from the notified rules is to provide a phase-wise, equitable framework for penal action to ensure payment discipline. The draft also has provisions to enable automatic sale of unrequisitioned power by generators on a day ahead basis.

Strict payment discipline is critical to sector sustainability and thus, timelines to ensure phase-wise resolution of pending dues as well as a framework for penal action for delay in payment is the first imperative step to realizing this goal, and is welcome. However, there are challenges with the current approach inherent in the proposed framework. If unaddressed, it could result in the sector being mired in significant litigation, increased cost to consumers and contribute to the growing liabilities of the state distribution companies.

Our comments on potential implementation issues and challenges are detailed in this submission.

Specific Suggestions on the proposed framework

In addition to change in approach, this document also captures issues with the current proposal which require clarification to ensure smooth adoption and implementation.

1 Dues pending due to ongoing disputes should be exempted

As per the PRAAPTI portal[1], about 24% of the outstanding dues to IPPs, central sector generating stations and renewable energy generators are disputed. Thus, as the matters are not resolved, it is not yet clear if the buyer is obligated to make payments. In such a case,

[1] https://praapti.in/

disputed amounts should be exempt from this payment discipline framework. To operationalise this, the following underlined changes are suggested in proposed Rule 2 (1)(d) and (h)

*"**Due date**" means the date by which the bill for the charges for power supplied by the generating company or electricity trading licensee or for the transmission service provided by a transmission licensee are to be paid, in accordance with the Agreement, as the case may be, and if not specified in the Agreement, forty-five days from the date of presentation of the bill by such generating company, electricity trading licensee or transmission licensee; as long as the payment amount is not subject to any claim, dispute pending before the appropriate regulatory commission, courts or subject to ongoing arbitration proceedings.*

*"**Outstanding Dues**" means the non-disputed dues of a generating company, electricity trading licensee, or a transmission licensee, which remains unpaid by the beneficiary beyond the due date and includes the amount of installment not paid after the redetermined due date under rule 4.*

2 Lack of clarity on claim of generators to late payment surcharge

Rule 6 details the framework for regulating contracted supply from generators in case of lack of maintenance of payment security and outstanding dues beyond the default trigger date. However, there is lack of clarity on applicability of late payment surcharge in case of non-maintenance of payment security in this framework. As per Rule 6 (4), in case of non-maintenance of PSM by the DISCOM, the generating company, in the first month, can reduce supply by 25% of the contracted capacity and has to continue to supply 75% of the contracted power the DISCOMs. However, Rule 6 (3) contends that the generator should not supply power at all without PSM and if it does so, it shall lose the right to collect late payment surcharge. Thus, from the draft, it is unclear of the generator is entitled to PSM for the 75% of power that it is obligated to supply under Rule 6 (4). Since default trigger date for proposed Rule 6 kicks in with non-maintenance of payment security mechanism as per Rule 2 (1)(e)(ii)[2], it falls upon the

[2] *"Default Trigger Date" shall mean*

i. *in case of non-payment of dues, one month after the due date of payment or two and half months after the presentation of bill by the generating company, electricity trading licensee or the transmission licensee, as the case may be, whichever is later, and:*
ii. *in case of non-maintenance of the Payment Security Mechanism, shall be from the next day after the Payment Security Mechanism due for to be replenished but not done;*

generator to regulate supply to the distribution company to 75%. Thus, the proposed framework can stipulate that in case supply is not regulated by the generating company as per Rule 6 (4) and Rule 6(5), it shall lose the right to collect late payment surcharge. The suggested change (underlined/ strikethrough) to Rule 6 (3) is detailed below:

> *The supply of power at any time shall not be without the PSM or advance payment. In case the generating company fails to regulate power supply as per sub-rule (4) and sub-rule (5), ~~supplies power without the PSM or without advance payment,~~ it shall lose the right to collect the Late payment surcharge from the distribution licensee.*

3 Sale of power only through power exchanges

Given the transparent nature of trades, multiplicity of contracts and clear process for price discovery and settlement, it should be clearly stated that all trades in the context of supply regulation mentioned in Rule 6(4) and Rule 6(5) and sale of unrequisitioned power as mentioned in Rule 9 (1) are to take place only through the power exchanges. This is particularly important as generators have multiple venues to sell power including DEEP, direct bilateral contracts with open access consumers and on OTC platforms which have been recently approved by the CERC in Power Market Regulations, 2021. Draft Rule 6(7) and Rule 9(3) propose that the gains from sale of power shall be calculated as the difference between the selling price in the power exchange and the cost incurred by the generator. If the power is sold bilaterally through other platforms and the price is different from the power exchange price, it would be difficult to justify using power exchange price as the benchmark.

With the imminent launch of forward contracts, generators will have multiple, flexible options on the transparent, regulated power exchanges. Thus, the suggested edits detailed in Table 1 are proposed in the mentioned sub-rules.

Table 1: Suggested changes to ensure power is sold through power exchanges

Sub-rule	Suggested changes (underlined/strikethrough)
6 (4)	*In case of non-maintenance of PSM or non-payment of outstanding dues by the default trigger date, the obligation of the generating company to supply power shall be reduced to 75% of the contracted power to distribution licensee and balance 25% of contracted power ~~may~~ shall be sold by the generating company through the Power Exchange .*
6 (5)	*If the Distribution licensee doesn't establish PSM or continues to default in payment of outstanding dues for a period of thirty days from expiry of the notice as referred to in sub-rule (4), then the generating company shall ~~be entitled to~~ sell upto100% of the contracted power through Power Exchanges.*
9 (1)	*A distribution licensee shall intimate its schedule for requisitioning power for each day from each generating company with which it has an agreement for purchase of power at least one hour before the end of the time for placing proposals/bids in the Day Ahead Market for that day , failing which the generating company ~~may~~ shall be free to sell the un-requisitioned power only in the power exchange.*

4 Framework for tracking intra-state transactions

Draft Rule 7(5) states that NLDC is to issue detailed procedure to implement regulation of inter-state open access rights of defaulting entities. As per the proposed framework, the regulation of inter-state open access should apply to defaults of intra-state generators as well. The jurisdiction of NLDC to track payment default and ensure action is not clear. To enable such regulation, it is proposed that the Rule clearly identify the role of the state regulator and/or the State Load Dispatch Centre in implementation.

5 Need for separate gain and loss sharing mechanism for sale of power from must-run stations

5.1 Potential for gaming by DISCOMs in current proposal

- Regulation of supply under proposed Rule 6 takes place in case there is non-maintenance of payment security by the DISCOM at any time.
- Regulation of entitlements to inter-state open access under Rule 7 is applicable in case there are outstanding dues 2.5 months after the presentation of the bill. This is not applicable for non-maintenance of payment security.
- For must-run capacity without two part tariff, there is no fixed cost obligation on the DISCOM.
- Under the proposed framework, it is possible for DISCOMs to not maintain payment security for 1-2 months so as to force high cost must run capacity to sell power on power exchanges but still ensure all outstanding dues are cleared within 2.5 months so as not to face regulation of ISTS open access.
- Thus, these generators would be forced to compete in the power exchange and bear the risks of potential losses when investments were made with the assurance of payment as per regulated tariffs for the contract period.

To address this issue and to disincentivize such strategies, there should be clarity in the gain and loss sharing mechanism in the framework for must-run stations in case of non-maintenance of payment security, default in payments as well as sale of power due to curtailment.

5.2 Lack of clarity on distinction between power not requisitioned and power curtailment for must-run generators

Rule 9 enables sale of unrequisitioned power on a day-ahead basis which provides certainty as well as flexibility for dispatchable thermal generators to sell power rather than be backed down. However, for must run generators, it is unclear what would qualify as non-requisitioning of power. Rule 9 (5) provides some clarity stating that compensation for non-requisitioning of must-run capacity should be as per the PPA and it the absence of such a provision as per

Electricity (Promotion of Generation of Electricity from Must-Run Power Plant) Rules, 2021, notified in October last year. However, it is not clear if non-requisition of must run capacity can take place for reasons other than technical constraints, grid security. This should be clarified to ensure that non-requisition of must run capacity does not take place for commercial considerations.

5.3 Need for clarity and consistency in gain sharing mechanism for non-requisitioned thermal capacity

Rule 9 (2) proposes that the sharing of gains from sale of unrequisitioned power be adjusted in the following order:

- payment to generating company of upto 3 paise per unit
- recovery of fixed charges.
- liquidation of overdue amount.
- the balance shall be shared in the ratio of 50:50 between the distribution licensee and the generating company.

This would imply that the generator is guaranteed a payment of 3 paise per unit even if there are pending dues and fixed charge payable and over and above that, additional gains are to be shared on an equal basis. This is not consistent with provisions in existing PPAs with respect to gain sharing and is also not consistent with the sharing of gains in the Security Constrained Economic Dispatch mechanism administered by POSOCO where the CERC has capped generators gain share at 7 paise per unit.

Adequate clarity should be provided in these rules on the applicable sharing mechanism and subsequent action to ensure consistency in treatment.

5.4 Separate gain and loss sharing mechanism for must run plants

As thermal power plants have two-part tariffs and receive fixed cost payments irrespective of being scheduled, all of their debt servicing and O&M costs are covered. Thus, as is proposed in the draft Rule 6 (7), 9(2) and 9(3), only the gains from sale in the power exchanges should be shared. Losses, if any should be borne by the generator.

However, for must-run capacity, where there are no lump-sum, fixed cost obligations and debt servicing costs and operating costs can only be covered when power is requisitioned or procured. In such a case, there should be a different framework for gain and loss sharing as detailed below:

- **Non-maintenance of payment security**: In case of sale of power due to non-maintenance of payment security mechanism by the distribution company in compliance with Rule 6(4) and 6(5), **the gains from the sale of power, if any should be shared such that 90% is retained by the generator and 10% is shared with the procuring DISCOM. In case of losses, 90% should be borne by the procuring DISCOM and 10% retained by the generator.**

- **Non-clearance of outstanding dues**: In case of sale of power due to non-clearance of outstanding dues by the distribution company in compliance with Rule 6(4) and 6(5), the **gains from the sale of power, if any should be shared such that 90% is retained by the generator and 10% is shared with the procuring DISCOM. In case of losses, 90% should be borne by the procuring DISCOM and 10% retained by the generator.**

- **Curtailment of power**: In case of curtailment of power due to technical reasons, compensation should be provided as per terms of the PPA. However, as the curtailment is for technical reasons, any gains or losses from sale of power by the generator need not be shared with the DISCOM. Given the nature of the contract, non-dispatchable nature of power and the tariff design, non-requisitioning of power for must run plants should not be allowed for commercial and non-technical considerations.

  This should be clarified in Rule 6 and Rule 9 accordingly

  The proposed gain and loss sharing mechanism for dispatchable and must-run capacity is summarized in Table 2.

Table 2: Separate treatment of sharing gain and losses for must-run plants

Treatment of gains and losses from sale of power in exchanges	Must Run contracted capacity	Dispatchable contracted capacity
Sale of power in case of non-maintenance of payment security mechanism or non- payment of dues (Rule 6)	**Gains**: 90% retained by generator and 10% shared with DISCOMs.	**Gains**: Shared as outlined in Rule 6 (7)
	Losses: Shared with DISCOMs such that 10% is borne by generator and 90% is borne by DISCOM,	**Losses**: Retained with generator
Sale of non-requisitioned power (Rule 9)	Non-requisitioned only in case of curtailment. Compensation as per PPA. **No sharing of gains and losses.**	**Gains**: Shared as per Rule 9 (2) **Losses**: Retained with generator

Challenges with proposed approach

1 Potential increase in litigation as rules may be regarded as a change in law event

Given the strict timelines and penal provisions in the rules, DISCOMs will have to adhere to the applicability of default trigger date and maintenance of payment security as per the rules. Notification of these rules could be treated as a change in law event as defined in existing agreements as well as detailed in Rule 2(1)(c) of the Timely Recovery of Costs due to Change in Law Rules, 2021[3] notified in October last year. Article 10 of most power purchase agreements and Rule 3 of the Timely Recovery of Costs due to Change in Law Rules, 2021 stipulate that compensation with regards to a change in law event should be such that it *'restore such*

[3] https://powermin.gov.in/sites/default/files/Electricity_Timely_Recovery_of_Costs_due_to_Change_in_Law_Rules_2021.pdf

affected party to the same economic position as if change in law had not occurred'. In case notification of these rules are treated as a change in law event, DISCOMs may seek compensation from generators for:

— Increase in working capital borrowing to comply with newly introduced timelines for payment which potentially over-ride PPA timelines.
— Loss of open access as a consequence of non-payment which restricts access to contracted capacity
— Loss of access to contracted capacity due to implementation of automatic sale of unrequisitioned capacity or non-maintenance of payment security or non-adherence to payment schedule.

Retrospective applicability of rules on existing contracts could definitely lead to increased litigation on these grounds and further increase uncertainty around payments and contract terms for generating companies. Precious time to ensure introduction and implementation of robust frameworks could be lost with such litigation as was seen with long drawn litigation of a similar nature in other sectors.

Thus, notification of the proposed framework may increase legal complexity and result in cost implications for the sector.

2 Increase in working capital liabilities of the distribution companies

As per draft Rule 5 of the proposal, all pending dues of distribution companies upto the date of notification of these rules, along with applicable surcharges are to be liquidated within a two year period in equal monthly installments. If the proposed timelines are not adhered to, the non-compliant DISCOM faces penal action. Going forward, delay in payments beyond 2.5 months would result similar penal action (curtailment of supply from contracted capacity as well as curtailment in inter-state short-term open access and progressive reduction in medium term as well as long term open access if defaults persist). Such severe penalties would encourage timely payment by DISCOMs to generators. However, in order to ensure this payment, without commensurate increase in revenue recovery, DISCOM working capital requirement will increase significantly. Without a scheme to address this build up of short-term

borrowing, the liabilities are just being transferred from generators and transmission companies to banks and power sector NBFCs such as PFC and REC.

The timely recovery of generator dues must be complemented with strategies to ensure equally timely revenue recovery from DISCOM consumers and addressing cumulative working capital borrowing of DISCOMs.

Suggestions to address challenges with approach

1 Urgent need for complementary actions to protect consumer interest

Strict measures as outlined in the proposed framework to ensure payment discipline would lead to severe financial stress for DISCOMs and at worst could also lead to deterioration in quality of supply and service and even curtailment of supply to consumers. This outcome would make it even more challenging to meet the commitment to 24x7 power supply for all.

Thus, along with stringent measures to ensure payment discipline by the DISCOMs to generators, it is equally critical that the state and central government run public services are paying dues on time and that the state government is also ensuring timely subsidy payment. **The need for action to ensure timely payment of government dues and subsidies was also highlighted in the report of the Committee constituted by the Ministry of Power in 2019 to look at the issues of delayed payment of dues to Gencos and IPPs**[4].

With strict payment discipline for DISCOMs and lack of payment discipline by state governments, the ultimate casualties will be paying consumers, especially in rural areas who will be subject to poor quality supply despite timely payment. This would be a serious setback to various initiatives and investments to build a culture of timely payment by consumers.

To address this, MoP could approach APTEL to initiate a suo-motu process to provide directions towards:

- Monitoring payment of subsidies and ensuring any working capital cost due to delay in subsidy payments is paid by the state government.

[4] https://cea.nic.in/wp-content/uploads/f ca/2020/10/D 754 1603265813247.pdf

- Ensuring regulation of supply in line with action mandated in the Electricity Act and applicable supply code in case of non-payment of dues by any consumer.

The directions can be provided in a process similar to O.P 1 of 2011 when the APTEL provided directions to ensure timely tariff determination and true-up processes.

2 Need for an incentive-based transition framework

Rather than summarily changing over to the proposed framework, it is desirable that distribution companies are nudged to participate or opt in and adopt the proposed framework. Initially rules could be voluntary for DISCOM and generators, similar to states voluntary participation in Ujjwal DISCOM Assurance Yojana, Power for All scheme and the newly launched RDSS scheme. The arrangement can be formalized, i.e. states / DISCOMs and concerned generators, through a multi-partite agreement between central government, state government, generators and the distribution companies and incentives can be provided under pre-existing or new schemes to nudge participation. To operationalise this approach it is suggested that the Rules include the following:

These rules will be applicable to all agreements signed by distribution companies consenting to adopt this framework based on an agreement between the distribution companies and the central and state government.

It is hoped that the Ministry of Power will take cognizance of the proposed suggestions of:

- *providing DISCOMs incentives to adopt the proposed framework.*
- *ensuring complementary efforts to ensure timely payment of subsidies and dues to DISCOMs.*
- *ensuring all sale takes place on power exchanges and that there is separate treatment of gain and loss sharing for must run stations.*
- *exempting disputed amounts from the proposed framework.*
- *giving clarity on applicability of late payment surcharge in case of default.*

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