

## Overview of the framework

To meet the infrastructure deficit, the Twelfth Five Year Plan envisages a renewed thrust on investment in infrastructure, with greater participation from the private sector. Of the projected investment in infrastructure, about 29 per cent is envisaged in the power sector, of which about 47 per cent is expected from the private sector. Bulk of the private investment in power sector will be in the generation segment.

Power sector in India, has been witnessing a significant interest from both domestic as well as foreign investors following the policy initiatives taken by the Government of India. However, the actual inflow of investment has been slower than expected, and future prospects would depend significantly on adoption of a comprehensive policy and regulatory framework necessary for addressing the complexities of Public Private Partnerships (PPP), especially for balancing the interests of utilities and investors.

**A comprehensive framework is a pre-requisite for sustainable supply of electricity**

Supply of short term power, typically for durations of less than a year plays an important role in a power market. It caters to the short term and seasonal fluctuations in the power requirements of utilities. In India, the volume of short term segment is approximately 10 per cent of the total electricity market. Bringing competitiveness and efficiency in short term procurement by the utilities would reduce costs and benefit the consumers. To this end, a precise policy and regulatory framework is being spelt out in this Model Agreement for Supply of Power (MASP).

The framework contained in the MASP addresses the issues which are important for producers and electricity traders who supply electricity to the utilities through short-term contracts. These issues include mitigation and unbundling of risks; allocation of risks and rewards; symmetry of obligations between the principal parties; precision and predictability of costs and obligations; reduction of transaction costs; force majeure; and termination. It also addresses other important concerns such as consumer protection, monitoring and dispute resolution.

The MASP provides the framework for optimal utilisation of available generation capacity on the one hand and adoption of international best practices on the other. The objective is to secure value for public money while providing reliable and cost-effective electricity to the consumers.

This MASP is a base document to be used by procuring utilities for inviting bids from producers and suppliers for supply of electricity over the short term. The MASP can be customised for base-load as well as peak hour procurement of electricity. Variations required for procurement of electricity from coal-based, gas-based and hydro-electric power stations have been provided within the MASP.

## **Fixed Charge**

The utility shall pay to the Supplier tariff comprising the sum of Fixed Charge and Variable Charge. The bidder offering the lowest tariff would normally be the selected bidder. The Fixed Charge would be determined through competitive bidding for availability of the contracted capacity.

**Fixed Charge to be competitive**

## **Variable Charge**

Variable Charge will be the amount payable by the Utility to the Supplier for the landed cost of the fuel utilised in the generation of electricity. Since the risk of variation in fuel price cannot normally be managed by the Supplier, it must be passed on to the Utility, which, in turn, will have to reflect it in the distribution tariff. Since pass through of Variable Charge affords full protection to the Supplier against potential losses on account of a rise in fuel prices, it follows that the benefit of reduced fuel prices cannot be retained by the Supplier. As a result, Variable Charge cannot be a profit centre for the Supplier and the principles for determination of Variable Charge must ensure that costs are recovered on the basis of actuals, assuming that the Supplier would function with the efficiency expected of a prudent and diligent operator.

**Variable Charge to be a pass through**

The framework contained in the MASP provides alternative formulations for determination of fuel costs depending on the source and pricing of fuel supplies. Each category of supply is, therefore, covered through its respective formulation. In case where fuel is to be procured from domestic market the cost of fuel shall be linked to the monthly average of a Fuel Price Index as may be mutually agreed upon.

When imported fuel is to be used, reliance should be placed on pre-selected coal/gas indices used widely in international supplies of coal/gas, but always subject to the actual cost incurred by the Supplier. For supply of electricity procured from a hydro-electric power station, the lump sum tariff option has been provided. Options for fuel imported under a fixed-price gas contract and for gas procured from ONGC/GAIL have also been stipulated with provisions for 'take or pay' supply of fuel. In all cases of imported fuel, the foreign exchange risk would have to be borne by the Utility as the Supplier would have no means to hedge such risk on a long-term basis.

The MASP also provides an option to invite bids based on a lump sum tariff for a period of up to six months even in cases where electricity is generated at thermal power stations. This implies that the Supplier would have to bear the risk of variation in fuel price over the contract period.

## **Concessional Fuel**

Fuel which is procured through any form of concessional, preferential or captive allocation or sale by a Governmental Instrumentality shall be deemed as Concessional Fuel and shall not normally be used for production of electricity

**Restricted use of Concessional Fuel**

for supply under a short term contract. However, in cases where a Supplier, including a distribution licensee, sells electricity produced from Concessional Fuel, the tariff payable would not exceed the sum of the tariff regulated by the appropriate Commission under section 62 or adapted by it under section 63 of the Electricity Act and the trading margin specified by the Commission. However, in case gas is supplied by ONGC/GAIL on concessional terms, it may be used for supply under a short-term contract with prior approval of the Government.

### **Availability and Despatch of Power Station**

The Supplier shall ensure and procure availability of supply to the extent of 85 per cent of the Contracted Capacity which shall be deemed to be the Normative Availability. Any shortfall in the Normative Availability will attract damages while any additional supply will be rewarded. The Supplier shall declare the availability of the Power Station at frequent intervals and the Utility shall be free to direct the Supplier to produce and despatch electricity in accordance with the despatch instructions given by it from time to time. Payment of Fixed Charge shall be computed on the basis of availability of the Power Station while the Variable Charge shall be payable only for the electricity actually produced and despatched.

**Fixed Charge to be paid for Availability of Supply**

Normally, the Availability shall be deemed to be to the full extent. In the event of any defect or deficiency, the Supplier must declare the actual availability so that its Fixed Charge is computed accordingly. The MAPP stipulates stiff damages in case of mis-declaration by the Supplier.

**Penalties for mis-declaration**

### **Outcome orientation**

The efficiency of the Supplier would normally be reflected in the quality and reliability of power supply. In particular, the Supplier shall be required to ensure the availability of Contracted Capacity at pre-determined normative levels.

**Outcome orientation is the key**

### **Selection of Supplier**

Selection of the Supplier will be based on a single-stage two-envelope process of competitive bidding. All project parameters such as the supply period, technical parameters and performance standards are to be clearly stated upfront. Based on these terms, the bidders will be required to specify their technical capacity and their financial offer in two separate envelopes, without any qualifications. The bidder who seeks the lowest tariff should win the contract.

**Competitive bidding on Fixed Charge will be the norm**

### **Risk allocation**

As an underlying principle, risks have been allocated to the parties that are best suited to manage them. The commercial and technical risks relating to production and supply of electricity are being allocated to the Supplier, as it

**Risk allocation and mitigation are critical**

would be best suited to manage them. On the other hand, all direct and indirect political risks are being assigned to the Utility.

### **Conditions Precedent**

Procuring approval of the Appropriate Commission for payment of Tariff by the Utility to the Supplier has been proposed as condition precedent to be satisfied by the Utility. Access to the transmission system for carrying electricity from power station to delivery point and procurement of applicable permits have been proposed as conditions precedent to be satisfied by the Supplier. The Utility would provide reasonable support and assistance to the Supplier in procuring the applicable permits. Damages have been prescribed for delay in fulfilling the conditions precedent by the Utility as well as the Supplier.

**Fulfilment of conditions precedent**

### **Force majeure**

The MASP contains the requisite provisions for dealing with force majeure events. In particular, it affords protection to the Supplier against political actions that may have a material adverse effect on the project.

### **Termination**

In the event of termination, the MASP provides for a calibrated termination payment by the Supplier or the Utility, as the case may be. Termination payments have been quantified precisely as compared to the complex formulations in most such agreements relating to infrastructure projects. Political force majeure and defaults by the Utility would qualify for adequate compensatory payments to the Supplier and will thus guard against any discriminatory or arbitrary action by the Utility.

**Pre-determined termination payments should provide predictability**

### **Miscellaneous**

The MASP addresses other important issues such as dispute resolution, change in law, insurance, indemnity, and disclosure of project documents. It incorporates the best practices that would enable a fair and transparent framework for private participation.

**An effective dispute resolution mechanism is critical**

### **Conclusion**

Together with the Schedules, the proposed contractual framework addresses the issues that are likely to arise in supply of electricity over the short-term. The proposed policy and regulatory framework contained in the MAPP is critical for attracting competitive supply of electricity with the concomitant efficiencies and lower costs, necessary for making electricity affordable.