

# The IPP Agreement

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Recently an agreement has been signed between a section of IPPs and the Government Committee towards resolving the undue and high cost of generation charged by the IPPs. Two separate agreements have been made, one with Wind IPPs and the other with Furnace Oil IPPs(FOIPP). There is a mixed reaction from the knowledgeable circles. We will in this space analyze the pros and cons of the agreement.

1. The most extensive agreement that has been made is with Wind IPPs and the most egregious and violating tariff has been in this sector as we will see later in this space. First let us the major clauses of the agreement with Wind IPPs.1.debt tenor to be extended by 5 years and reduce the LIBOR spread by 50-75 points and KIBOR spread by 100-125 points;2.reduce O&M expenses by 20-25%;3.reduce insurance premium in the operational years;4.Delayed payment interest rate to be reduced from KIBOR +4.5% to KIBOR + 2% for the first two months and remains LIBOR+4.5% for further delays;5.RoEDC(Return on Equity during Construction) to be reduced to 13%.

2. Let us give you a breakdown of a typical wind power tariff on existing plants; April-June 2020, total tariff is Rs 26.39/kWh; out of which O&M is Rs 3.0875, RoE is Rs. 8.5049, debt repayment and interest is Rs 14.00. One would be surprised to learn that the wind power tariff is around 25-26 Rs per unit for the already installed WPPs under the 2013 tariff as against 6 Rs for new power plants under the new tariff. Admittedly, Wind power cost and tariff was high internationally and have come down only recently and the new and old tariff is not comparable. On the other hand, the Wind tariff under 2013 prices was unreasonably high; 60-100 % higher than international prices then. Knowledgeable circles including this scribe kept protesting against such an excessive tariff but no bell rang in the ears of NEPRA and other relevant authorities. NEPRA awarded wind power levelised tariff in 2013 was 13.52 USc as against 7.3 USc in Turkey, 7.78 in the USA, 8 USc India,6.235 USc in South American countries. Similarly NEPRA CAPEX based on which the tariff was calculated was unreasonably high;2.4 Mn USD per mw as against 1 Million USD per MW elsewhere including India and the U.S. while in Europe it was slightly higher i.e. 1 million Euro per MW. In China, it was even under 1 million USD per MW.\*for further details, the reader is referred to my book Issues in Energy Policy, 2014).

3. Keeping in view the abnormal profit made by Wind IPPs and the one that they will continue to make, there was a scope for much harsher treatment than what the Committee has been able to negotiate. IPPs have hardly agreed to give any concession from their pocket. All concessions are conditional and on behalf of others; the financial institutions, which may or may not agree to the terms of agreement as are relevant to them. There is no reduction in RoE but the reduction is in ROEDC which is a negligible amount and a share of which would be really negligible.

4. Whose fault is there in such excessive tariff; obviously NEPRA is the regulator who did it despite the advice to the contrary. NEPRA even did not bother to engage third-party consultants or simply browse the internet and get the data from regional countries, Europe and the U.S.

5. Some oversight is due on regulatory agencies against exercise of arbitrary powers or incorrect decisions hurting public interest as is evidenced by high tariff that it has been awarding. Appellate Tribunal is provided in the Electricity Legislation, which has not been implemented yet and should be implemented without further loss of time. Now that, there is a combined Ministry of Energy, Appellate Tribunal may be extended to Oil and Gas sector. We have seen how KE has been playing with the legal system and obtaining stay orders against NEPRA decisions. Courts take almost infinite time to hear and adjudicate the cases.

6. A lot of regulatory reforms are required to be implemented; 1. Public hearings have to be made more representative and meaningful. Normally, investors are well represented and consumer interest is not adequately represented. Fortunately, internet meetings have been held by NEPRA which managed to gather points of view from a diverse section of population. This should continue beyond the prevalence of COVID.

7. The problem in such cases is that graft is consumed and transferred instantly and is not available for returning and only future proceeds can be subject to some adjustments. A classic case is of F-16 purchased during Ziaul-Haque regime when the Boeing was prepared to give back the money it received but did not know what to do with the money; it did not receive and went to the intermediaries.

8. Fortunately, the volume of Wind power purchase is small 1000 MW or so. Had it been a large volume, the level of destruction could have been much higher. Imagine Rs 26 per unit plus losses plus transmission and distribution cost, while average tariff is ..... Thus the scope of causing destruction and damage in an unrestricted authority of the regulator is very high and thus the overriding rationale for a reasonable oversight.

9. The corrections that are required are in area of financing i.e. RoE and interest rates. All costs are translated into these two financial parameters. There is confusion on RoE reduction; some newspapers have reported that RoE would be reduced prospectively by 3 percent. However, the signed agreement available with this scribe does not mention any such reduction. If this is indeed the case, then it may be considered as a significant achievement.

10. Let us see what has happened in the region in the area of RoE and energy tariff. Firstly, India has gone for competition/reverse auction in the area of renewable energy for a long time now and has been able to reduce the solar and wind tariff by more than 100%. CERC (the electricity regulator in India) has reduced RoE for renewable energy by 3% i.e. from 17% to 14%. Similarly, RoE for fossil power plants has been reduced to 15.5%. Regulatory Interest rates are 8 percent points above treasury rates.

11. There is a separate agreement with F.O. IPPs. The coverage of the agreement has been estimated to be under 5%; CPEC and Hydro projects are out of it. Thus both in terms of agreement terms and its sectoral coverage, the agreement does not offer anything significant. What is more injurious is that it creates a

bad template for negotiations in CPEC projects. Had it not been there, there could have been a scope for a more beneficial arrangement in CPEC projects.

12. Concluding, a competitive market is the solution for all future energy investments, which is easier said than done. A voluntary electricity exchange (ala India, where two such exchanges are operating which are planned to be extended in market share) could gradually bring the electricity sector under competition. The proposed CTBCM does not, however, offer a good competitive foot print. The issue should be deliberated upon by the policy makers carefully.