CERC's 'compensatory tariff' augurs well for power sector credits: CARE Ratings

CARE Ratings views Central Electricity Regulatory Commission's (CERC) recommendation of 'compensatory tariff' for the power sector projects based on imported coal as a positive development for the sector. Power generation entities rated by CARE Ratings, stand to benefit if the recommendations fructify to result in tariff increases.

Power generators with imported coal as fuel are staring at significant losses, as a result of steep escalation in price of imported fuel (for example price of thermal coal imported from Indonesia has increased sharply from US dollar 40 per tonne in 2007 to about US dollar 75-80 per tonne in 2012). CARE Ratings estimates losses to be in the range of Rs. 0.50-0.80/kWh for large power projects based on imported coal. The situation arose due to substantial difference in the assumption of fuel price at the time of bidding and what these generators are actually required to pay for procuring coal from overseas; the rise in coal prices and foreign exchange rates have impacted the viability.

CERC has issued its order dated 2nd April 2013 on Adani Power Limited's (APL, rated CARE A+ (SO)) petition for frustration of long-term power purchase agreements (PPAs) signed with power distribution entities in the states of Gujarat and Haryana. The adverse movement in price of coal due to the change in Indonesian coal regulations resulted in steep increase in APL's fuel cost. As a remedy APL sought suitable resolution of dispute by upward revision in tariff. CERC has recommended compensatory tariff to make the project viable and has directed for constitution of a committee to submit its recommendations on compensatory tariff. While calculating tariff, potential gain arising due to ownership of mines abroad is also required to be factored in. This tariff shall be variable in nature and be applicable for a certain period (period of hardship).

Says Amod Khanorkar GM-Ratings, 'while arriving at credit rating for the power sector entities which are contractually committed to supply energy at competitively bid prices, CARE Ratings critically examines risk allocation and mitigation tools deployed by the power project developer. Resourcefulness of the sponsor, its ability and willingness to support such projects is an integral part of the assessment'.

According Mr. D. R. Dogra, CEO and MD, CARE Ratings, 'the quantum of compensatory tariff and timeline within which the consensus arises on the issue is important from credit perspective. In CARE Ratings opinion the regulator's approach is pragmatic and if taken to logical end shall pave way for resolution of one of the key challenges faced by the sector'.

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