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The best guarantee is a restructured SEB

The four-tier formula, mooted by the power ministry, to ensure full and timely payment to IPPs is not viable, as it steers clear from factors underlying sickness of the SEBs, says Uttam Gupta

THE ministry of power has recently mooted a four tier formula to ensure full and timely payment for the electricity bought from the independent power producers (IPP) in accordance with the power purchase agreements signed respectively.

The contemplated four tiers are:

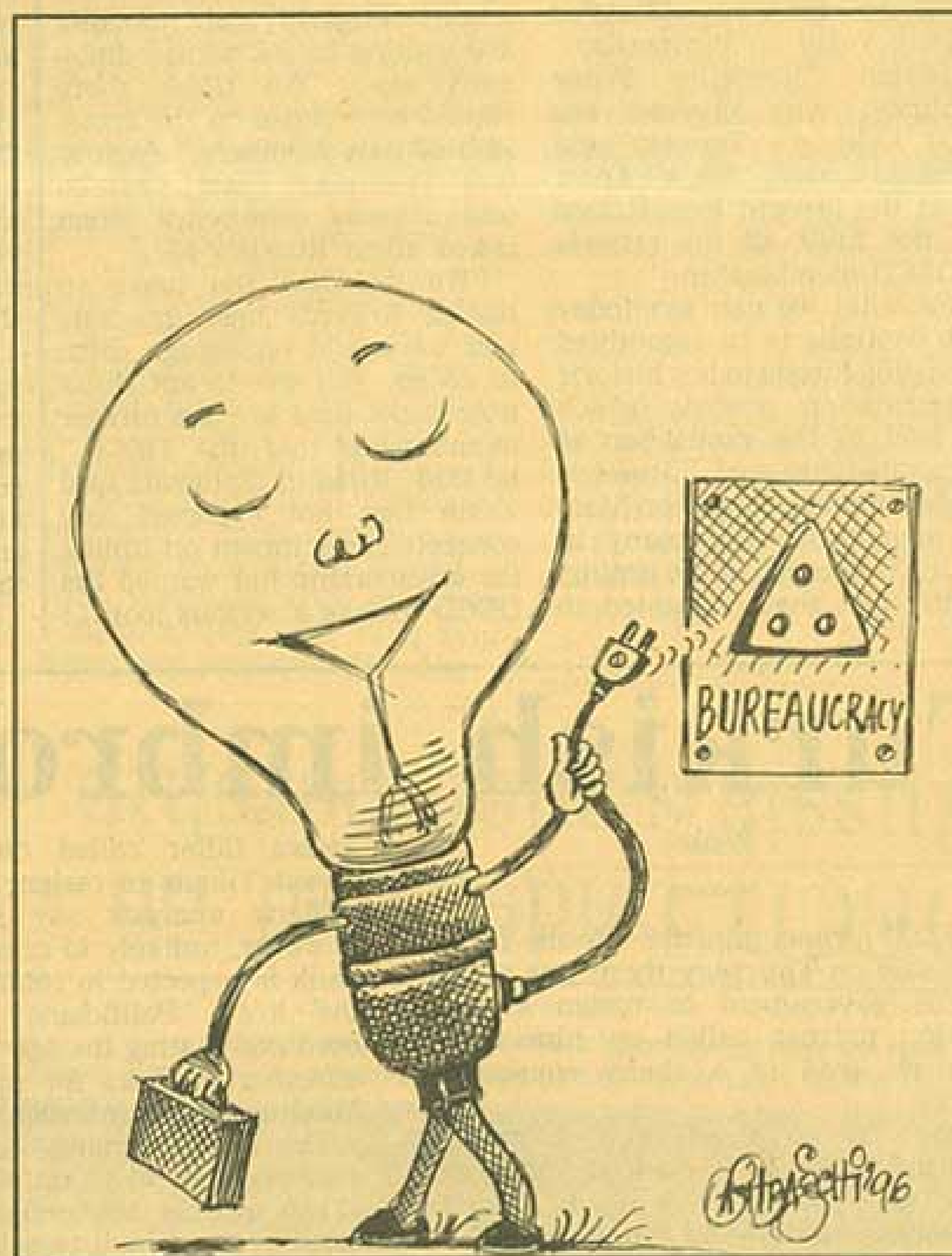
- letter of credit (LC) opened by the concerned state electricity board in favour of the IPP — value being proportionate to the power purchased during any given period,
- backing of the LC by an escrow account,
- guarantee of payments by the state government and,
- undertaking by RBI to compensate the IPP from the state account with it in which the share of the central taxes are deposited.

At the root of these different layers of assurances is the lingering doubt that the SEB may not be able to honour the payment obligations to the IPP. Invariably, in all commercial transactions, the seller is satisfied with payment through LC. In fact, in cases of buyers with good track record and financial soundness, even the requirement of LC is not insisted upon. In the case of SEB, however, the ministry deems it necessary to have three more guarantees over and above the LC to ensure that in the event of failure at the lower rung, the next mechanism in the line up could be operated.

There is an implicit rationale in providing for guarantee at each level. First, let us consider the backing of LC by an escrow account. The operational angle to this is that all proceeds from sale of electricity by the SEB will have to be deposited in this account and the IPP will have the "first charge" on it. This is to guard against a situation in which the proceeds of power sold by the SEB are less than its "total" payment liabilities and the possibility of this mismatch affecting payments to all including the IPP.

Undoubtedly, the financial interests of the IPP need to be safeguarded. However, the proposed dispensation is clearly detrimental to the interests of the central power utilities. For instance NTPC, which also sells power to the SEB, will not avail of such safeguards. This may also affect payments to the suppliers of fuel such as coal, fuel oil, LSHS etc., used for running SEB's own power plants. This will be a totally unfair and discriminatory arrangement.

The provision for guarantee by the state government reflects upon an even more serious situation in which the proceeds from sale of electricity by SEB may fall short of the payment liabilities to the IPP alone. In this eventuality, the state government will be required to divert funds from its budgetary resources to meet the shortfall in payment to the IPP.



Already, majority of the state government are running huge revenue deficits. On top of this, if the SEB defaults in payment to IPP have also to be accommodated, this situation will aggravate leading to further cut in spending on development schemes, particularly social infrastructure such as health, education etc.

The fourth layer of guarantee tantamounts to drawing upon the central transfers to states in the event the SEB as well as the state government fail to make the payments to the IPPs. Consequently, in this situation also, development in the state will be jeopardised.

The proposed approach is not viable as it glosses over the fundamental question as to why the SEBs are not in a position to generate adequate resources to fully meet their payment obligations? Even worse, it seeks to condone their inability to do so by transferring the burden of payment to some other heads. In sum, the formula suffers from the same drawbacks as does the central government's counter guarantee scheme in the case of fast track projects.

The crux of the problem is that majority of the SEBs in India are financially bankrupt. Year after year, they have been incurring huge losses. This is because of the high cost of generation in their own plants due to low plant load factor (PLF), excess manpower and poor maintenance on the one hand and poor realisation on account of transmission and distribution losses, short billing or delayed collection of dues and sale of a major chunk of the electricity at subsidised rate to agriculture on the other hand.

There is an urgent need to make the existing power supply and distribution system in the state sector financially viable. Towards this end, improved collection of dues in respect of power sold to various users on the basis of proper billing should receive immediate attention. Apart from willful defaulters, even in other cases, payments remain in arrears for long because of the sheer lethargy of the collection staff in not raising and sending the bills in time. Consequential loss by way of interest alone contributes significantly to SEBs' sickness.

The second area needing attention is the revamp of the transmission and distribution infrastructure. This will go a long way in reducing the T & D losses and consequently augmenting revenue earnings for the SEBs.

Renovation and modernisation of the existing power plants under the SEBs should be next on the agenda. This would help in improving their PLF and lowering the per unit cost of generation, thus improving the financial health of the SEBs.

Finally, there is the imperative to rationalise the tariff structure along the lines of users' cost principle. The present structure is highly imbalanced involving exorbitant rates charged to industries and commercial establishments whereas power is sold virtually free to agriculture. The latter may be raised suitably which will help in reducing the burden on the former and improve overall recovery.

Effective implementation of these measures is not possible under the existing organisational structure. SEBs need to be restructured whereby they are delinked from the government and reconstituted as undertakings. Power generation should be separated from T and D operation by creating autonomous corporations to undertake these activities. The T and D corporation will buy electricity form the central power utilities, say NTPC, the power generation corporation or the IPPs, and organise sale from this pool to various users. The responsibility for implementing PPA with the IPP will also rest with it.

To get the best results, these corporations should be managed and run by autonomous boards with directors drawn from professionals. The boards should have freedom to act in regard to undertaking investment, mobilising funds, deciding on tariff policy and so on. To help the management in achieving successful turnaround, the corporations should start on a clean slate, free from the burden of past loans and the cumulative interest thereupon, used for supporting the losses of the SEB.

With the restructured state power supply and distribution system in place and its effective functioning free from bureaucratic and political interference, the T and D corporation should emerge as a credible and financially sound entity capable of meeting its payment obligations in full to all its suppliers including the IPP. That indeed, will be the best guarantee against a possible situation of default.