

## APP Comments on Draft Electricity (Late Payment Surcharge) Rules, 2020

The covering letter to the Draft Electricity (Late Payment Surcharge) Rules, 2020, talks about the ‘extremely high rates of late payment surcharge’ and the need for the Late Payment Surcharge (“LPS”) to reflect the current cost of borrowing. Clause 3 of the Draft Rules proposes that the LPS shall be payable at the applicable bank rate (*where bank rate has been defined as SBI MCLR plus 500 basis points, which is around 11.65% as per current rates*) or the rate as provided in the PPA/TSA, whichever is lower. Clause 4 further specifies that the LPS rate shall increase by 50 basis points after expiry of each month after the due date, subject to a maximum of applicable bank rate plus 200 basis points.

In this regard, it may be noted that the proposed base rate of LPS (~11.65% annual) is much lower than the LPS rates applicable to PPAs under Section 62 (*1.5% per month as per Regulation 59 of CERC Tariff Regulations 2019*) and PPAs under Section 63 (*while the rates vary across PPAs, majority of the Section 63 PPAs provide for LPS at SBI PLR plus 2%, which currently comes to around 15% on annualized basis*). It is also evident from the above that the LPS rates under Section 63 PPAs are reflective of the market cost of borrowing, which is contrary to the position stated in the covering letter.

LPS is a penal provision which seeks to disincentivize the DISCOMs from making delayed payments against the invoices. This problem of delayed payments by the DISCOMs has been the bane of the power sector for the last 3-4 decades. Despite the efforts made by Ministry of Power to streamline payments to the generators through introduction of payment security linked scheduling and dispatch mechanism and the Liquidity Infusion window under REC/PFC, payment discipline among the DISCOMs has not shown the desired improvement. **As on today, the overdue amount due to generators is Rs 97,088 Cr (exclusive of LPS) as per the PRAAPTI Portal. In addition, APP members are also owed an amount of Rs 18,000 Cr by the DISCOMs against pending Late Payment Surcharge. Therefore, if we add the pending LPS of other generators, the amount due will be beyond Rs 115,000 Cr. This huge amount is outstanding despite the disbursement of Rs 31,135 Cr through the liquidity infusion window.**

The move to rationalize and reduce the LPS rate has to be viewed in the above backdrop. First question that we need to ask is, why are the generators not being paid on time by the DISCOMs?

The main factors behind this are:

- a. Buyer's market – Procurers know that notwithstanding delays in payment, the generator will continue supplying power as the generators cannot sell anywhere else.
- b. Huge cash deficit in DISCOM operations – The DISCOMs utilize the outstanding amount for meeting their working capital requirements and part of their cash deficit.

Due to the above reasons, the DISCOMs resort to delaying payments to the generators, knowing very well that they will ultimately be able to browbeat the generators into waiving off LPS dues and agreeing for discounts on the principal overdue amount. Many developers have faced such situations.

**We need to keep the above behaviour of DISCOMs in mind before taking any step for LPS rationalization. The objective of LPS rationalization must be to instill discipline in making timely payments because the effect of delayed payments cascades down the entire value chain and vitiates the health of the entire system. Any dilution of the LPS norms would lead to a negative end result, as the DISCOMs will continue to use the outstanding amounts for their working capital requirements, but at lower interest rates.**

**Therefore, we strongly feel that in order to resolve this decades-old problem of delayed payments from DISCOMs, any proposed measure of rationalization/lowering of LPS rates would need to be coupled with a fool proof payment security mechanism, which can ensure automatic payment to the generators at the end of the target date (fourth month beyond the bill due date).** This can be done through institutionalization of a bill discounting mechanism through REC/PFC, with REC/PFC having recourse to recover the outstanding amount along with applicable LPS inclusive of penal rate from the Central Appropriation of the concerned State. A similar setup is already being followed under the Liquidity Infusion Package where REC and PFC are backstopped by State Government guarantees.

In conclusion, any relaxation of LPS provisions without a foolproof payment security mechanism would lead to further deterioration of payment discipline and larger outstanding dues, thereby

impacting the ability of the generators to pay for fuel supplies, transportation, transmission of power and their debt servicing obligations – an unintended outcome.

Apart from the above, there are some other concerns with the Draft Rules, such as clarity on its applicability to both Section 62 and Section 63 PPAs, and clarity on how any inconsistency between the Draft Rules and the existing provisions in PPAs/Tariff Regulation would play out in actual practice. Our para-wise comments are provided as follows.

Clause No.	Provision as per Draft Electricity (Late Payment Surcharge) Rules	APP Comments
2 (1) (b)	<p>Definition of “Bank rate”:</p> <p><i>“bank rate” means Marginal Cost of Funds Based Lending Rate for one year of the State Bank of India plus 500 basis points and in the absence of Marginal Cost of Funds Based Lending Rate, any other arrangement that substitutes it, which the Central Government may, by notification in the official gazette, specify.</i></p>	<p>It is not clear whether MCLR will be average MCLR for one year and if so, what will be the period to be considered for working out the average (whether from 1<sup>st</sup> day of the relevant financial year or one year period prior to the date of bill). This needs to be explicitly clarified in order to avoid future disputes on this account.</p>
3	<p>Late Payment Surcharge shall be payable on the payments outstanding after the due date at the applicable bank rate or the rate as provided in the agreement for supply or transmission of power, whichever is lower.</p>	<p>It may be noted that the Late Payment Surcharge is a penal provision which seeks to disincentivize the DISCOMs from making delayed payments against the invoices. To instil payment discipline, it is imperative that the penal provision should be higher than the DISCOM’s working capital interest rate.</p> <p>In the Draft Rules, applicable bank rate has been defined as SBI MCLR plus 500 basis points, which is around 11.65% as per current rates. This is much lower than the LPS rates presently applicable to</p>

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		<p>PPAs under Section 62 (18% per annum as per Regulation 59 of CERC Tariff Regulations 2019) and PPAs under Section 63 (while the rates vary across PPAs, majority of the Section 63 PPAs provide for LPS at SBI PLR plus 2%, which currently comes to around 15% on annualized basis).</p> <p>It may be kept in mind that the main reasons for delayed payments are that the cash-strapped DISCOMs are utilizing these outstanding amounts for meeting their working capital requirements and part of their cash deficit. We are in a Buyer's market where the DISCOMs are very well aware that the generator will continue supplying power as they cannot sell the power anywhere else. Thus, DISCOMs resort to delaying payments to the generators, knowing very well that they will ultimately be able to browbeat the generators into waiving off LPS dues and agreeing for discounts on the principal overdue amount. Many developers have faced such situations.</p> <p>In this backdrop, the objective of LPS rationalization must be to instill discipline in making timely payments because the effect of delayed</p>

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		<p>payments cascades down the entire value chain and vitiates the health of the entire system. <b>Any dilution of the LPS norms would lead to a negative end result, as the DISCOMs will continue to use the outstanding amounts as their working capital tools, but at lower interest rates. Therefore, we feel that the penal provision of LPS should not be diluted in the form of lowered rates.</b></p> <p><b>Accordingly, it may be clarified in the Rules that in the event of any inconsistency in respect of base LPS rate between applicable Tariff Regulations/PPAs and the Rules, the base LPS rate as per the Tariff Regulations/PPA shall prevail. In case the Agreement does not specify any rate for LPS, the rate specified in the Rules may be considered.</b></p> <p>Further, a bare reading of the draft Rules does not make it clear as to whether these Rules would apply to both Section 62 and Section 63 PPAs. In case the draft Rules are made applicable to Section 63 PPAs, and if our request for keeping the LPS rates as per the existing PPA/Tariff Regulations is not considered, <b>the Generator /</b></p>

Clause No.	Provision as per Draft Electricity (Late Payment Surcharge) Rules	APP Comments
		<p><b>Transmission Licensee should be entitled to recover the consequential impact of the reduction in LPS rate, if any, under Change in Law provision of the PPA.</b></p>
<p><b>4</b></p>	<p>The rate at which Late Payment Surcharge shall be payable on outstanding payment shall increase by 50 basis points each month after the expiry of the first month after the due date, subject to a maximum of applicable bank rate.</p> <p>Provided that the rate shall not be higher than the rate provided in the agreement for purchase or transmission of power, if any.</p>	<p>While we welcome the introduction of incremental increase of LPS on monthly basis, the increase has been capped at 200 basis points after 4 months beyond the due date. It has been further stipulated that the LPS rate (after accounting for staggered monthly increase) shall not be higher than the rate provided in the PPA. Coupled with the lowered LPS base rate, this cap will anyway result in final LPS being lower than current LPS rates under PPA and will thus fail to be a sufficient deterrent to the DISCOMs to avoid late payments.</p> <p>To provide teeth to the penal provision of LPS in order to achieve the ultimate objective of instilling payment discipline, we suggest the following:</p> <p><b>a. The monthly increase in LPS rate may be considered as 100 basis points instead of 50 basis points.</b></p>

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		<p><b>b. There needs to be a fool proof mechanism to ensure automatic payment to the generators at the end of the target date (fourth month beyond the bill due date). This can be done through institutionalization of a bill discounting mechanism through REC/PFC, with REC/PFC having recourse to recover the outstanding amount along with applicable LPS inclusive of penal rate from the Central Appropriation of the concerned State. A similar setup is already being followed under the Liquidity Infusion Package where REC and PFC are backstopped by State Government guarantees.</b></p> <p><b>c. Proviso to Clause 4 which states that the LPS rate shall not exceed the rate provided in the PPA / TSA should be deleted.</b></p> <p><b>d. These Rules shall apply subject to the condition that the Distribution companies fully establish Letter of Credit as per PPA / TSA provisions.</b></p>



Clause No.	Provision as per Draft Electricity (Late Payment Surcharge) Rules	APP Comments
		<p>e. <b>Interest should be computed based on monthly compounding interest as in the absence of non-payment of working capital loans by the generators (due to delayed payments from the DISCOMs), the banks charge compound interest to the generators.</b></p>
5	<p>All payments by a distribution licensee to a generating company or a trading licensee for power procured from it or by a user of a transmission system to a transmission licensee shall be first adjusted towards late payment surcharge and thereafter, towards monthly charges, starting from the longest overdue bill.</p>	<p>We welcome the precedence of apportionment of payment made under late payment surcharge (i.e. First towards LPS, thereafter towards monthly charges starting from longest overdue bill).</p> <p>However, it may be clarified in the Rules that the provisions of Clause 5 shall prevail over the provisions mentioned in PPA, in case of any conflict.</p>
General Comment		<p>Considering the provision for staggered increase in LPS for a period of 4 months, for Section 62 based PPAs and Transmission Agreements the Receivables component in working capital should be increased to 4 months and the RBI may be directed to issue necessary guideline to</p>

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		Banks and FIs to increase the working capital loan facility accordingly.