

# India's coal-fired IPPs wait on restructurings

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Indias 2012 blackout covered 22 states and affected 600 million people. It reminded policymakers of the scale of Indias energy investment requirements. Indias power sector is in disarray, unable to meet the growing gap between supply and demand. Many prospective developments have stalled and others have been abandoned altogether.

Coal-fired power supplies around 60% of Indias electricity. But domestic coal reserves are hard for generators to access. Plants that run on imported coal struggle to pass on higher costs from Indonesian coal producers to their offtakers. As a result, Indias project pipeline has run dry and bankers subsist on refinancing and restructuring existing plants that are struggling to deal with cost overruns and delays.

## The coal conundrum

Indian projects should not have trouble using domestic coal. The country has abundant reserves, but regulatory delays to adding new mines, plus questions around coal quality and logistical challenges, like railway access, hinder greater use of domestic fuel.

State-owned Coal India supplies more than 80% of domestic consumption, but has been unable to keep up with demand, which is forecast to climb 43% from 2013 levels to 730 million tons by 2017. The coal is there, the problem lies with who controls it, argues Nandan Nelivigi a partner in White & Cases project finance practice and the head of its India practice. The government allocated coal resources to projects without understanding Coal Indias ability to supply that coal. Its a classic case of the government being involved in a business which it is not in a position to manage.

Many projects closed their financings without having guaranteed supplies of domestic fuel in place because they took for granted Coal Indias ability to supply their plants. Coal India was able to meet demand from the first wave of recent power projects, but as demand has grown the state-owned company has itself come to rely on imports. Coal India is the third largest importer of coal anywhere, even though India possesses the worlds fifth-largest coal reserves, with resources of 293.5 billion metric tons, of which 118.1 billion tons are proven, according to the coal ministry.

Compounding the shortages is a messy dispute over the allocation of coal blocks between 2004 and 2009. Many coal blocks were allocated to power companies using a screening process rather than competitive auctions. Indias Comptroller and Auditor General have suggested that regional authorities sold the rights to mining areas for much less than they were worth, resulting in the new owners receiving undue benefits. New allocations are now on hold.

Questions have arisen as to whether allocations were appropriate. The general view is that a tender or auction process would have been preferable to ensure a level playing field and to rule out any preferential treatment, says Piyush Mishra, a partner at Luthra & Luthra law offices in Delhi.

Imported coal will not be able to compensate for these shortcomings. Indonesia, Indias biggest source of coal, increased prices in 2011 after mandating that all long-term coal export contracts be set at prevailing international benchmark prices and no lower. Power developers bid power purchase agreements (PPAs) with tariffs that reflected the earlier, lower, coal

prices. Indonesias actions were deadly to Indian power plants that closed financing based on those tariffs.

### **Room to renegotiate**

The victims include some of Indias flagship projects, among them Adani Powers Tiroda plant in Maharashtra and Tata Powers 4,000MW Mundra ultra mega power project (UMPP) in Gujarat, which was fully commissioned in March 2013. These large-scale projects are now trying to renegotiate their tariff structures in an attempt to pass on the higher cost of imported coal to offtakers. Those offtakers, most of them owned by Indias states, will in turn have to pass on those increases to consumers.

Tata won its UMPP in 2006, bidding Rs2.26 (\$0.035) per kWh. Now Indias regulator, the Central Electricity Regulatory Commission (CERC) has recommended that Mundras tariff increase to Rs2.85 per kWh to make the project viable. The ruling would make tariffs more responsive to movements in global coal prices, but Indias state electricity boards (SEBs) are all reluctant to pay more for their power, and are challenging the ruling.

The SEBs are already struggling to cope with transmission losses and to collect consumer payments, and say they are unlikely to be able to sell power at higher prices. Its a stalemate that promises more brownouts and blackouts, says one banker.

Unlike Mundra, which was always meant to run on imports, Adanis Tiroda plant has been forced to turn to imports because a ruling from Indias environment and forests ministry prevented it from using the domestic coal block it was allotted.

If these flagship plants succeed in renegotiating their fixed tariffs other power projects will follow suit. Critics of the process argue that if generators can renegotiate their tariffs, it will undermine Indias entire bidding process, and leave government open to legal action from unsuccessful bidders that lost out to unsustainably low tariffs. It is very difficult to renegotiate tariffs after the awarding of a tender or post signing of the PPA. In the case of bid-based tariffs, allowing any re-negotiation after the award could open the process to challenges, says Luthras Mishra.

### **Wider woes**

Indias macroeconomic woes are also a source of trouble for generators. Plants running on imported coal rarely possessed dollar reserves, or put in place currency hedging. The fall in the value of the Rupee has increased their mismatch between costs and revenues. Equity markets have dried up, constraining sponsors ability to deleverage.

Lenders are under pressure to restructure their loans to struggling generators. Local banks were the biggest source of debt for Indias power projects up to 2010. Now even rupee lenders have reduced appetites. Banks recently approved a corporate debt restructuring package, for power developer Lanco Infratech, increasing the repayment period on its loans and reducing the interest rate on the debt. Other developers are heading the same way; its not pretty, says the banking source, adding that although banks exposure to the power sector is limited by sector caps, the number of non-performing loans will rise going forward.

Multilaterals increasingly reluctant to support coal-fired power for environmental reasons will not ride to the rescue. US Ex-Im and the World Bank, the parent of the International Finance Corporation, will only support new coal projects under very limited circumstances. The lenders on Tatas Mundra plant included the IFC, Asian Development Bank, South Koreas KEXIM and K-Sure, and Japans JBIC.

But Mundra was seven years ago and things have changed since then, says one lender familiar with the market. We are very selective when it comes to coal-fired power and would insist on high efficiency on coal consumption and the most advanced technology. Our focus in India has shifted to renewables.

Multilaterals lack of enthusiasm will make financing future coal-fired projects even more challenging, given the lead they take in helping developers mitigate environmental and social risk and in creating comfort for commercial lenders coming in on these deals.

Asian export credit agencies are still willing to support coal. Chinese lenders took a prominent role in the 2012 refinancing of Reliance Powers Sasan UMPP in Madhya Pradesh. Sasan benefited from a strong sponsor and guaranteed domestic coal supply, and replaced Indian lenders with Chinese banks offering cheaper debt and longer tenors, including the Bank of China and China Development Bank Export-Import Bank of China came in on the back of supplies of Chinese equipment to the project.

Overzealous bidding during the initial stages of Indias power liberalisation process meant plants were financed without either robust power purchases or guaranteed fuel supply. The structure around awarding projects was flawed. New developers jumped in with aggressive bids while many of the experienced developers actually walked away. Because of aggressive bids and flawed government policies the industry is now in a mess, says White & Cases Nelivigi.

Indias still evolving environmental regulatory regime and land acquisition stumbles have also held up projects. Now a new Land Acquisition Act requires greater compensation for landowners whose property is required for infrastructure or industry, and project developers complain it will lead to increased project costs, though it promises to speed up a chaotic process.

Market observers say the market will continue to recover until consumers adopt a realistic view of the value of electricity. Politicians continue to capitalise on consumer sensitivity to power prices by announcing tariff cuts and subsidies for specific sectors, creating uncertainty around projects revenues. State governments in Delhi and Maharashtra recently announced power price cuts as pre-election sweeteners.

The current stalemate gripping Indias power sector is creating pressure for change. Projects are now approved more quickly and the government has worked hard to make permitting easier. Offtaker delinquency levels are lower. Developers know they need to bring more tightly structured transactions to market, not least power purchase agreements that allow owners to pass through any rise in fuel prices to consumers. The pressure to reform the industry will grow, argues White & Cases Nelivigi. Power regulation isnt easy anywhere and is always harder in growth markets like India. What the Indian market needs now is a comprehensive restructuring.

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