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Lights out for the power sector?

Its pre-pandemic crisis is likely to worsen with the prolonged lockdown unless the government offers some vital concessions

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When many Indians switched off their lights and lit lamps at Prime Minister Narendra Modi's request on April 5, the Indian power transmission sector was saved from any possible disruption by direct monitoring under Union Power Minister R K Singh. The long struggle to revive the Indian power sector, however, that started under this government through Ujjwal Discom Assurance Yojana (UDAY) debt restructuring scheme in 2015, is no way near ending.

Unlike steel, cement and even cars, the hope of pent-up demand from consumers does not apply. Units that could not be generated during the lockdown phase represent lost demand, since there is no inventory in power generation. After the lockdown, only a partial pick up in power demand can be expected since industrial units will initially start with low capacity and then ramp up to make up for production losses through extra shifts.

The pain point for power sector, however, is that unlike the petroleum sector it was largely a loss-making enterprise at the retailing end even before the Covid-19 crisis. A Confederation of Indian Industry (CII) quotes the UDAY website saying there is a shortfall of 40 paise a unit built into the revenue for every unit that is bought net of subsidy. In technical terms, this is called the Annual Revenue Requirement (ARR). "With the last reported annual subsidy level of ₹88,545 crore in 2017-18, there is an annual economic shortfall for the sector of ₹1.4 to 1.5 trillion if the subsidy is not given," says the CII paper.

The paper adds that there has been an improvement in distribution company (discom) losses and a marginal improvement in transmission or Aggregate Technical & Commercial (AT&C) losses and the gap between earnings calculated as ARR and average cost of supply (ACS), but discom debt has gone back to the pre-UDAY levels, and the dues to generators of ₹90,000 crore are also higher than pre-UDAY levels. Slower than expected demand growth had already led to 55-60 per cent plant load factor in the thermal sector, and 30-40 Gw of stressed assets. There is a 25-28 per cent reduction in demand now, compared to pre-lockdown levels, according to Power System Operation Corportion's data. "This can result in an even higher impact on DISCOM revenues, since the demand contraction is largely from industrial and commercial customers who pay higher tariffs. This coupled with delays in collections is expected to cause a cash shortfall of ₹30,000-40,000 crore for DISCOMs." With the lockdown being extended a further by two weeks, this gap could grow even larger. "This liquidity shortfall will likely worsen the challenging payment position in the sector," added the paper.

On March 28, the government allowed distribution companies to defer payments to generators for three months. This meant that while distribution companies get some reprieve during the crisis, generators suffering lower plant load factor face deferred payments. In CII's view, thermal generators could face an additional ₹20,000-25,000 crore cash crunch in addition to the already overdue amount of ₹90,000 crore.

The Association of Power Producers, the private generators' lobby, has also represented to the government seeking relief for gas-based generators. They want companies such as Petronet LNG Ltd and Shell, which sell imported gas, should not levy "use or pay" charges for lower utilisation of regasification facilities during 2020. They also want payment of regasification charges, without any interest or penalty should be extended by three months for all bills raised during the March 15-June 30, 2020 period. They have also petitioned to allow LNG to be stored for a longer period without extra charges and for incoming cargoes not to be denied on account of high inventories.

Though this is the best time for gas-based power generation since global natural gas prices are low, reduced demand from discoms has prevented them from leveraging this opportunity. In fact, the Union government's package for power sector has overlooked generators' concerns. "We believe that a more significant and structural intervention is required so that the sector is able to emerge viable and robust," says the CII paper. It points out the liquidity gap will transmit to other players in the value chain that include conventional and renewable generators, transmission licensees and vendors/service providers. Further, this will impact their ability to buy fuel, meet debt service obligations and ensure seamless operations.

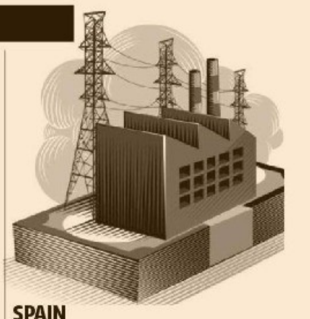
Outlining a roadmap for recovery in the sector, the paper has suggested minimising cash outflows by allowing deferral of payments of indirect taxes such as electricity duty and coal cess, and extending the debt-servicing moratorium to six months from three that Reserve Bank of India announced last month. Besides, Coal India could extend 30 to 45 days of credit to thermal plants for procurement.

The CII has also proposed overhauling the tariff structure with lower commercial and industrial tariffs, which could accelerate the recovery of economic activity in the Indian economy. It cited examples of 20 countries including Germany, Japan, the UK, Spain and the United States, and says only India has higher prices for industrial consumers compared with residential ones. Further, average tariff levels in India are higher than these peer countries. Taking this argument forward, it says the Central Electricity Regulatory Commission could consider supporting industrial demand revival by waiving the cross-subsidy surcharge. But this could mean that the states who have done well in rural electrification down to the household level would lack resources to strengthen transmission and distribution.

The paper itself admits that while a large section of the residential population may not be in a position to afford to pay full tariffs and suggests that an approach based on direct benefits transfer (DBT) can be adopted to ensure power affordability and access to electricity.

The road to recovery for Indian economy will be long and tough even if the national shutdown is lifted on May 4, but it will be particularly challenging for the power sector since private players have created generation capacity in both conventional and renewable sectors over the past decade, which now faces prospects of a complete shutdown.

EPIDEMIC EFFECT



CHINA

IMPACT: Power generation in Jan and Feb fell 8.2% year-on-year. Hubei was severely affected due to a shutdown in factories. The solar supply chain, however, saw only a limited impact due to previous oversupply of PV modules and fragmentation in the market. China's battery manufacturing capacity is expected to decline 10%.

Response: Most utilities ensured normal operations and sent special support teams to the most-affected regions such as Hubei. The State Grid Corporation of China plans to offer subsidies worth $7 billion to industry customers. Solar and wind equipment manufacturers have quickly returned to normal-level production levels.

ITALY

IMPACT: Power demand in Italy decreased 20% year-on-year from mid-Febr to March 23. Northern Italy was most affected, with large industrial players (Fiat Chrysler) shutting down production. This demand is likely to stay muted or decrease further in the short-run.

Response: Relatively healthier utilities reduced the shocks they suffered in the stock market. To reduce operational costs, the utilities have reduced customer-facing activities (retail sales) and non-critical tasks (training). Market regulator Consob implemented a three-month short-selling ban on the entire stock exchange list starting March 18.

SPAIN

Response: Utilities have enacted changes across commercial, personnel, operational and pricing policies. They have deferred bill payments to help SMEs and B2C clients with liquidity shortages, suspended service cuts to delinquent customers, lowered the contracted power of B2B clients free of charge. Most power, however, are running well below capacity. This may cause short- to mid-term disruptions in the supply chain of T&D operators.

Source: CII