In order to engage with our readers and simplify the legal complexities of the infrastructure sector, EPC World has partnered with Rajani Associates, a full-service law firm for a series of legal Q&As. Through this Legal Q&A column, **SHISHAM PRIYADARSHINI**, Partner, Rajani Associates and **AMISH SHROFF**, Principal Associate, Rajani Associates, will endeavour to address the queries and challenges faced by our readers.

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What is a Captive Generating Plant?

Captive generating plant means a power plant set up by any person to generate electricity primarily for its own use and includes the power plant set up by any co-operative society or association of persons for generating electricity primarily for use of members of such co- operative society or association. Simply put, a captive generating plant is a power generation facility used and managed by commercial energy users for their own energy consumption. Typically, such users are power intensive industries or large offices where continuity and quality of energy supply are crucial.

Such plants can operate off-grid or they can be connected to the electric grid to sell their surplus power, if any, to the Grid, on payment of remuneration as per the tariff, as per mutually agreed terms.

What is the statute which deals with setting-up of the captive power plant in India?

In India, the provisions in relation to generation of power through captive power plant are governed by the Electricity Act, 2003 (together with the rules prescribed under the Electricity Act). As per the Electricity Act, a person may construct, maintain or operate a captive generating plant subject to the provisions of the Electricity Act.

What are the advantages of a captive power plant?

Captive power plants have been growing at a fairly aggressive pace in India and studies show that it would be beneficial to encourage more captive growth in India. Having captive power plants has many advantages as the same can add the much needed capacity for quality power supply at competitive rate, ensures security of power supply, reduction in cost through high fuel efficiency and improved environmental conditions resulting from fuel efficiency.

Another significant advantage is that once the project is classified as captive power plant, the cross subsidy will not be applicable to power generated from it. Such protection to captive projects stems from the Electricity Act and an order of the Supreme Court.

Are there any recent significant developments in the Electricity Act?

The Ministry of Power (MOP) received a number of representations suggesting certain modifications in the provisions relating to captive generating plant in the Electricity Rules, 2005. Based on the suggestions received by the MOP, the draft amendments for the same were issued by the MOP through its notification dated October 6, 2016.

In terms of this notification, amongst other proposed changes, the amendment has been proposed in the term "ownership". The extent of shareholding the captive consumer has to maintain in the generating company is determined as per the provisions of this term.

What is the rationale behind proposing the amendments in the Electricity Rules?

In order for the plant to be considered as "captive power plant", the present provisions of the Electricity Act require the consuming entity or the entities to (i) consume at least 51% of the power generated and (ii) own at least 26% of the equity.

Currently, the ownership in relation to a generating station or power plant set up by a company (or any other body corporate) is defined to mean the equity share capital with voting rights.

Taking existing provisions into consideration, the generating companies devise several structures to qualify themselves as captive power plant under the Electricity Rules. Essentially, this is done by infusing huge capital in the generating company by subscribing to the preference shares of the generating company and not its equity shares. As far as equity shares is concerned a very small portion is being subscribed, more so, for the purpose of complying with the conditions of owning 26% of the equity capital (as required under the Electricity Act to be qualified as "captive"). In such cases, owning 26% of the equity capital will actually amount to a very miniscule portion in comparison with the overall capital base of the generating company. Even the face value of the equity shares subscribed by the consumers is kept very low while the promoters and investors are the owners of higher value shares.

The existing provisions also leave some scope to impose certain restrictions on the consumers as far as exercising their voting rights right, transfer of shares, or earning dividend by the consumers is concerned.

In order that the generating companies comply with the provisions of the rules in letter and in spirit, the proposed amendments have been proposed in the Electricity Rules.

How will the proposed amendments affect the generating companies and captive consumers?

In terms of the proposed change in the Electricity Rules, the entity consuming power is required to have ownership of 26% or more in the "paid-up equity share capital". Accordingly, the equity structures with different face value of shares will no longer be tenable as ownership will have to be 26% or more of the total value of equity capital. However, it appears that the structures where a large majority of the capital is brought by way of subscription of preference shares are likely to still qualify under the draft rules. This is because the draft rules refer to "equity capital" alone, not "preference capital", or "total paid up capital".

The scope of the ownership definition has also been widened to give clear rights to the consuming entity to transfer shares, exercise voting rights, share dividend and profits in the generating company.

The proposed change in the Electricity Rules will make group captive structures more difficult as it will require the consumer to invest significantly huge equity in the generating company.

Moreover, considering that the consumers will be entitled to all the rights as a shareholder in the generating company and the promoters (of the generating company) will not be able to put any restrictions on the consumers (which to some extent is possible now), even the promoters may be reluctant to enter into power supply agreement with few consumers.

The proposed changes in the Electricity Rules have not been notified by the Government.

Who are the partners in a public private partnership (PPP)?

At the face of it, the PPP arrangement is entered between a public partner and a private company.

The public partner is usually the central or state government body who is fundamentally responsible for land acquisition, consents and approvals, capital grant and other forms of financial support, revenue guarantee, tax incentives, and giving protection against reduction of tariffs or shortening of concession period.

The private partner is a company undertaking the project that signs the contract with the public partner. Depending upon the requirement for the project, the private company may also bring in separate companies to do the construction, the operation and the maintenance work of the project.

A typical PPP structure will thus involve contractual arrangements between a number of parties, including the government, project sponsor, project operator, financiers, suppliers, contractors, engineers, third parties (such as an escrow agent, utility provider), and customers. Additionally, oversight bodies (such as Kelkar committee), non-government organizations, community groups and other such bodies are mentioned as partners, however, these partners are usually not part of the core PPP contracts and arrangements.

What are the sources of project finance?

The project finance plays a crucial part in implementation of any project. While there are several sources of project finance, the main sources include equity, debt (including external commercial borrowings) and government grants. The other sources include grants from the dedicated funds set-up by the Government for the project, internally accrued cash reserves and supplier's credit.

Depending upon the sources of finance, the servicing of debt, repayment of funds, payment of dividend and assured returns to the investors will have to be done. As such, financing from a particular source has important implications for the project's overall cost. Also, the source of funds will have direct bearing on the available cash flow, ultimate liability on the project participants, and claims to project incomes and assets. EPC World