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Regulatory updates on captive generating plants and other amendments under the Electricity (Amendment) Rules, 2023

Section 176 of the Electricity Act, 2003 ("**Electricity Act**") has vested the Central Government with the power to make rules for carrying out the provisions of the Electricity Act. In exercise of said power, the Central Government had notified the Electricity Rules, 2005 ("**Electricity Rules**") on June 8, 2005, and subsequent amendments were made to the Electricity Rules on October 26, 2006, December 31, 2020 and December 29, 2022.

On June 30, 2023, the Central Government has notified additional amendments to the Electricity Rules ("**2023 Amendment**") which primarily impact: (a) the captive requirements under Rule 3 of the Electricity Rules, (b) the period of grant of license for transmission, distribution and trading, deemed licensing and renewal under Section 14 of the Electricity Act; and (c) clarify certain issues with respect to the implementation of uniform renewable energy tariff for central pool under Rule 19 and Schedule I of the Electricity Rules.¹

Requirements of a 'captive generating plant'

1. Rule 3 (1) (a) of the Electricity Rules originally stated that, to qualify as a 'captive generating plant': (a) not less than 26% of the ownership of the power plant should be held by the captive user(s); and (b) not less than 51% of the aggregate electricity generated by such plant (determined on an annual basis), must be consumed for captive use.
2. The 2023 Amendment has substituted Rule 3(1)(a)(i). The amendment substitutes the term 'captive user' instead of 'captive users'. This amendment is being interpreted to mean that each captive user, even in a group captive structure must hold a minimum of 26% ownership interest individually. This effectively means that there can be a maximum of 3 (three) captive users in a group captive structure. However, no analogous change has been made in the remaining part of Rule 3, which indicates that the substitution of 'captive user(s)' with 'captive user' seems to be an inadvertent error. We understand that clarifications from the Ministry of Power are awaited in this regard.
3. The proviso in Rule 3 (1)(a)(i) has been newly incorporated to provide, that in case of an affiliate company, the qualifying requirement for a captive generating plant is that 51% of the ownership must be held by the captive user in the affiliate company. The term 'affiliate company' is not defined under the Companies Act, 2013 ("**Companies Act**"), Electricity Act or the Electricity Rules. The amendment implies that if the captive user offtakes electricity from an affiliate company, the ownership requirement would be at least 51%. On a plain reading of Rule 3(1)(a) and the proviso thereto, introduction of the proviso may be defeating the intent of the main proviso in the absence of the definition of the term 'affiliate company' (as 26% shareholder may be considered as an affiliate

¹ By an amendment to the Electricity Rules in December 2022, uniform renewable energy tariff for central pool was introduced for renewable energy sources connected to interstate transmission systems. Uniform renewable energy tariff is expected to result in contract and tariff sanctity with State Discoms and promote development of the renewable energy sector.

depending on the contractual relationship between the parties). We understand that various stakeholders and associations have reached out to the Ministry of Power, seeking clarifications in this regard.

4. The definition of 'captive user' has been expanded in explanation (b) after Sub-rule (2), such that consumption of electricity by captive user may either be directly or indirectly, through energy storage system. Further, consumption by a subsidiary company (as defined in Section 2 (87) of the Companies Act) of a company which is an existing captive user, will also be considered as captive consumption by the captive user.

Period of license

The Central Government, *vide* the 2023 Amendment has supplemented Rule 4, to resolve the continuing issue around the period of licenses granted to licensees and deemed licensees under first, second and fifth proviso to Section 14 of the Electricity Act as follows:

1. Rule 4A - The term of a transmission, distribution or trading license granted to an entity under Section 14 of the Electricity Act, will be in accordance with the terms and conditions of the licence as granted by the appropriate commission;
2. Rule 4B - Deemed licensees (under first, second and fifth proviso to Section 14) have a 25 (twenty-five) year license period from the enforcement date of the Electricity Act²;
3. Rule 4C read along with the provisos - The licence granted by the appropriate commission under Section 14 of the Electricity Act and the deemed licence under first, second and fifth proviso to the said Section 14 will be deemed renewed unless revoked. Such renewal will also be for a period of 25 (twenty-five) years at a time (or for a lesser period, if requested by the licensee). However, if the appropriate commission has renewed the licence for a particular period before the notification of the 2023 Amendment, the licence will be deemed renewed for that particular period under the 2023 Amendment. Rule 4C excludes the 2023 Amendment application to the transmission developers license holders, selected through tariff-based bidding, under Section 63 of the Electricity Act.

Implementation of uniform renewable energy tariff for central pool

The Central Government had introduced uniform renewable energy tariff for central pool by amendments to the Electricity Rules in December 2022 and the introduction of Rule 19 and Schedule I. The 2023 Amendment has clarified certain ambiguities by amending Rule 19 and Schedule I, as below:

1. Rule 19(1)(a)(c) now requires intermediary procurer to pay carrying cost at State Bank of India marginal cost of funds-based lending rate for non-payment by due date. Previously, the proviso to Rule 19(1)(a)(c) required the implementing agency to pay such carrying cost on non-payment by the intermediary procurer by the due date;
2. Further, under Rule 19(A)(1)(ii)(m), the implementing agency is mandated to publish the relevant details including the monthly accounts statements, on its website (the words "provide public" which appeared as a typo is replaced with the word "publish");
3. Rule 19 (2) makes the uniform renewable energy tariff applicable only to 'end procurers', i.e., discoms for their contracted capacity which forms part of central pool and not to 'renewable energy generators'.
4. Schedule I (methodology for calculation of tariff for the month) is amended to provide that tariff will be calculated based on energy scheduled to end procurer from the central pool, instead of being calculated based on actual energy supplied.

² In *Noida Power Company Limited vs Uttar Pradesh Electricity Regulatory Commission*, Appeal No. 72 of 2021, decided on August 23, 2022, the APTEL has, on a co-joint reading of first proviso of Section 14 and 15 (8), calculated the deemed licensee's tenure of 25 (twenty five) years after lapse of 1 (one) year of the enforcement date of the Electricity Act.

Amendment to Schedule II of the Electricity Rules

Lastly, the 2023 Amendment has also amended Schedule II (fuel and power purchase adjustment methodology) in relation to Rule 14 (timely recovery of power purchase cost by distribution licensee). Clarifications have been provided in formula for computation of fuel and power purchase adjustment surcharge.

Analysis

1. As discussed above, the deletion of the letter 's' from the term 'captive user' in Rule 3 (1)(a)(i), appears to be inadvertent, as corresponding changes have not been carried out in 2nd Proviso to Rule 3(1)(a), 3(1)(b) and 3(2) of the Electricity Rules. The interpretation that there can only be 3 (three) captive users in a group captive plant is also not in consonance with Section 9 of the Electricity Act as well as the National Electricity Policy (issued under Section 3). In the absence of 'Statement of Objects and Reasons' and on a harmonious reading of Section 9 and the amended Rule 3, the term 'captive user' should be read as 'captive users' (in plural), such that all captive users are permitted to collectively hold 26% ownership in the captive generating plant. The said interpretation would not only be in line with the Electricity Act but would also make the other provisions under Rule 3 workable. The Hon'ble Supreme Court in *Chhattisgarh State Power Distribution Company Ltd. v. Chhattisgarh State Electricity Regulatory Commission & Anr.*³ has held that the intent of the Electricity Act is to promote establishment of captive generating plant, hence, liberal interpretation ought to be given. Otherwise, the Electricity Rules will have to be read as a whole to give meaning to it. Further, as per the General Clauses Act, 1897, in all central legislations unless there is anything repugnant in the subject or context, the words used in singular are to include plural and vice versa. Hence, it appears that the substitution of 'captive user(s)' with 'captive user' is an inadvertent error. We have discussed this issue on a no-name basis with certain renewable energy players who are active in the group captive sector, and they are also of the view that this appears to be an inadvertent change and that the Ministry of Power is expected to issue a clarification soon in this regard.
2. Since, the term "affiliate" or "affiliate company" is not defined in the Companies Act, Electricity Act or Electricity Rules, the requirement of a captive user to have at least 51% ownership interest in an "affiliate company" which is setting up the captive generating plant needs to be clarified. An "affiliate" with respect to an entity is understood to mean another entity that controls, is controlled by, or is under common control with such entity. The term "control" under the Companies Act is defined as "the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner." Control may also be defined to mean ownership of a certain threshold of shares. For example, in the Standard Case -1 PPA⁴ 'control' is defined as "ownership by one company of at least twenty six percent (26%) of the voting rights of the other company". Hence, there is a need to define "affiliate company" and clarify under what scenarios will a captive user be required to own 51% of the ownership interest in the captive generating plant. Additionally, typically the captive user does not have a board seat or management control in captive structures. With respect to an "affiliate company" where a captive user owns 51% ownership interest in the captive generating plant, it will have to be considered how board control and management rights should vest, vis-vis the captive user and the developer (since the captive user's investment and therefore risk exposure is much higher).
3. The express recognition of energy storage systems as an indirect means of consumption by the captive user is in consonance with the Government of India's vision on energy transition and encourages the use of energy storage solutions. Further, the requirement of 51% consumption by a captive user or its subsidiary company on an annual basis, is a welcome step. It will help in streamlining captive transactions for group companies at the flagship level, as opposed to having multiple captive arrangements for each subsidiary.

³ 2022 SCC OnLine SC 604, Para 23

⁴ https://powermin.gov.in/sites/default/files/uploads/standard_bidding_doc_PPA.pdf

4. Other amendments to the Electricity Rules, such as providing clarity on the duration of license of licensees and deemed licensees under Section 14 of the Electricity Act, changes in Rule 19 and Schedule 1 (implementation of uniform renewable energy tariff for central pool) and Schedule II (fuel and power purchase adjustment methodology) are primarily clarificatory and to remove interpretational ambiguities.

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