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The Supreme Court on Captive Power Plants – Recent Judicial Development

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Captive power generation in the Indian solar sector is, literally, a hotbed of policy and regulatory contradiction. While the Electricity Act, 2003 ("Act") incentivises captive power generation, losing lucrative industrial and commercial customers to captive power consumption is a deeply unpopular outcome for our financially beleaguered state power distribution and transmission companies which rely on high industrial tariffs paid by such customers. As a consequence, notwithstanding the statutory lure of financial incentives to captive power generators (such as non-discriminatory open access and the waiver of onerous cross subsidy surcharges) and the promise of uninterrupted captive power supply, the "captive status" of power producers is routinely subjected to scrutiny, denial of benefits and judicial challenge by (state owned) power distribution companies ("**Discoms**").

The Electricity Act read with the Electricity Rules, 2005 provide that in order for a power project to qualify as a captive generating plant, captive user(s) must maintain at least 26% of the ownership of the project (i.e., equity share capital with voting rights) and ensure that at least 51% of the aggregate electricity generated in such plant, determined on an annual basis, is consumed for captive use. However, the qualifying criteria above are a perennial subject of interpretative

contention between power producers and Discoms, often resulting in a 'cat and mouse' exercise in innovative "structuring" by captive users on the one hand and denial, by Discoms, of group captive status/open access/waiver of cross subsidy surcharge to power producers on the other.

Against this backdrop, a new judgment of Supreme Court on May 12, 2022 in Chhattisgarh State Power Distribution Company Ltd. vs. Chhattisgarh State Electricity Regulatory Commission & Anr. ("SC Judgment") serves as a welcome reprieve to captive power producers by reading down the test of proportionality prescribed for group captive plants set up by an 'association of persons' or "**AOP**".

The SC Judgment settles, with some finality, a longstanding contention by Discoms that for a captive user to avail of open access and wheeling through a public transmission network, the usage of power produced by the concerned off-takers should be directly proportional to the captive users' share of ownership of the plant, within a permissible variation of 10%. In the present case, Chhattisgarh State Power Distribution Company Ltd ("**CSPDCL**") relied on a proviso in the Electricity Rules mandating proportionality of offtake by an AOP, to contend that disproportionate offtake *inter-se* by group captive users would negate the plant's claim to captive status.

It may be noted that for a "captive" power plant, the Electricity Rules provides that "*not less than 26% of the ownership is held by the captive user(s), and not less than 51% of the aggregate electricity generated in such plant, determined on an annual basis, is consumed for the captive use*". However, the proviso to the foregoing Regulation states that if (multiple) off-taker(s) are an AOP, the aforesaid qualifying offtake requirement (i.e., a minimum of 51% of the total power produced) would apply in proportion to the captive users' respective shareholding/ownership of the power plant.

In the specific facts of the SC Judgment, 72% the power plant claiming captive status was owned by Shri Bajrang Power and Ispat Ltd. ("**SBPIL**") while its sister concern Shri Bajrang Metallics and Power Ltd. ("**SBMPL**") owned 27.6% of the plant. However, when it came to power consumption, SBPIL consumed just 14.16% of the power produced while SBMPL consumed 57.87%. CSPDPL argued that as the drawal of power was not proportionate to SBPIL and SBMPL's respective ownership of the power plant (as required by the Electricity Rules) the power plant did not qualify as "captive" and – accordingly - would not be entitled to open access or a waiver of cross subsidy surcharge for the transmission of the power produced.

Dismissing CSPDCL's appeal, the Supreme Court affirmed the paramountcy of the twin tests of minimum equity ownership (26%) and off-take (51%) for captive use ("**Twin Tests**"), reading down in the process the additional requirement of inter-se proportionality of usage and offtake between group captive users. In doing so, the SC Judgment settles a long pending bone of contention in captive projects involving multiple captive offtakers with disproportionate inter-se use, even while satisfying the Twin Tests above.

The Supreme Court's analysis was as follows:

"*20. Admittedly, SBMPL holds 27.6% equity shares in SBPIL. As such, the requirement of not less than 26% of shares is fulfilled by SBMPL…..Since SBMPL holds 27.6% of the ownership, the use of electricity by it would be for captive use under the provisions of the said Act. The other requirement would be that the consumption of SBIPL and SBMPL together should not be less than 51% of the power generated. Admittedly, the joint consumption by SBIPL and SBMPL is more than 51%. As such, both the conditions as provided under Rule 3 of the said Rules are satisfied*."

Curiously, while ascribing weightage to the Twin Tests, the SC Judgment skirts the issue of whether SBIPL and SBMPL are an AOP; or whether going forward the proviso in Regulation 3(1) mandating proportional power consumption by AOPs is a superfluous qualifying parameter in light of the 'higher' Twin Tests. On the contrary (and somewhat problematically) the Supreme Court concludes that SBIPL and SBMPL are, in fact, an 'association of persons'. If so, one could argue that a captive plant is bound by the additional test of proportionality in the Electricity Rules, failing which the plant would qualify as 'captive'.

The SC Judgment instead invokes the objects and purpose of the National Electricity Policy, 2005 of securing reliable, quality and cost effective power and facilitate creation of employment opportunities, to conclude that "…*the interpretation which advances the object and purpose of the Act, has to be preferred*."

Our view

By favouring the Twin Tests in preference to the test of proportionality of use, the SC Judgment appears to have erased the distinction between captive power plants established by an AOP versus those established other than by AOP. The concluding implication of the SC Judgment seems to be that as long as the Twin Tests are satisfied, multiple captive users are not bound to adhere to consumption that is proportionate to their shareholding considering the object and purpose of the Act to facilitate captive power plants.

Despite its flawed reasoning to brush proportionality of use aside, the SC Judgment is a welcome change for embattled captive power plants, providing much-needed respite for group captive projects involving multiple captive offtakers. However, despite the ostensible clarification offered by the SC, for abundant clarity it is advisable that project developers and off-takers should:

- clearly identify and delineate the entity that is designated as 'captive user(s)', in contradistinction to the entity that is the 'project developer';

- specifically mention that the off-taker and developer have distinct commercial roles and do not constitute an AOP with common purpose (even if the developer is an incidental consumer of power from the captive plant, as in SBPIL's case)

Separating, in clear contractual terms, the 'project developer' from the 'captive offtaker(s)' would prevent future confusion and the unwarranted disallowance of captive status and benefits by Discoms through perverse arguments on qualification, entitlement and use.
