

# Comments on

## “Proposed Modification in the Methodology for Calculating Escalation Indices for Use in Tariff Based Competitive Bidding”

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1. The objective of escalation rates is to compensate the generators/transmission companies for compensating against increase in various cost components. The choice of any escalation methodology depends on the way the escalation rates would be applied. The process of ‘deriving’ the escalation rate should be symmetric to the way it is to be applied. The geometric mean is always less than the arithmetic mean.
2. In case of a change in the way escalation rates are computed, the potential suppliers / investors would use the similar methodology and bid rates so as to ensure that they get similar rates of return as in the case of a previous escalation methodology. Theoretically speaking, a bidder would raise for the base rate for the escalable component in case the applicable escalation rate would be lower to compensate for the loss associated with change in escalation rate. The bidder would essentially reverse engineer the bids to be quoted based on the escalation rate applicable. Hence, it is important that the methodology/basis for deriving the escalation rates be specified so that bidders can take informed decisions accordingly.
3. We can note the following from Clause 5.6 (iv) of the Guidelines for competitive Bidding

“The index to be adopted for escalation of the escalable component shall be specified in the RFP. For the purpose of bid evaluation, median escalation rate of the relevant fuel index in the international market for the last 30 years for coal and 15 years for gas / LNG (as per CERC’s notification in (vi) below) shall be used for escalating the energy charge quoted by the bidder.”

The escalation rate for the purpose of bid evaluation would have less impact on the bids as the investors would make appropriate adjustment in the bid values. However, the choice of escalation rate for ‘payment’ purposes needs to be simple and realistic. This means that the investor/generator should be adequately compensated for change in prices. Any method which artificially/statistically reduces the ‘actual escalation’ realized in the recent past (for e.g. choosing geometric mean instead of arithmetic mean) would be inadequately compensating against change in prices/underlying indices.

4. The rationale for combining hybrid series is justifiable and be implemented. However, the following may be noted in terms of choice of indices.

Rate of inflation for indexed energy charge in case of captive fuel sources should be reviewed. It is expected that ‘captive fuel’ in most cases would be coal rather than petroleum products like HSD, In this context, appropriate weightage should be included for domestic coal and that HSD be replaced with heavy fuels (and its weight should also be reduced). Role

of CPI is also limited in the case of 'energy charges' and hence its weight should also be reduced. A suggested in this regard is tabulated below.

	Existing	Proposed (a scenario)
CPI	20	10
WPI	10	10
WPI for coal	0	25
WPI for HSD oil	25	15 (for Heavy Oil)
WPI for matches explosives and other chemicals	10	10
WPI for tyres	10	10
WPI for heavy machinery and parts	25	20

5. A change in the basis for escalation rate for transmission charges should consider the applicable basis for charging for transmission services. In case transmission charges are applied on per MWh basis, provision of escalation rate in per MW of connected load would require additional inputs. This would be especially be applicable in case transmission pricing for intra-state transmission network, which continues to be per MWh basis and where there is a need to apply escalation rate as well.