The most fundamental problem facing the IPP policy remains the financial weakness of the SEBs, and their doubtful ability to honour their PPA commitments. Unwilling to provide more counter-guarantees, the Central Government has suggested alternative forms of investor security, which include allowing generating companies to sell directly to the Powergrid Corporation, distribute to and collect directly from credit-worthy industrial users (in effect, "cherry-picking" among the SEB's customers), or establish various types of priority-claim escrow accounts, into which the SEB would make deposits. The World Bank is also prepared to provide limited guarantees for private investors where the SEB in question is undertaking suitable reforms.

Box 2.3: The Dabhol/Enron Project

The recent controversy over the Enron project at Dabhol, in Maharashtra State – the largest-ever foreign private investment in India – has threatened to derail India's drive to attract private power developers.

Dabhol, the first (and so far the only) IPP to begin construction, has been in the spotlight since the unsolicited proposal was first made in 1992. Enron Corp. of Houston, Texas, with an 80 per cent stake, together with GE Capital (10per cent) and Bechtel (10 per cent), proposed to build a two-stage 2,015 MW, US$ 2.8 billion plant to be fuelled initially by distillate and later by gas. Financing was provided through equity, Indian and off-shore bank loans, US Eximbank and OPIC. There was no Indian partner, nor were any of the multilateral financial institutions involved.

When the State government of Maharashtra changed after elections early this year, the incoming Shiv Sena-BJP coalition set out to review the Power Purchase Agreement (PPA) contract signed by the previous Congress government, for "irregularities". In July, the new Chief Minister, Mr Joshi, announced suspension of Stage I and cancellation of Stage II. His stated objections to the project were essentially that:

- It was a negotiated deal, concluded "in secret" without competitive bidding or public scrutiny.
- The capital costs used to calculate the tariff to the SEB were inflated, and Maharashtra was going to pay too much for the power.

In addition there was opposition from environmental groups — although the project had been through two environmental clearances — and from nationalists who objected to the proposed import of LNG from the Mid-East.

After months of negotiation and legal manoeuvring, Enron and Maharashtra in late November announced that they had reached a settlement which entailed sharply reduced capital costs and a lower price for electricity, thus clearing the way for work to resume.

Meanwhile, there was wide speculation that the "Enron fiasco" would frighten off other IPP promoters, and cause lenders to exact a higher country-risk premium for India. With the announced settlement, major Western industry sources now feel that the damage to India's reputation can be repaired, and suggest that IPP promoters can draw valuable lessons from the Dabhol case.