COMMENTS
ON
CONSULTATIVE PAPER
ON
LONG TERM TARIFF PRINCIPLES
FROM
PEOPLE'S MONITORING GROUP ON ELECTRICITY REGULATION

A public discussion and debate to lay down the strategy to evolve long term tariff is to be welcomed. But the question is how far the present document released by the Commission serves the purpose of improving the situation in the state on the power sector front. How far this strategy is in line with the sustainability of the sector and its social goals? According to the Public Notice issued by the Commission on 22nd February, 2002 the comprehensive long term tariff regulations are intended

- To bring in efficiency in Licensees' operation
- To benefit the consumers in terms of quality of supply and prices, and
- To ensure financial viability of the Licensees

A perusal of the Consultative Paper shows that it is the last point which is the major, in fact the only concern of the Commission. It is doubtful whether the first two objectives will be automatically achieved by ensuring the last one. Long Term Tariff Principles (here after LTTP) is flawed because of its urban, industry, privatisation bias and the weak assumptions

Neglect of Power Purchase Costs

Even more importantly this long-term exercise does not include the transmission or bulk supply issues and takes them as pass through even while mentioning that nearly 70% of the costs are claimed by this. Without addressing this it is very difficult to visualise that second of the above issues will be effectively addressed. To this extent this exercise appears to be incomplete and hence doubtful whether it will achieve its aims. There is need for a comprehensive strategy to combine both bulk and retail supply.

Weak Assumptions

There are many hidden assumptions which are at work in an integrated utility or when all players are under government ownership. These cannot be taken for granted when the sector is privatised. Privatisation has started in the generation area and is going to be taken up in distribution soon. Many assumptions on which the Consultative Paper is based are on weak foundations.

a) Private investors will follow the rules in letter and spirit.
b) Actors in the sector will do fair business while maximising their profits. Benefit of this will go uniformly to all consumers.
c) Each actor will keep the long-term interest of the power sector in mind and cooperate with others to meet this.
d) Accountability and Transparency of private utilities will be as good or better than state owned utilities.
e) Volume of energy sale is beyond the control of DISCOM
f) Financial incentive ONLY will work. Tariff/market signals will set the house in order

g) ERC is strong and independent

Given the prevailing conditions in the state as well as the country it is very difficult to believe that any of the above assumptions are valid. Private investors are interested more in making a fast buck rather than follow the rules of the game. And they are ready and capable of bending the rules of the game in their favour. In the present policy milieu of liberalisation where making money anyhow is a virtue this should be much easier.

A large part of the present Consultative Paper is concerned about the unpredictability of the outcomes and goes out to provide cushioning to the private investors. Given the present technology and other instruments and mechanisms at the disposal of the investors most of the outcomes are predictable and hence capable of being dealt with alternatives. It is the consumers, particularly domestic and agricultural consumers scattered all over the place, who end up suffering from uncertainties and unpredictable outcomes. In stead of grappling with this the Paper talks about doing away with subsidies and cross subsidies placing these consumers at greater risk.

Last three years experience shows that ERC is amenable to the control of the state government.

The LTTP is also based on the assumption that information provided by the private companies is reliable. It has implicit faith in the private operators that they will provide correct data based on which major decisions would be taken. It suggests that while arriving at the costs of distribution the information provided by the Licensee would be accepted and returns/incentives/disincentives will be calculated on the basis of this information. Hitherto experience in AP itself shows that the information provided by the private companies is highly unreliable.

In this context the following passage from the LTTP appears to be very educative: " Given the flexibility, it is possible that licensees will spend less, on capital works and maintenance than that approved. But this should not cause concern, as long as the corresponding physical achievements such as, new sub-stations commissioned, transformation capacity added, new network expanded, meters installed, new customer services and quality initiatives undertaken, etc are fully satisfied" (para: 3.6). This naturally leads to many questions such as: who will decide the capital costs for the "corresponding physical achievements"? Who approves them? On what basis these costs are decided and approved? If these "corresponding physical achievements" can be fully satisfied with less than the approved capital costs why approve higher capital costs? Which figure will enter the accounts to arrive at the cost to serve: approved capital costs or actual expenditure? Will there be any review of this discrepancy at any level, at any stage, by whom so ever concerned? Whether the information related to such things is accessible to the public?

Welcome to the Private Investors

According to the World Bank's Project Appraisal Document on Andhra Pradesh Power Sector Reforms Programme at least one Distribution Company need to be privatised by the end of 2002-03. This exercise is aimed at this but not any other ostensibly claimed aim.

The Consultative Paper is mostly concerned in providing comforts to the future Licensees from the private sector. In other words it tries to address the concerns of the future investors who need to be attracted to invest rather than the consumers who are ultimately going to pay the bill. In the name of providing predictability to their incomes, in the name of minimising the risk and in the name of providing freedom this Paper sought to create the conditions conducive to the operation of the private investors.

This paper also gives the impression that it is Industry/urban oriented. The emphasis on quality of supply as opposed to outreach of supply makes more sense to urban or industrial consumers rather than other sections of the population for whom the electricity is still inaccessible. While the importance of quality of supply cannot be denied, it should not be used as a pretext to make it inaccessible to nearly half of the population in the state. It is to be noted that quality of power supply could be improved within the existing conditions through motivational measures. Financial signals alone will not work.

Some of the comforts sought to be provided to the future Licensees is based on the argument that the conditions are not under control. This is far from truth. Given the knowledge and understanding of the sector it should be possible to visualise the emerging situation and evolve strategies to cope with them. But they are in no way beyond control.

The overriding concern of the Consultative Paper is to see that the Licensee should not collapse. This attempts to provide a shock reduction methodology.

Usually it is argued that the private investors are rewarded for their risk taking. But once such an elaborate mechanism is put in place one wonders what are the risks for IPPs and Private DISCOMs in this field? Should they be rewarded even in the absence of risks also?

This Consultative Paper evinces keenness to finalise a long-term contract on tariff, which will re-assure private investors interested in DISCOMs and minimise their risk burden. The LTTP is being formulated as a shield against regulatory risk. In turn these regulations may shift risks to the poor consumers and state utilities/government from the investors. If all these care/ correction factors are taken in to account, what is the risk taken by the Licensee?

Against Consumers

These regulations are loaded against consumers. Providing predictability to the licensee’s income and other comforts provided to them may add to the costs of power supply, which in fact may not be needed.

The concerns of the consumers do not attract the same attention. Consumers are assumed to get benefit automatically from this as this paper assumes that efficiency of the Licensees will improve consequent to the implementation of these regulations. We are told that quality of power supply will automatically improve with the private sector entry and protection of its interests. It appears to be another kind of trickle down theory!

Further, given the over all direction of the present reform programme in “rationalising” tariff while industrial and commercial consumers are rewarded with declining tariff other sectors, particularly domestic and agriculture sectors may have to face increasing burden. Given the present political situation where the powers that be hesitate to hurt the agriculture sector, it will be the domestic consumers who may have to bear the burden of the reforms.

If risk is there it will be borne by the under privileged, domestic and agriculture consumers. In the logic of the programme it is they who need to be given comforts! What about the regulatory risk faced by the consumers?

The Consultative Paper is based on the assumption that efficiency will automatically improve if these regulations are followed. This may not hold true. In fact the cost plus principle which is embedded in this paper may not provide any incentive for improving efficiency. This is borne out by our experience with PPAs, which are based on similar cost plus principle. It only added to the burden of the consumers and the state government. The IPPs armed with PPAs are holding the state to ransom with cost plus principle. The application of similar principle to transmission and distribution shows that apprehensions about impending burden of increased tariffs are very much real.

Inadequacy of the Financial Signals

The LTTP signifies change in the framework according to which the sector is functioning. It is the financials that matters. This sets aside other factors that will improve efficiency in the sector at little or no cost to the public. Motivational factor can be described as one such factor. It need not be financial all the time. Market signals/tariff signals alone can not work in addressing the crisis facing the sector. The mounting commercial losses, which are a major drain on the finances of the sector, can not be dealt with financial signals but only by changing the overall atmosphere in the sector. There is vast scope to improve the revenues of the licensees through improving efficiency and reducing T&D losses without imposing higher tariff on the consumers.

Subsidies and Cross Subsidies

One of the important elements of this LTTP is to remove subsidies and cross subsidies. Cross subsidy is being projected as one of the biggest risks faced by the private investors and the LTTP wants to do away with them. This amounts to absolving the consumers who have capacity to pay (Industry, Commercial) from holding the long-term interest of the sector.

Subsidy is because of the inefficiencies in the system, not just because of the support given to the particular/agriculture sector. Solution to this subsidy burden is in improving efficiency rather than in hiking tariff gradually or suddenly! It was argued that because of unmetered power supply farmers are using power indiscriminately. But the ground situation proves this to be wrong. Farmers are not given power round the clock but only for 9 hours in a day. Even during this 9 hours quality of power supply is so uneven that average hours of pump operation will be half of this time. To this one has to add the declining ground water table. If we take all this into account the subsidy amount going to the agriculture sector will be far less than what we are told. But showing agriculture sector as a scarecrow all subsidies are sought to be removed.

The way subsidies and cross subsidies are treated in the Consultative Paper gives rise to an impression that social issues related to the supply of power are being set aside. This will lead to deprivation of increasing number of people as in the present conditions only about half of the population has direct or indirect access to power. The prevailing situation calls for a societal response but the Consultative Paper largely confines it self to financial signals only. This will have far reaching impact on the society.

Rationalisation is an important theme in the LTTP as well as the reform programme as a whole. Rationalisation means reducing cross subsidies and subsidies and see that tariff reflects cost to serve and full costs are recovered from all the consumers irrespective of their capacity to pay. In the recent public hearings on tariff for the year 2002-03 the legal consultant representing APTRANSCO explained as to how rationalisation of tariff is taking place and cross subsidy is being reduced. But this rationalisation does not include correcting irrational input costs. The inflated, fictitious costs of the licensees' along with power purchase costs are treated as pass through. These costs will be recovered through "rationalised" tariff reflecting cost to serve.

Scary Cash Flows

According the Reform Act it self in the state similar tariff will be charged from similarly placed consumers. But this will become one of the casualties if the proposed LTTP is accepted. At present BST charged to different DISCOMs is different in order to take into account variation in consumer mix and also different subsidy amounts channeled to them. In the changed circumstances the BST will be different from the present one and it will have serious implications for regional development and also cash flow between different licensees and power generators. And escrow accounts will have little meaning. The Orissa example shows the dangers involved in handing over the distribution networks to the private sector. While it would be easy to deal with if they are public sector units, it will become an intractable problem if private investors appear on the scene.

This also brings into question the basis on which the state is divided into four DISCOMs. An important issue related to this is, on what basis assets and liabilities of the erstwhile APSEB are distributed among the unbundled elements. This distribution of assets and liabilities has serious implications to the health of the sector. Major proportion of the liabilities is transferred to APGENCO. As a result of this cost of power generation from APGENCO increased more than any other source though it has achieved higher PLF. Whether merit order is followed or pure market operations take place APGENCO will be at the receiving end. The ARR for the year 2002-03 has proved that this is a reality, not just an estimate based on guesses. As the power purchase costs are treated as pass through such irrationalities are swept under the carpet. Thanks to LTTP this will not come out.

Role of the Government

The Consultative Paper is silent on the role of the state government. One of factors for the collapse of the power sector in Orissa is the absence of government support to the distribution companies. What would be the implication if in AP also the government disappears from the scene with the transfer of DISCOMs to the private sector?

Increasing Rigidity

The LTTP sought to clear the ground for the private investors to easily visualise the conditions for the next 5 to 7 years. While this may be attractive to the investors, for the sector as such it may prove to be costly. It may lead to rigidity and loss of its maneuverability. The flexibility that is available with present annual exercise of ARR and FPT will be lost. Even though the annual review exercise continues it will loose its importance. As the rules for the long term tariff is already set the importance bestowed on the annual exercise of tariff formulation will decline. Whatever elbowroom available at present to deal with the emerging situation will be lost. This only shows the readiness of the ERC to sacrifice the flexibility in retail tariff fixation

This readiness on the part of ERC may adversely affect its ability to regulate the sector. As its stance is tied up for 5 to 7 years any attempt to correct the course may prove to be difficult. This attempt to protect the investors from regulatory risk will only result in weakening the regulatory authority itself. This may lead to ERC's inability to address the concerns of the consumers, as the Licensees would be given protection and freedom to the detriment of the interests of the consumers.

Setting of tariff for long periods also calls in to question the role of the regulator in the sector. Regulators may end up as personages detached from the daily happening and concerned about the long term and that too only within the rules of the game. The regulators will no more be a proactive institution concerned about the efficient and economical functioning of the sector. For the LTTP is based on the assumption that efficiency will automatically improve with the predictability of income and freedom provided to the investors.

Sabotage prone

This process is also prone to sabotage. As the information availability is based on the implicit faith reposed in the private investors and accepting the figures given by them without any questioning the public scrutiny of the expenditure is done away with. With the division of the whole exercise into long term tariff and annual appraisal the investors will dodge the supply of information saying that relevant information will be made available during the other exercise. The Orissa experience (CESCO) also shows us that the private investors would not reveal their profits, and in fact profits will appear as losses. If the regulators do not scrutinise accounts/expenditures of the licensees the only other source will be auditors' reports. It will take time before auditors' report is out. Still it may not be a public document. Even if it is made public it may not be paid any attention while taking decisions. Example for this is the Spectrum electricity unit. Though the auditors' report containing irregularities in its operation is out long time back it is not taken into account at any stage, making a mockery of the whole exercise. This points to the possibility that the whole exercise of public hearings will become meaningless.

Need to Reexamine the Basis of LTTP

The basic question that surfaces with LTTP is: How far LTTP is a solution to the present crisis? An examination of the Consultative Paper shows that instead of mitigating it is going to exacerbate the crisis further. It is needless to mention that this LTTP is a prelude to privatisation of DISCOMs. To facilitate this Paper also mulls over how best to circumvent the time tested Sixth Schedule. It holds that privatisation is the only solution to the crisis in the power sector and goes out of the way to provide more and more incentives to the private investors. In support of this the Paper mentions the experiences in UK and Argentina as examples of success of LTTP in reducing losses, increasing power reliability. But actual experiences within the country as well as outside, including UK and Argentina, show that these reforms pose unmitigated disaster to the consumers, particularly the underprivileged. This LTTP also upholds the discrimination. While concessions to private sector are termed as incentives, concessions to the public sector units are termed as drain on the government's resources, and concessions to the farmers are termed as subsidies. It is to be categorically stated that the set of reforms that the Commission intends to usher in through LTTP needs to be rejected.

Before the Commission takes a decision on the LTTP either way it will be in the fitness of things if the last three years is treated as a control period and the Commission comes out with a status paper to examine the hitherto experience in AP and facilitate public discussion on the same.

We also take this opportunity to place a few suggestions before the Commission:

a) RC to keep long term viability of the sector in mind, not just profits of the investors. Risk implies not only profits but losses also. In the name of ensuring profits to the private investors the interests of the sector should not be sacrificed.
b) RC should keep maximum elbow room for corrective actions during this formative stage. Do not surrender control by such hasty contracts
c) Quantifying performance indices makes sense. Policy on incentivising them can wait.

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