

## **KARNATAKA ELECTRICITY REGULATORY COMMISSION BANGALORE**

### **Comments on the Draft National Tariff Policy Issued by the Gol on 16.03.2005**

**The Gol has issued a draft National Tariff Policy on 16<sup>th</sup> March 2005 requesting comments from the State Governments and the state Regulatory Commissions. As per the Electricity Act 2003, the state Commissions are guided by the National Electricity Policy and Tariff Policy. Hence, the tariff Policy issued by the Gol shall act as guidelines for the state Commissions in specifying terms and conditions and shall not be in the nature of mandatory guidelines. The norms proposed in the tariff policy shall be specified as minimum norms and State Commissions shall be free to determine the terms and conditions of tariff keeping in view the tariff policy.**

Subject to the above, KERC hereby furnishes its comments on the Tariff Policy:

**5.3** It is stated that the tariff policy lays down framework for performance based cost of service regulation in respect of aspects common to generation, transmission and distribution. It is further stated under section 5.3(a) that ROE for generation and transmission projects notified by CERC shall be followed by SERCs also and the same shall be followed for distribution also by SERC. Similar provisions have been made in the draft policy under depreciation (5.3(c)), Operating norms for generation and transmission (5.3(f)) etc. KERC reiterates here that the Tariff policy as well as the norms notified by CERC shall be only a guideline to the State Commission as specified under section 61 of the Act and shall not be mandatorily binding on the State Commission. The State Commissions shall be at liberty to determine their own terms and conditions of tariff as specified under section 61 of the Act, as otherwise, such provisions in the policy would be against the spirit of the Act.

**5.3(f):** It is stated in the draft policy that Suitable performance norms of operation together with incentives and dis-incentives would need to be evolved along with appropriate arrangement for sharing the gains of efficient operations with the consumers and further that the operating parameters in tariffs should be at normative levels only and not at 'lower of normative and actuals'. When the intention is to share the gains of efficient operations with the consumers, KERC is of the view that the parameters in tariffs should be 'lower of normative and actual' and further that 'the norms notified should be considered as ceiling norms and this shall not preclude the parties from agreeing to accept improved norms'. Further improvement in norms can also be brought about if better quality fuel is used and higher steam parameters are adopted for thermal generation. Consequently, benefits accruing out of improved performance should be shared with the consumers.

**5.3(h) Multi-Year Tariff (2):** It is stated in the draft policy that the revenue allowance and the improvement trajectories should be recognised at "actual" levels and not the desired levels. While it is agreed that the actual levels be

considered, such “actual” levels be derived after careful evaluation to exclude deliberate padding of inefficiencies under the actuals. It may perhaps be incorrect to simply adopt the information provided by the utilities as actuals without validation. KERC also opines that for achieving the desired performance levels, a timeframe needs to be prescribed under the MYT regime

**6. Generation:** The Policy is silent about the procurement of fuel. Procurement of fuel in case of thermal stations is one of the most important aspects, which needs to be monitored by the Commissions in view of the recurring nature of expenditure through out the life of the project. KERC is of the view that generating companies shall obtain process approvals from the Commissions for procurement of fuel.

6.2 Procurement of power: In the case of intra-state ABT, it shall be the State Commissions which will introduce differential rates of fixed charges for peak and off-peak hours instead of the Central Commission.

**6.4 (2) NCE Sources of Energy:** It is stated that procurement of NCE power by the distribution companies shall be done through competitive bidding process within suppliers offering energy from NCE sources. KERC opines that as the cost of energy from NCE sources is higher compared to that of the conventional sources and also there is wide variation in the tariff between various sources like wind, mini-hydro etc., the procurement by bidding process may not promote NCE sources as envisaged in the Act. Hence, for the present, the tariff for NCE sources should be as determined by the State Commissions under section 62 of the Act.

**7.1 (7) Transmission Pricing:** It is proposed that metering should be ABT and TOD compliant. KERC opines that a definite time frame has to be prescribed for replacing existing meters in the system by ABT compliant meters.

**8.1(4)** It is stated that the licensees may have the flexibility of charging lower tariffs than approved by the State commission if competitive conditions require so. This shall be limited to proviso under section 62 of the Act.

**8.1(8) Suo motu initiations on tariff fixing:** The Commission notes that the ARR and the tariff filings are not being made by the state owned licensees in time since the state governments do not permit them for tariff revision. Therefore if the tariff is determined by the Commission under suo motu proceedings, it may not be implemented at all by the licensees. In such a situation , what is the remedy available to the Commission would be a big question. Although penalties may be levied on the licensees under the Act for non-implementation of the Commission's order, that itself would not provide the required remedy besides inviting severe criticism from the consumers. Therefore the Commissions may not be in a position to enforce tariff increases under suo motu proceedings. Hence KERC does not agree with the proposal to determine tariff under suo motu proceedings since the same is not practicable. It is suggested that it shall be included in the Policy that ' in case the ERC and tariff filings are not made by the

licensees in time, any revenue gap for such period shall be borne by the respective licensees'.

**8.2.1(1) Framework for revenue allowances:** It is stated that the practice of restricting the power purchase costs on the basis of normative T & D loss should be discontinued. KERC does not agree to this proposal for the reason that the power purchase costs account for 70 to 80% of the total ARR, which needs to be regulated. If normative loss levels are not adopted for fixing the tariff, there would be no initiative on the part of licensees to reduce the T & D Losses. As a result, the entire burden of inefficiencies/ leakages would be passed on to the consumers. This is against the very objective of the EA2003 to protect the interest of consumers and to promote efficiency and economy in the sector. It is therefore necessary that the normative level of losses is adopted for estimating the power purchase requirement for tariff purposes.

**8.2.1(3) Payment of subsidy by the Government:** It is stated that if the utility could not charge the applicable tariff and any uncovered gap on account of unpaid subsidy remains at the end of the year, the same would be added in the annual revenue requirement of next year for the purpose of tariff determination. The KERC does not agree with this proposal, as the governments may not release the subsidy if such a policy is in vogue. KERC is of the view that the State Commission should determine the tariff initially, without considering the subsidy commitment from the government and subsidised tariff shall be arrived at thereafter considering subsidy allocation by the government for the respective categories of consumers. In case the government defaults in payment of the committed subsidy the licensees shall be at liberty to charge the normal tariff determined by the commission. Similarly where the state government requires grant of any subsidy to any consumer after the tariffs are determined the Commission, the state government shall pay in advance in such manner as may be specified by the Commission, the amount to compensate the person affected by the subsidy as provided under section 65 of the Act. which would completely defeat section 65 of the Act. In case the unpaid subsidy is added in the subsequent ARR as proposed in the draft policy it would burden the paying consumers and would hamper the consumers' interest, which is against the provisions of the Act.

**8.2.1(4) Bad Debts:** While the KERC agrees with the proposal on bad debts, the amount of bad debts shall be based on the norms to be developed by benchmarking.

**8.2.1(5) Pass through of profit & losses:** It is proposed to allow pass through of profits and losses due to uncontrollable factors. As per section 62(4) of EA 2003, no tariff or any part of any tariff may ordinarily be amended more frequently than once in any financial year, except in respect of any charges expressly permitted under the terms of any fuel surcharge formula. KERC opines that the proposal to allow all costs beyond the control of the utility is not in tune with the provisions of the Act. KERC is of the view that under the above provision, difference in the power purchase cost both on account of change in power

purchase mix and change in the variable cost can be adjusted through fuel surcharge formula and such pass through should be linked to efficiency parameters. Other uncontrollable expenses should be included by the licensees in the subsequent tariff filings as otherwise there is scope to include every other expenditure as uncontrollable and the debate whether an item of expenditure is controllable or uncontrollable would continue. In the opinion of KERC, all variation in the power purchase cost both on account of change in mix and change in variable expenses only should be a pass through under the fuel surcharge formula.

**8.2.2 Regulatory Asset:** As stated earlier, KERC is of the view that any revenue gap on account of failure to make ERC and tariff filings in time by the licensees shall be borne by the respective licensees / State Governments and shall not be passed on to the consumers.

### **8.3. Tariff Design:**

**8.3.2.** It is stated that by the end of year 2010-11 the tariffs are within plus or minus 20% of the average cost of supply. In Karnataka average cost of supply is fully covered in Tariff Order 2003 for all categories of consumers other than BJ/KJ and IP sets. KERC opines that instead of average cost of supply we should move towards 'cost to serve". A provision in the policy stating that the State Govts should provide subsidy fully for power supply to subsidised categories (BJ/KJ and IP sets) based on cost to serve by 2011-2012 may facilitate rationalisation of tariff for these categories. This will also go a long way in reducing the cross subsidies to other categories of consumers as mandated in the Act.

**8.3.3** It is stated that a higher level of subsidy could be considered to support poorer farmers of the region where adverse ground water table requires larger quantity of electricity for irrigation. KERC notes that providing higher subsidy to farmers in such region would promote further depletion of the ground water and would cause adverse impacts on cropping pattern, health of the people and on the ecological balance. Instead, other alternatives such as scientific farming, change of cropping pattern etc should be encouraged in such areas. A holistic approach on power supply and water supply for irrigation purposes with involvement of all the concerned Agencies would go a long way.

8.4. Definition of tariff components and their applicability. Under para 8.4(2), it is indicated that the existing PPAs with generating companies would need to be suitably assigned to the distribution companies. That means, the other alternative models of market design are being ruled out. Infact, KERC has brought out a discussion paper on the design of the Trading activity in the State under which 4 alternative models have been discussed, one of which is assigning the PPAs to the distribution licensees. Therefore, the design of the trading activity shall be left to the appropriate Governments in the policy instead specifying a specific model.

## **8.5 Cross subsidy surcharge:**

It is stated that the amount of cross subsidy surcharge & the additional surcharge to be levied from consumers who are permitted open access, should not be so onerous that it eliminates competition which is intended to be fostered in generation and supply of power directly to the Consumers through open access. Further, when open access is allowed, the surcharge would be computed as the difference between i) the tariff applicable to the relevant category of consumers and ii) the cost of the distribution licensee to supply electricity to the consumers of the applicable class. In case of a consumer opting for open access, the distribution licensee would be in a position to discontinue purchase of power at the margin in the merit order. Accordingly, the CoS to consumer for this purpose may be computed as the aggregate of a) weighted average of power purchase cost (inclusive of fixed and variable cost) of top 5% power at the margin in the merit order approved by SERC adjusted for average loss compensation of the relevant voltage level and b) the distribution charges determined on the principles as laid down for intra state transmission charges.

Since Karnataka State has been under continuous power shortage situation, it is not likely that the state would discontinue purchase of power at the margin for the present in the merit order as and when open access is implemented. Further, if the methodology indicated in the draft Tariff policy for determination of surcharge is applied to Karnataka, the surcharge for HT category of consumers would be negative. Hence it would not be appropriate to adopt this methodology for computation of surcharge in Karnataka and similarly placed states. As such the computation of cross subsidy should be based on cost to serve with a definite time frame for reduction and elimination of cross subsidies. The cross subsidy surcharge could be a percentage of the full cross subsidy (80 to 90%) so as to encourage open access instead of charging 100% cross subsidy.

\*\*\*\*\*