

Remarks on the DRAFT Electricity (Amendment) Act 2018

A consolidation of opinion pertaining to the draft Electricity (Amendment) Act 2018, evolved through consultations with stakeholders and organisation level deliberations is presented hereunder. An assessment of the considerations that are perceived as the primary objectives of the proposed amendment and their impact on the sector in Kerala is furnished here. Section wise modifications proposed is attached as an Annexure to this document.

1. The proposed amendment aims at a comprehensive remodeling of the power sector in the country in general and a complete recast of the power distribution sector in particular. It also attempts to introduce certain untested models in to a sector that is the life blood of human development and sustenance. The deliberations that lead to this feedback reveal that all the stakeholders harbor serious apprehensions regarding the sweeping reforms that the power distribution and the regulatory regimes are proposed to undergo by the amendment.
2. All developments in power sector, including setting up of power plants, construction of power transmission lines and substations, installation of power distribution infrastructure, development of the power market, institutionalization of the regulatory regime and all other appurtenant functions have a single objective to achieve, which is providing quality power at affordable rates to all categories of consumers. The proposal herein tends to introduce several uncertainties to the sector, many of which seems to have no conceivable benefits in this context.
3. The power distribution sector in the State has evolved in its own unique manner in harmony with the endemic social and economic requirements. Kerala achieved 100% village electrification during late 1970's itself and achieved total electrification status in the year 2017. The situation here is different from many other States. The State has ensured power availability to all it's citizens irrespective of their social status or paying capacity.
4. The early achievements of Kerala in the area of village and rural electrification have resulted in a unique consumer pattern for the State. The domestic consumer group constitutes around 80% of the consumer base of the State and they consume about 50% of the electricity distributed within the State. Unlike in other parts of the country substantial portion of the consumption in the domestic sector is in the low income group consuming around 1 to 3 units a day and this group constitutes around 75% of the domestic consumers. The consumption by this section needing tariff support comes to about 52% of consumption in the domestic category. The basic minimum requirement in

this context is that the new proposals shall not deprive the people of the State of the fruits of universal electrification. Regulatory systems are also required to be positioned in this perspective. Considering these requirements, positive differential retail costing of electricity or cross subsidy is to remain as an inevitable aspect of the system here.

5. One of the major changes envisioned in the draft is separation of distribution and supply functions. Distribution provides the physical connectivity and competing suppliers provide power to consumers through the connected system. The concept as such presents a complicated scenario having several dark areas and a number of serious bottlenecks. In addition to this, it is apprehended that the system is likely to jeopardize the equilibrium of the system and totally electrified status of the State.
6. In Kerala, the support for cross subsidy mainly comes from the commercial and services sector which is presently having a lower base but is growing. However, this small segment is supporting cross subsidy at present and can easily be cherry picked by subsequent supply licensees in the unique context of Kerala. Unhindered cherry picking may lead to significant escalation in tariffs of the underprivileged classes with low upfront paying capacity which may in turn lead to forfeiture of connections. The combined impact of low base of subsidising consumers, higher proportion of costly power and high proportion of low end domestic consumers and the factors above call for a different approach in handling the cross subsidy content in tariff within the State.
7. The uniqueness of Kerala situation by way of low T&D loss of around 13 %, 24X7 hours supply to all sections of consumers, 100% energy metering, small geographical area, lack of natural resources suitable for commercial power generation resulting in higher import dependence etc all call for special treatment. The strengths of Kerala power system can be leveraged for progress towards global standards only with higher levels of coordination among various functions like power procurement, generation, transmission, distribution and supply of electricity.
8. Considering the relevant facts and prevailing circumstances, it is felt that retaining the domain in an integrated manner would be the most ideal course of action in the Kerala context. An assessment based on a detailed analysis of impacts of the proposals is provided hereunder:

Separation of Distribution and Supply functions

9. The separation of power distribution function into distribution and supply is presented as a prominent guiding concept in the formulation of the 'National Electricity Policy and Plan', as per Section 3(1)(c) of the draft amendment. The concept is a totally untested one in the Indian scenario and optimism regarding it's success in implementation in very

low among stakeholders. The draft amendment proposes segregation of distribution and supply functions, but does not present any viable roadmap for implementation. There are several technical and financial hurdles involved in addition to certain unaddressed dark corners. The power sector at the current state of automation is not ready to cope up with the complexities of the segregated system. It would certainly lead to serious coordination issues as well. None of the obvious technical and financial issues in the model are found addressed in the draft.

10. The concept is touted as measure for providing choice to consumers, introducing competition and providing better service at a better price. Even a cursory analysis of the concept as proposed defeats the claim. Any consumer in the system would be connected to a single network maintained by the proposed 'distribution licensee'. The quality and reliability of the power supplied is entirely dependent of the condition of the network. This condition obviously forecloses the claim regarding competition or choice in service or quality of power supplied. The draft amendment is devoid of concrete proposals for improvement of the power system infrastructure. Consequently, the consumer stands to gain nothing in terms of quality of service, but stands to lose on several fronts. As recovery of system development expenditure through logically regulated tariffs ceases owing to competitive pricing, network development would be the causality. Segregation of carriage and content would ultimately lead to a poorly developed and maintained network and inferior service to consumers.
11. The incoming supply licensees who played no part in the development of power sector in the state and the associated hardships would definitely target only the fruits of the evolved system. They would not normally have any consideration of the realities of the system in which they supply. They would approach the sector with plain economic objectives and would market power only to the high end consumers. This would jeopardize the equilibrium prevailing in the sector. The high demand consumers who are few in number (the consumers with a load of more than 100 kW [0.1 MW] is around 5000 only out of more than 1.2 crore consumers in the State of Kerala) and consumes huge quantum of electricity (about 27% of the entire consumption in the case of State of Kerala by less than 0.04% of consumers) can easily be picked up by the incoming supply licensees by offering lower tariff, since the cost of supplying them is lower than their prevailing tariff. As stated above, the combined impact of low base of subsidising consumers, higher proportion of costly power and high proportion of low end domestic consumers would definitely lead to large scale picking up of the presently subsidising consumers by incoming supply licenses. Such 'cherry picking' of the cream of the consumers by subsequent supply licensees will abnormally increase the present tariff of all other

consumers supplied by incumbent supply licensee, especially the subsidized sector of consumers. Unhindered cherry picking of subsidising consumer segments by competing supply licensees may lead to bankruptcy of the incumbent supply licensee and to unbridled increase in price for power provided to the poor and needy sections of the society. It would most certainly lead to forfeiture of electric connections and deprivation of electricity to the weaker sections.

12. The concept of separation of supply and distribution functions is devoid of any feature that would improve the quality of power supply or benefit network development. Any improvement in the quality of power can be achieved only by improving the operational efficacy and financial viability of the mutilated distribution licensee. As the retail tariff becomes supply licensee determined with the Regulator deciding the ceiling only, its relation to the real cost of power gets eliminated. In the prevailing system, the cost of system development and power quality improvement works gets recovered by being factored in to the tariff. When this relation gets disturbed by irrational retail pricing of power by incoming supply licenses, the investment in power infrastructure is likely to dwindle further, which may lead to further deterioration of power quality.
13. The draft amendment proposes formation of a new entity named the 'Intermediary Company', ordained as the inheritor of all power purchase agreements and power procurement arrangements of the integrated distribution licensee. This means that the 'Incumbent Supply Licensee' who inherits the supply obligations of the integrated distribution licensee stands deprived of rights on assets that were acquired by its parent company. Thus, the Incumbent Supply Licensee is in the predicament to inherit the obligations of the integrated distribution licensee but none of its assets. The proposal forces the Incumbent Licensee to venture into the business of supply of electricity forfeiting all the advantages it garnered by being part of the system development process and shouldering all the disadvantages of catering to all classes of embedded consumers including the economically unviable ones. The proposition denies the Incumbent Licensee a level playing ground to compete, is grossly unfair and is against all accepted principles of natural justice. Such institutionalized discrimination is likely to make operations of the Incumbent Supply Licensee financially infeasible and may lead to bankruptcy. The end result of such policies would be denial of electricity to a large section of consumers.
14. Lessons in this context are to be learnt from the Odisha example. In the State of Odisha which has been a harbinger of several ill fated reforms in the Indian power sector, a situation similar to that envisaged in this draft amendment exists. Most of the power procurement agreements and rights there are held by the GRIDCO, which sells power procured by virtue of these arrangements to individual distribution companies. Default of

payment by distribution companies of power that they have availed has now led to the bankruptcy of the GRIDCO. The same situation has repeated in relations between distribution licenses and franchisees also in many States. This situation can happen in relations between the Supply Licensees and Intermediary Companies as well, which may lead to collapse of the system as such. Recovery of such dues may also become impossible as Supply Licensees as well as Franchisees are required to hold no material assets for conducting their business.

15. Besides all these, it is pertinent to note that the terms 'Intermediary Company' and 'Incumbent Supply Licensee' are conspicuously absent in Section 2 which includes definitions of terms used in the Amendment Act.
16. At present a prospective consumer can avail supply by approaching a single licensee. Same is the case for enhancement of load etc. For issues related with supply quality or billing issues also the same licensee is answerable at present. However, after separation of supply function from distribution function the consumer has to approach different agencies for each of these services. To avail supply, the consumer has to first approach the distribution licensee for getting connectivity. After obtaining connectivity the consumer has to approach the supply licensee for getting supply of power. Security deposit has to be maintained with both the distribution and supply licensees separately. Periodical charges are to be paid both to the distribution and supply licensees separately. For changes in connected load etc also the consumer has to approach both the licensees sequentially resulting in wastage of time and resources. On complaints related to supply voltage, supply interruptions etc the consumer has to approach distribution licensee whereas for complaints related to routine bills both the agencies need to be approached. For resolution of disputes the consumer has to approach both licensees separately. Thus unnecessary overheads are created for the licensees as well as for the consumer through the separation of these related functions.
17. The present under-developed state of distribution network could create issues in supply side like (i) distribution loss which has to be borne by the supply licensee as unnecessary power purchase cost (ii) low quality of supply like low voltage, supply interruptions etc leading to low revenue realisation (iii) overloading of lines which may necessitate shedding of loads of supply licensee (iv) low level of access, especially in rural areas leading to unmet demand. One of the identified chronic problems in Indian power sector is the high level of transmission and distribution loss and one of the major performance parameters prescribed now for distribution licensees is the loss reduction targets. If the distribution business is disintegrated without settling these problems it is likely to create

anarchy in the whole value chain. The burden of additional power procurement due to higher transmission and distribution losses will go unattended in the new arrangements.

18. Thus the introduction of supply licensees shall be only after ascertaining readiness of the industry. The separation of network and supply business was achieved in developed economies when the distribution network was in a fully developed state and the cross-subsidies for bulk consumers were minimum or negative. When the distribution network in the country is under-developed there will be serious coordination issues among distribution licensees, supply licensees and consumers at every stage right from availing connection, enhancing contract volume for supply, supply quality etc. The cross subsidy pattern in the country is also different from that prevailing in developed economies. In India large bulk consumers like industries are bearing the burden of cross subsidy and small consumers who are large in number like domestic consumers are getting the benefit of cross subsidy. However in the developed economies the pattern is different with the bulk industries getting subsidized electricity to ensure their competitiveness and the domestic consumers bearing the burden of cross subsidy. The peculiar pattern of cross subsidy in India results in a small section of consumers consuming huge quantum of energy is paying at rates well above the average cost of supply and the same is mostly higher than the price discovered in the market. This pattern of cross subsidy can lead to large scale cherry picking by subsequent supply licensees and thus their entry has to be done only after testing the efficacy of the envisioned separation scheme by conducting pilot studies.
19. Contrary to the general principles regarding segregation of content and carriage envisioned in the draft, several entities like Special Economic Zones are seen permitted to hold deemed licenses which are inferred to be multifunctional including both supply and distribution functions. This is a discriminatory clause in the context of segregation and requires to be addressed appropriately.
20. Relevant provisions of the Electricity (Amendment) Bill 2014 necessitated mandatory segregation of distribution and supply functions within a period of one year. The provision regarding mandatory segregation within a stipulated timeline has been eliminated in the Electricity (Amendment) Act 2018. The new proposal facilitates segregation of distribution and supply functions in a phased manner, in accordance with a trajectory laid down by the State Government. The revision in the scheme is in line with demands made by various stakeholders, and is a welcome change to that extent. But the revised proposal contain no checks or balances to preempt discriminatory service practices by incoming supply licensees. The proposals impose no condition requiring supply licensees to undertake supply to all classes of consumers in different areas within the area of supply. A

mechanism for ensuring that the obligation of supplying to representative localities and all classes of consumers, both the profitable and the economically unviable, to all supply licensees is to be introduced in the Act. There shall be an obligation to all Supply Licensees to supply to a representative mix of consumers in different localities. There are such established models in energy sector itself. The general principles of equity adopted in the model followed for supply of city natural gas by the Petroleum and Natural Gas Regulatory Board is worth consideration.

21. Taking the peculiarities of the ingrained cross subsidy structure in the State, as well as the area and demographic differences within the State, segregation of distribution business and supply business, throughout the State in one go at this point of time is not advisable. Thus, Kerala requires exemption from the provision from separation of carriage and content for the entire area of supply. Provisions to enable pilot implementation, i.e., implementation of the concept of segregation in selected areas only are essential for ascertaining the impacts and effects.
22. Section 131 A of the draft amendment enables implementation of the proposed separation of distribution and supply functions in a phased manner, as decided by the State Government. This enabling provision was not there in the draft Electricity (Amendment) Bill 2014 and was included considering demands from various stake holders. Inclusion of such an enabling provision considering the sentiments of stakeholders is a step in the right direction and is appreciated wholeheartedly. In spite of such welcome changes, there are certain grey areas that may lead to implementation level issues, if left unaddressed. There is manifest ambiguity regarding whether notification of transfer scheme for an area selected for pilot implementation by the State Government shall lead to opening up of the entire area of the State for new Supply Licensees. This condition would defeat the purpose of pilot implementation and the provision enabling implementation of segregation in a phased manner. To avoid ambiguities in this context, an explicit provision for enabling area wise transfer schemes for conducting pilot studies in separation in representative locations and phased addition of licensing areas may please be included. Also the provision stating 'Provided also that a distribution licensee, after implementation of the Transfer Scheme shall not engage in trading or supply of electricity, 'unless otherwise specifically approved by the Central Government'' in Section 14 of the proposed amendment may kindly be amended as 'unless otherwise specifically approved by the Appropriate Government'.

Abrogation of the cross subsidy system

23. The cross-subsidy system in electricity tariff is followed in all the States which results in tariffs higher than the average cost of supply for consumers like commercial customers, industrial customers etc who consume electricity in large quantum. It also allows tariffs lower than the average cost of supply for low end domestic consumers and small scale industries. Roughly about 75% of the domestic consumers in Kerala are presently paying electricity tariffs at far less rates than the cost of supply due to cross subsidy structure in tariff. Currently the distribution utilities could serve these sections since part of the burden is shared by the wealthy households and profitable business ventures through cross subsidy in their tariff. Once these consumers who are paying at rates much above the cost of supply are selectively picked up by the new supply licensees, no one will be left to share the burden.
24. Section 61 (1) (g) of the proposed amendment limits the maximum extent of cross subsidy to 20 % which is to be eliminated totally in three years. The provision for levying cross subsidy surcharge to open access consumers in Sections 38 to 40 has also been eliminated in the draft. An amendment is proposed in Section 42 of the Act regarding cross subsidy surcharge which is 'Provided that such open access shall be allowed on payment of wheeling charges and a surcharge thereon as may be determined by the State Commission; provided that the surcharge shall not be more than twenty percent of the wheeling charges. Provided also that such surcharge shall be progressively reduced and eliminated in two years in the manner as may be specified by the State Commission'. The proviso is basically flawed. Cross subsidy surcharge is not a function of wheeling charge, but is related to tariff structure.
25. Subsequent transfer of subsidy or 'direct benefit transfer scheme' which is presented as a remedy in lieu of the cross subsidy system, has been a fiasco in several other sectors and is likely to be even more disastrous here, as most of the consumers benefitting the cross subsidy system have limited upfront paying capacity. Considering the huge consumer base, transferring of subsidy to individual bank accounts of consumers may not be practical either. The present level of subsidy commitment of the State government in Kerala is less than 400 Crores per year. If the cross subsidy system is eliminated, the subsidy commitment required to maintain the same level of retail tariff, would be more than 2000 Crores, which would break the financial backbone of the State, and is unenforceable as such. Hence, the Section 61 (1) (g) and 42 of the proposed amendment mentioned above may kindly be dropped. Considering all the factors presented above, the provision for levying cross subsidy surcharge may please be restored.

Selection of the State Electricity Regulatory Commission

26. The State Government is vested with the power to appoint the Chairman and Members of the State Electricity Regulatory Commission. But the selection committee has been reconstituted comprehensively in the draft amendment. The committee in the amended form provided in Section 85 of the Act comprises of six members of which five are nominees of the Central Government. The Chairman as well as the Member Secretary, who moots the agenda of the Committee, is to be nominated by the Central Government. Composition of the committee obviously leaves no room for the State for exercising any meaningful control. For effective regulatory intervention, the Members and Chairman of the Commission are to have sufficient exposure to and experience in the State Power Sector and are to have an awareness of the peculiarities of the Sector in the State and the priorities therein. To enable this, a meaningful role of the State in the selection process is essential. As such, the amendment proposed in Section 85 of the Act may please be withdrawn.

Negation of the spirit of federalism and State specific solutions

27. Electricity is not within the exclusive domain of the Central Government, as per the Constitution of India. The item is placed in the concurrent list in the 7th Schedule of the Constitution. Constitutional propriety requires the Central Government to allow a stake for each State in deciding matters within its jurisdiction, considering the endemic peculiarities, the stage of development, general aspirations as well as the general development road map. Besides being in line with the general spirit of federalism enshrined in the Constitution, it is the most practical approach as well. It is to be understood that the power sector in each state has evolved independent to each other and are presently in varied stages of evolution. The comparison of the vital parameters of power sector in a state like the percentage of electrification, power availability, peculiarities of the load curve, consumer mix as well as extent of metering would reveal that the conditions are entirely disparate. The challenges that confront the power sector in each state are different, likewise are the solutions. The policies adopted for mitigation of problems faced are different for each state as well as the strategies for growth. The draft amendment proposes certain rigid policies intended for uniform implementation throughout the nation, which is a sure recipe for retardation of growth in evolved power sectors as that of Kerala. The concept of 'Pan Indian Panaceas' in power sector is absolutely illogical, unrealistic, impractical and portends of a future of overloaded/ underdeveloped systems as well as dissatisfied or even bankrupt stakeholders including consumers.

28. Section 11 of the draft amendment empowers the Central Government to control all generating stations within any State other than those owned by the State itself. This power, if exercised may create unwarranted hardships to the parties who have contracted the power and may be detrimental to the interests of the State in general, besides being an infringement of the spirit of federalism. In such conditions, it is suggested that the power shall only be exercised after ensuring consent of the respective State Governments and providing adequate compensation.
29. Each state should be enabled by loose leashes to formulate state specific solutions to address endemic challenges and to evolve the power industry, the mother of all industries in harmony with the general development perspective of the State. Such an approach would be rooted in constitutional propriety and would be in consonance with the spirit of federalism that the Constitution upholds.

Self defeating provisions regarding markets and power procurement

30. The Act proposes to promote development of a market in power in Section 66 and goes to the extent of proposing development of forwards and futures contract in electricity. The newly inserted subsection 2 of section 42 of the draft proposes that the distribution licensee or supply licensee, as the case may be, shall tie up long term/medium term power purchase agreements to meet the annual average demand of power of the area which it has the obligation to serve. The condition curtails the scope of developing a dynamic power market, as compliance of this condition may lead to a situation where trading becomes unnecessary. This condition coupled with the newly inserted section 66 A which proposes mandatory enforcement of all power purchase agreements, once approved by the Appropriate Commission, would undoubtedly stifle the life out of the power market even if it survives in any manner.
31. It is an accepted fact that at least reasonable competition is necessary for any market driven reform to succeed. The scenario envisioned by the proposed amendment tends to promote competition in retail power sector and non competitive tie ups in bulk power purchase. This is a serious logical incongruity and is likely to make the envisaged system unviable. Encouraging competition at one end and restricting or virtually banning it in another end of the same value chain would definitely be self defeating as stated above. The experience of the State of California, United States of America is worth remembering at this juncture, where competition was permitted in bulk power procurement and was restricted in retail power pricing. This condition of stifled competition ended up in failure of the system there. Considering the incongruities in policies and procedures stated above, the proposed reforms are likely to yield the same result here also.

32. Section 42 (2) of the draft amendment mandates every licensee to contract enough power to meet the annual average demand of power of the area which it has obligation to serve. In a situation where more than one supply licensee operate in the same area, each such licensee tying up power enough to meet the annual average demand, shall lead to gross over contracting of power, making operation of licensees financially unviable and to idling of generation assets. This would unnecessarily push up the cost of power also. The situation is likely to be even more serious, considering the provisions for deemed licensees like Special Economic Zones and Renewable Generators that require no license for supply of electricity, with the area of supply of a licensee.
33. The infatuation towards purchase agreements and notions regarding their inviolability are to cause several operational hardships to licenses. It may lead to situations where a supply licensee may be unable to procure available, reasonably priced power from generators or traders without conforming to the common PPA grind. As the licenses are obliged to provide power 24 X 7, at reasonable rates, they shall be allowed the freedom to procure available power without unnecessary statutory hurdles. It is suggested that a system permitting ad hoc PPAs with willing generators or traders at ceiling rates fixed by the Commission regulating the supply licensee.

Infringement of the Regulator's domain, contrary to the spirit of the parent law

34. The general spirit of the repealed Electricity Regulatory Commissions Act 1998 and the Electricity Act 2003 is distancing the Government machinery from the process of evolving regulations and fixing tariffs. Third paragraph of the 'Statement of Objectives' of the Electricity Act 2003 projects 'distancing the Government from the processes of evolving regulations and determining tariff' as a prominent objective of the Act. The spirit of the parent Act, the Electricity Act 2003 is that all such functions are to be carried through quasi-judicial processes, by the regulator.
35. Several inclusions and alterations suggested in the draft tread in a direction opposite to this spirit of the parent Act. The draft amendment tends to narrow down the Regulator's domain, whereby the scope of all related quasi judicial processes gets curtailed. The Regulator would be forced to function in line with Rules framed by the Government. This is against the general concept of fairness and stakeholder participation envisioned in the parent Act and is absolutely retrograde.

A Section wise consolidation of suggestions for modification of the draft amendment is attached as Annexure. The suggestions may please be considered appropriately.