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Comments on the Draft Electricity (Amendment) Bill, 2020

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These comments are drafted based on internal discussion at the Centre for Policy Research (CPR). They should not be considered an institutional position, as CPR does not take institutional positions on issues. Rather, they reflect the result of internal deliberations, aimed at understanding and reflecting on the draft amendments, with the aim of constructive feedback to the MoP. The document has been prepared by ***Ashwini K. Swain, Parth Bhatia, Ira Sharma, Sarada Prasanna Das*** *and* ***Navroz K. Dubash****.*

The importance of reliable electricity access is further amplified in the current pandemic situation. The Government of India (GoI) fittingly recognises electricity as a critical infrastructure for the nation's economy and welfare. Improving electricity supply to citizens and businesses has been a consistent priority for the Central government, as evident in a range of interventions taken up in the past two decades. However, persistent inefficiencies in the sector not only continue to be a drain on the state exchequer, but also compromise the quality of electricity supply for all.

Seventeen years since the Electricity Act of 2003 (the Act) was enacted, many of the desired objectives regarding market transformations and efficiency gains in electricity system are yet to be achieved. Undoubtedly, the status quo is unsatisfactory. Indian electricity remains beset with long-standing problems, even while it is faced with a new set of disruptions from ongoing technology-driven transitions. The Ministry of Power (MoP) aptly claims that the unresolved critical issues "have weakened the commercial and investment activities in the electricity sector" and "few provisions of the Act are unable to cope with the rapid development of the electricity."

Therefore, there is an urgent need to revisit India's electricity priorities, laws governing the sector and approach to improving electricity. The Central government clearly recognises the urgency of reforms in the sector. In recent years, it has made multiple interventions to improves access, improve discoms finance, strengthen grid capacity, add cleaner sources to energy mix and secure adequacy of power. Simultaneously, there is equal emphasis on reforming the legal and policy framework governing the sector. In past six year, this is the third attempt to amend the Act (past attempts in 2014 and 2018 were unsuccessful). Multi-pronged interventions and continuity in thrust is certainly commendable.

The draft Electricity (Amendment) Bill, 2020, released on April 17, 2020, is an improvement from its predecessors. It has dropped some significant proposals that were resisted and has added new provisions. Are these reform proposals adequate and appropriate to address India's long-standing electricity challenges? Are these prescriptions based on a proper diagnosis of current trends and future challenges? How will these reforms proposals affect India's ongoing transition to 21st century electricity? While we appreciate the endeavours and intent, in our comments we focus on some serious concerns the draft raises, vital gaps and issues that need serious consideration.

I. Rationale, Objectives and Intended Outcomes

A legislative reform needs to be based on clear rationales, defined objectives and intended outcomes. For this purpose, a brief (3-pages) 'Statement of Objects and Reasons' is appended to the draft Bill that provides rationale for an amendment in the Act and highlights 11 key proposals. But it fails to provide a long-term vision for the sector, define key objectives, explain the rationale for proposed provisions and identify intended outcomes. It does not explain how the proposed reforms in the

legislation will work together to achieve the larger goal of improving electricity access for citizens and businesses.

Given that the opportunities for legislative reforms on a concurrent subject are rare (the last amendment to the Act was made in 2007), any attempt must be based on a decade-long vision, consider the existing and upcoming challenges in the sector, and appropriately engage with political economy constraints and opportunities at the state level. The reform proposals notified are not based on consultation with the state governments, as evident in the resistance from several states, and fail to weigh in future electricity challenges. Further, the proposed amendments are only a part of reforms being planned in the sector, as claimed by the MoP, while more detailed reforms are to be prescribed as part of the upcoming tariff policy and a Centre-designed financial and efficiency improvement scheme for the distribution utilities (discoms). Without those details, the draft Bill remains ambiguous.

Moreover, the timing of this amendment proposal is bit puzzling. The Covid-19 pandemic has disrupted electricity system operations across states and at national level. While it exacerbates existing ailments of the sector, the pandemic impacts have created impetus for a faster transition to the electricity future.[1] The draft Bill has failed to draw insights from this unprecedented disruption in the existing order.

- *The draft Bill has stimulated significant public discourse on the future course of electricity reforms. The MoP must tap the opportunity and articulate a long-term vision for the sector. Such a vision must build on a proper diagnosis of the existing chronic electricity challenges and imminent 21st century challenges, draw insights from the pandemic experiences, and weigh in state level constraints and opportunities. Such an analysis may be presented in a white paper that also identifies clear rationales, defined objectives and intended outcomes. The white paper may be used for consultation with stakeholders and seek their buy-in for a pragmatic reform strategy.*
- *For better clarity and stakeholders' buy-in, the MoP need to present a consolidated reform strategy by putting up the legislative framework, complementing policy tools and fiscal measures as a package, rather than staggered interventions.*

II. An Economically Viable and Investment Friendly Electricity System

Economic viability of the electricity system has been a key focus of successive reform interventions. Despite these efforts, commercial losses and insolvency have been persistent in the electricity distribution business, making government bailouts a regular feature. The urgency to make electricity industry economically viable has been further heightened by the growing need for private capital investment to make a transition to the 21st century electricity. The draft bill makes four proposals to achieve this goal and build investors' confidence in the sector. We discuss the scope and limits of these proposals.

A. Commercialisation of Distribution Business through Micro-Privatisation

Commercialisation and privatisation of distribution businesses was a key feature of the 1990s standard reform prescriptions. Privatisation was widely resisted and eventually given up by most states. However, the discoms were corporatized, as mandated by the Act, to instil commercial practices under government ownership. The outcome has been dismal in many cases.[2]

In recent years, there has been a renewed interest in privatisation of electricity distribution. The 2014 and 2018 amendment proposals prescribed separation of network and supply businesses, seeking to

[1] Swain, AK (2020): 'The Politics of Power in Times of a Pandemic', *Hindustan Times*, April 21, New Delhi.

[2] See our comparative analysis of 15 state experiences: Dubash, NK, SS Kale and R Bharvirkar (2018): *Mapping Power: The Political Economy of Electricity in India's States*, New Delhi: Oxford University Press

bring in private players in the latter in a multiple supply licensee framework. The proposal received wide criticism.[3]

The draft Bill proposes to achieve the goal through micro-privatisation of electricity distribution. It makes provisions for 'distribution sub-licensees', in addition to existing provisions for distribution franchisees [Section 2(17a), 2(27), 14]. A discom "can recognize and authorize a person as 'Distribution sublicensee' to distribute electricity on its behalf in a particular area within its area of supply, with the permission of the appropriate State Commission." However, the draft Bill does not provide further clarity on the selection criteria, nature of business, responsibilities, and accountability mechanisms.

The 21st century electricity system is unlikely to sustain the current discom models and will require further unbundling. Micro private entities like distribution sub-licensee and franchisee could be potential institutional options. But, those options must be chosen based on proper analysis, weighing of alternative options and learning from past experiences. Further, design of micro institutional architecture must be left to the states to tune with local political economy context, while the Central legislation should provide an enabling framework.

- *The Centre must seek to provide an enabling framework for institutional innovations in electricity distribution business, refrain from endorsing a single model, and allow the states to chart their institutional pathways. Varying political economy contexts across states require diversity in institutional architecture (especially at bottom of the structure), while economic viability must be a common agenda.*
- *The MoP can facilitate through providing insights from past experiences, assessment of alterative options and guidance on governance and accountability mechanisms.*

B. Cost-Reflective Tariff Structure and Reduce the Burden of Tariff-Based Redistribution

Cost recovery through tariff rationalisation is another long-standing reform agenda, since the 1990s. Despite persistent pressures from the Centre and multilateral lending organisations, the results are often sub-optimal and demonstrate a wide variation across states.[4] To achieve this objective, the draft Bill makes three important proposals: 1) Reduction of cross-subsidies as prescribed by the National Tariff Policy [Section 61(g)]; 2) No deferral in revenue recovery [Section 61(g)]; and 3) tariff determination without subsidy consideration [Sections 65, 62(g)]. While these objectives are critical to economic viability, we must consider the diversity in state specific contexts and allow some degree of flexibility in approach.

There has been a persistent push for timebound reduction in cross-subsidization to make businesses competitive. However, growing demand for subsidies and rising electricity-centred clientelism in the states has resulted in expansion of redistributive welfarism. There is an urgent need to manage subsidy demands and contain the pressures for redistribution. However, a uniform and rigid tariff regime is not the solution, and will likely incentivise defiance by the states operating under constrained financial space. Rather, the focus must be placed on finding alternative ways to limit the subsidy burden. Potential options lie both within the electricity sector and outside the sector: 1) Drive a shift away from electricity tariff subsidy to electricity infrastructure subsidy. The Centre needs to ramp up efforts to deliver the low-cost benefits of renewable energy directly to the poor through capital subsidies for solar home systems, solar pumps and solar agricultural feeders, thus reduce the growing subsidy burden on discoms.[5] 2) Address inefficient patterns of cropping and groundwater usage in agriculture, and thus, reduce agricultural electricity demands.

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[3] See our views: Swain, AK, P Bhatia and NK Dubash (2018): 'Power Politics at Play', The Hindu, October 09, New Delhi.

[4] See our comparative analysis of state experiences: Dubash, NK, SS Kale and R Bharvirkar (2018): *Mapping Power: The Political Economy of Electricity in India's States*, New Delhi: Oxford University Press.

[5] Swain AK, A Agarwal, P Bhatia (2019): 'Our Electricity Future', *Indian Express*, July 04, New Delhi.

The proposal to restrict deferral of revenue recovery is a welcome move and can potentially address the mounting burden of regulatory assets. But we must allow space for extreme situations like current pandemic that has disrupted discoms' revenue recovery and find ways to manage similar situations.

The draft Bill prescribes the State Electricity Regulatory Commissions (SERCs) to determine tariff without consideration of subsidies and requires the governments to pay the subsidies through direct benefit transfer (DBT). But it does not consider the complications in identifying and targeting beneficiaries and limits of credibility of payment promises by state governments. Therefore, it will be premature to universalise and mandate DBT immediately. However, it may be promoted and tested with pilot cases.

In addition to efficient management of subsidy distribution, consumers' ability and willingness to pay for electricity is critical to cost recovery. To address the latter, India's electrification policy needs a paradigm shift from 'redistributive welfarism' (that prioritises subsidised costs for the poor while compromising on the quality of service) to 'productive power' (that empowers and enables the poor to pay for better quality service through productive use of electricity).[6]

- *While reduction and elimination of cross-subsidy is a credible reform measure, it needs a pragmatic strategy to avoid tariff shocks for poor consumers and direct subsidy burden on state governments. Any such strategy must be based a clear understanding of the factors that limited pursuit of this goal over past the 17 years.*
- *The Centre must identify alternative ways to limit and manage subsidy demands as discussed above. Instead of enshrining DBT as a mandatory policy, there is a need to promote pilots for states to understand context-specific implementation challenges and benefits.*
- *Simultaneously, building on recent success in electrification, the Centre needs to develop a broad strategy around 'productive power', seeking to promote rural industries and businesses (such as agro-processing and cottage industries) with required financial and infrastructure support.*

C. Payment Security Mechanism

The draft Bill seeks to provide a legal mandate to payment security mechanism in wholesale market, to address the rise of accumulated discoms' dues to generators. It makes provisions "to empower load dispatch centres [LDCs] to oversee the payment security mechanism before scheduling dispatch of electricity and to be made mandatory considering sanctity of the existing contracts unless it is waived by the parties to contract themselves" [Sections 28 (3a) and 32 (2a)].

Payment security is critical to minimise investors' risks, particularly when the sector is in need of huge private capital investment. We consider the legal mandate to payment security mechanism, that is already being pursued through the MoP order, as a welcome move. However, there are two risks. First, the provision for waiver in case of mutual agreement leaves scope for political manoeuvring between the Centre and states through the Central generators, and may potentially divert the debt burden from state-run discoms to state generators. Second, the overseeing responsibilities with LDCs may lead to political capture of state LDCs and thus, constrain their technical functions.

Though not mentioned in the draft Bill, there is a simultaneous drive to ensure payment security in retail market through mandatory switch to prepayment. The Centre has mandated a universal switch to prepaid smart meters in next three years. However, prepayment at retail level has serious consequences for electricity access for the poor, and may not solve the long-standing problems of discom finance and losses, and accountability and governance in the Indian electricity system.[7]

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[6] See our recommendations for electricity access security: Swain, AK and NK Dubash (2019): 'Beyond Poles and Wires: How to Keep the Electrons Flowing?', in *Policy Challenges 2019-2024: The Key Policy Questions for the New Government and Possible Pathways*, New Delhi: Centre for Policy Research, pp. 34-38.

[7] See our analysis: Swain AK (2020): 'Not So Smart Meters', *Indian Express*, March 20, New Delhi.

- *Payment security is critical to economic viability and attracting private investment in the sector. But it cannot be enforced without enabling conditions. Payment security at wholesale level is dependent on an effective payment security mechanism in the retail market. Enforcing prepayment on the poor is not the right way forward. Rather, the priority is to understand the causes of non-payment and find a strategy to fix them.*

D. Better Contract Enforcement

The adherence to contracts is an important principle to make the sector attractive to private capital and should be upheld, except in the case of corruption. However, if the goal is to make the sector viable, enhanced discipline in adhering contracts must be complemented by enhanced scrutiny while signing these contracts, especially from the point of view of the end consumer who is a price taker. At discom level, integrated resource planning and technical validation could put checks on unwarranted power purchase contracts.

States that are considering contract renegotiation despite of these risks are the proverbial canary in the coal mine, signalling that the costs imposed by inflexible long-term contracts outweigh the imperative to attract private investment into the sector. Thus, while breaking contracts is damaging to the sector, a mechanism is needed to allow legitimate renegotiation of contracts that brings both sides of the table. Without such a mechanism, the risks of overly optimistic demand forecasting (as we have seen over the last decades) and rent-seeking contracts falls entirely upon the discoms.

For better contract enforcement, the draft Bill creates provisions for establishment of an Electricity Contract Enforcement Authority (ECEA) at the Centre [Sec 109A(2)] and strengthening of Appellate Tribunal for Electricity (APTEL) (Section 112, Section 121). It states that the ECEA shall have the sole authority and jurisdiction to adjudicate on contract related matters but not on tariff related matters. As power procurement costs constitute 70-80% of the average cost of supply, settlement of contract disputes will have major knock on effects on retail tariff determination, leading to jurisdictional issues between the SERCs and the ECEA.

Further, the constitution of a central body to enforce contracts creates additional incentives for political buck-passing and forum shopping. State governments could pursue contract disputes as a tactic to withhold honouring expensive contracts, while posturing as victims of central interference. Such disputes would be particularly challenging for small and mid-sized RE developers, who may not have the financial wherewithal to go through a long process of resolution at the ECEA followed by an appeal at the APTEL. Moreover, the dynamic between the state regulator and private generators may shift, with developers losing their importance as a constituency for the SERCs. This may lead to increased instances of favouritism towards discoms in tariff matters, leading to a spillover of tariff related litigations onto APTEL.

- *Instead of creating a new institutional body, strengthen the ERCs and APTEL to swiftly adjudicate on contract disputes.*
- *Create a protocol or Code for parties to trigger legitimate contract renegotiation proceedings in extreme circumstances, with guidance from the Forum of Regulators. This Code can have a high threshold to admit cases.*
- *Supplement efforts for enforcement of contracts with innovative and flexible PPA model proposals and greater regulatory scrutiny while awarding long term PPAs.*

Economic viability of the electricity system is of paramount importance and must be pursued. We recommend that, in designing a reform strategy, the MoP must consider the costs of specific policy options, assess alternative approaches and allow some space to the states to chart their institutional pathways. Simultaneously, the current pandemic experience has highlighted the weak resiliency of our electricity systems. Therefore, the long-term vision and reform strategy for the electricity sector must treat building system resiliency as a critical complement to the goal of economic viability.

III. Federalist Structure of Power-Sharing

Several proposals in the draft Bill, in line with the past proposals, have serious consequences for the federal structure of power-sharing in the sector. The key proposals include a Central Selection Committee for selection of chairpersons and members all electricity regulatory agencies, including the SERCs (Section 78), a new provision allowing the Centre to temporarily entrust the functions an SERC to another state or joint commission in case of prolonged vacancy leading to non-functional commission [Section 82(7)], and transfer contract disputes to the proposed ECEA at the Centre. Further, the draft Bill seeks to enforce Centre dictated targets and penalty structure without adequate consideration of state-specific resource base and contexts.

The stated reason for the Central Selection Committee is that there are a plethora of Committees at national and state level, leading to an inefficient and non-uniform selection process. Besides, there is an enduring concern over unhealthy nexus and political alignment between state governments and state regulators selected by them, which consequently has fostered political capture of regulatory decisions. While these concerns have proved broadly valid over time, the proposed way forward could be equally detrimental by providing the Centre additional powers and influence over vital state institutions.

The challenge related to non-functional SERCs is slightly more vexed. While the diagnosis of this as a serious issue is valid, the proposed solution (the Centre entrusting power to other state or joint commissions) may lead to suboptimal decision-making and scope for greater (and politically motivated) influence from the Centre. Commissions from other states are unlikely to have an in depth understanding of the issues, opening up their decisions to reversals and challenges.

There is no doubt that the performance of states and their electricity agencies has been poor. But the proposed approach to redirect key responsibilities to the Centre, instead of fixing the process in the states, is misplaced and could be counterproductive.

- *The draft Amendments shift the balance of responsibility and power between the Centre and the states. Either the rationale for these changes should be made clear or the current balance should be retained, with states managing the sector and the Centre playing a facilitating and coordinating role.*
- *Instead of undercutting state level regulatory institutions, the Centre should strengthen their capacity while creating greater transparency and accountability to the public in their functioning.*

IV. A Short-Sighted Energy Transition Vision

The draft Bill makes provision for a National Renewable Energy Policy (NREP), to be developed by the Centre in consultation with the state governments, "for the promotion of generation of electricity from renewable sources of energy and prescribe a minimum percentage of purchase of electricity from renewable and hydro sources of energy" (Section 3A). Simultaneously, it makes provisions for a separate hydro purchase obligation on all the designated consumers, in addition to solar purchase obligation as part of the renewable energy purchase obligation (RPO). It also makes provision for high penalties for non-compliance of these targets [Section 142(2)].

While prioritisation of RE is commendable, there are several concerns with the approach. First, the RE industry in India has substantially matured, through successful experimentation with key policy instruments, and now has a firm target and mandate. It is unclear what the NREP seeks achieve. Second, RE is a dominant component of the ongoing technology-driven energy transition, but it does require complementary technologies and institutions. Therefore, a siloed approach to promotion of RE is short-sighted and could be counterproductive. Third, a Central push for technology specific RPOs is misplaced in a country where states have diverse resource base. In the absence of adequate generation resources, the targets may not be complied with and high penalties may promote non-cooperation from the state governments.

However, the Centre could contribute to expediting the energy transition by accelerating the retirement of old, inefficient and polluting coal-fired power plants to create space for cleaner generation sources (addition of new RE capacity as well as utilisation of currently unutilised but efficient thermal plants). In the last budget speech, the Finance Minister has urged the states to do so. The draft Bill could go further to create a legal mandate and put in place a process.

- *The Centre must aim to develop a larger energy transition vision and strategy that creates enabling environment for penetration of RE as well as other modern energy technologies (like energy storage, electric vehicles etc.). Such a vision and strategy must facilitate credible configurations of technologies, institutions and politics.*[8]
- *The MoP may consider developing an Integrated Energy Policy at the national level that seeks to balance existing conventional energy resources and new energy resources and sets up procedures for a coordinated development in the sector*
- *Technology specific RPOs must be abolished and a broad RPO (or a non-fossil power purchase obligation) trajectory must be set for the designated consumers, who can choose to buy from the evolving range of clean energy sources.*

V. Many a Critical Slips

While capturing several aspects, the draft Bill fails to address some critical concerns. We discuss three of them below:

A. ***Consumers Protection and Participation:*** The provisions in the draft Bill and few other initiatives seek to hold the consumers accountable through various mechanisms. But the consumers are not rewarded with any additional avenues to hold the discoms accountable for supply and service quality. The existing avenues for consumers protection and participation are dysfunctional in most cases. There is a need to strengthen these avenues and provide adequate safeguards for consumer interest protection.[9]

B. ***Integrated Resource Planning:*** Planning oversights in recent years have resulted in unviable generation capacity glut and mounting power purchase costs at state level. While fixed charges for unutilised capacities account for about 10% of annual revenue requirement for some discoms, about 40 GW of generation capacity are non-operational at national level. This calls for a serious attention to integrated resource planning that the bill has missed.[10]

C. ***Energy Efficiency and Demand Response:*** The draft Bill also misses providing additional updated measures for promotion of energy efficiency and demand response. This may be considered as part of the recommended Integrated Energy Policy above.

[8] Our analysis: Dubash, NK, AK Swain and P Bhatia (2019): 'The Disruptive Politics of Renewable Energy', *The India Forum*, July.

[9] Our analysis of existing avenues for consumer protection and participation, and detailed recommendations: Khanna, A, D Singh, AK Swain and M Narain (2015): 'Transforming Electricity Governance in India: Has India's Power Sector Regulation Enabled Consumers' Power?', *Policy Research Working Paper 7275*, Washington DC: The World Bank.

[10] Our analysis and detailed recommendations: Singh, D and AK Swain (2018): *Fixated on Megawatts: Urgent Need to Improve Power Procurement and Resource Planning*, New Delhi: Centre for Energy, Environment & Resources.

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