

## Comments on the Proposed Amendments to the Electricity Act 2003

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*These comments are drafted based on internal discussion at the Centre for Policy Research. 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 and Navroz K. Dubash*

Universal access to clean, reliable and affordable electricity is vital to development. Government of India (GoI) certainly recognises the importance of modern sources of energy, which is evident in recent interventions to improve ease of electricity access and reliability of supply for both businesses and citizens.

India's electricity sector has been a drag on its economy and also risks its ambitious growth trajectory. Despite two and half decades of techno-economic interventions to improve sector performance, persistent inefficiencies not only continue to be a drain on the state exchequer, but also compromise the quality of electricity supply and service for citizens and businesses. Fifteen years since the sweeping Electricity Act of 2003 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 technological innovations and subsequent market transformations.

Therefore, there is an urgent need to revisit India's electricity priorities and approach to improving electricity. GoI clearly recognises the urgency for reforms in the sector. In recent years, it has made multiple interventions to improve 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. Multi-pronged interventions and continuity in thrust is certainly commendable.

The proposed amendments to the Electricity Act 2003, released on 7<sup>th</sup> September 2018, are most critical among the set of planned reforms in the sector. With significant changes, it seeks to provide an enabling framework for transformations in electricity market, pricing reforms, regulatory oversight, quality of supply and energy security. 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.

### 1. Rationale, Objectives and Intended Outcome

While there is a need to revisit the laws governing the electricity sector, the amendments in the legislation must be based on clear rationales, defined objectives and intended outcomes. The proposed amendment provides a set of tools to alter the electricity market and institutional accountability, without much clarity on how the proposed changes will result in the desired outcomes. It would have been useful if the Ministry of Power (MoP) had provided the rationale for these amendments and the desired outcomes, with consideration of the existing and upcoming challenges in the sector.

- *It would be useful if the MoP prepares a statement of rationale, objectives and intended outcomes. Such a document would be useful for public awareness, informed engagement and consensus building among the stakeholders.*

## 2. Retail Competition and Choice

The long-pending aspiration to bring in competition in retail supply and thereby choice for consumers remains a key feature of the proposed amendment. In this regard, the draft makes provisions to enable separation of wires and supply businesses and allow multiple supply licensees in any supply territory. The states are allowed time discretion to implement when they are prepared.

The wider criticism of this provision has been that Indian electricity market is not ready for retail competition. First, the prerequisites of retail competition, especially a well-functioning wholesale market and competitive fuel market, are absent in India. Without meeting these conditions, the proposed supply licensees will not have any competitive advantage over the existing discoms. Second, if the proposed changes are pursued, the consequence could be a partial reform equilibrium that generates concentrated rents for few and imposes higher costs on the rest of the society. Given the provisions, the private suppliers are likely to cherry-pick profitable locations and consumers for obvious reasons. In a likely consequence, the cash-starved public suppliers will continue the poor quality of supply and service for its customers, who are unlikely to have the 'exit' option.

If the desired objective is to improve electricity and reduce bills for the consumers through discipline of competition and choice, it can still be achieved without potentially damaging market disruptions. First, as power procurement costs constitute 70-80% of the average cost of supply, a significant part of bill reduction objective can be achieved by improving competition in the wholesale market and better managing power procurement at discom level. Second, there is a window of opportunity to improve operational efficiency and loss reduction at the discom level. In the proposed scenario, these inefficiencies if not addressed are likely to be transferred to the new wires business operators, and will limit the economic benefits of supply competition.

- *Both reduction of power purchase costs and improving operational efficiency are higher priority actions and the Act should be focused towards addressing these issues directly rather than indirectly through the introduction of potentially disruptive retail competition.*

## 3. Elimination of Cross-Subsidisation and Subsidies through Direct-Benefit-Transfer (DBT)

The draft requires capping cross-subsidisation at 20% immediately, reducing it in a phased manner and eliminating it within 3 years [Section 61(g)]. Cross-subsidy surcharge on open access customers to be capped at 20% of the wheeling charges immediately, and shall be progressively reduced and eliminated within 2 years [Section 42(6)].

The sector has the long-standing objective to eliminate the cross-subsidy burden on businesses, and thus increase their global competitiveness, and improve end-use efficiency of small consumers through price signals. The objective was first prescribed in the Act in 2003 and has been reiterated in the National Tariff Policy (NTP) of 2006 and 2016 with timebound targets. Proposed amendments to the NTP, released on 10<sup>th</sup> September 2018<sup>1</sup>, presents a confusing picture of abolishing cross-subsidy by redefinition. The proposed shift from consumer category-based tariff to sanctioned load and

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[https://powermin.nic.in/sites/default/files/webform/notices/Seeking\\_comments\\_on\\_revised\\_provision\\_at\\_Para.pdf](https://powermin.nic.in/sites/default/files/webform/notices/Seeking_comments_on_revised_provision_at_Para.pdf)

consumption-based progressive tariff allows to the subsidies to be retained across load and consumption brackets.<sup>2</sup> The only direct beneficiary of this pricing approach will be the small business consumers whose load and consumption are low. However, cross-subsidy surcharge abolition, if implemented, will enable the large consumers to migrate to open access and captive options. The likely outcome is greater subsidy demand with the state-owned incumbent supplier and shrunk fiscal space of state governments to pay.

The amendment recognises the need to subsidise certain sections of citizens and mandates direct benefit transfer (DBT) [Section 45 (b) & 65]. 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.

- *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 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 15 years.*
- *Instead of enshrining DBT as a mandatory policy, the amendments should promote pilots for states to understand context-specific implementation challenges and benefits.*

#### 4. Thrust on Renewable Energy

The draft amendment has a significant thrust on renewable energy promotion. It makes provision for a National Renewable Energy Policy [Section 3(1)]. The Central government will prepare a trajectory for binding Renewable Purchase Obligation (RPO) [Section 3(4)] and noncompliance will attract a penalty of Rs 1-5 per unit [Section 57(1A)]. Central government will also notify a Renewable Generation Obligation (RGO) for new coal or lignite-based generation plants (including expansion of existing plants) [Section 7(1a&b)].

Given the price drop in renewable energy, the necessity of instruments like RPO and RGO in the long run needs to be reconsidered. Moreover, a centrally determined and universal RPO undermines the state-specific context and capacity of discoms. As many of the discoms are already burdened with surplus power, forcing them to add new capacity will have severe implications for discoms' finance and retail tariff. The amendments should be drafted with the view of creating a long-term framework for upcoming technologies.

- *The draft does not pay any attention to new challenges posed by renewable energy, especially challenges of grid integration and potential for market disruptions. The draft needs to provide some guidelines and identify agencies to deal with these issues.*

#### 5. Energy Adequacy Priority and Supply-Side Inefficiencies

To ensure adequate power availability for 24x7 supply for all, the amendment mandates the distribution licensees to tie up long/medium term power purchase agreements (PPAs) to meet the annual average demand [Section 42(2)]. PPAs by supply utilities will be regularly reviewed by the respective SERCs; noncompliance and violation of PPAs may attract heavy penalties including suspension or cancellation of licence [Section 42(4)].

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<sup>2</sup> Neither the proposed amendments to the Act nor the posed amendments to NTP address the exorbitant and skewed electricity duties charged by states and rather the NTP continues to allow duties as substitute for cross-subsidy. This will allow the states to continue cross-subsidise beyond electricity tariffs.

The chronic past of energy scarcity has put energy adequacy and capacity addition at the centre of India's energy priorities. However, in the present context where many of the discoms and states are locked-in to over-capacity, the provision for binding PPAs raises serious concerns. First, 'annual average demand' is not defined in the amendment. If it implies an average of recent annual energy requirements, then most of the existing discoms are already surplus. When these PPAs will be transferred to the new supply companies, they will get their fair share. Second, as the amendment requires new supply companies to compete with each other for consumers, their demand will fluctuate as consumers migrate between competing suppliers. In that context, asking suppliers to tie up PPAs will have serious consequences and will also hamper advantages of competition.

At best, the provision may help the non-performing generation assets in short-run. But in long-run, it puts the suppliers into risks of lock-in to over-capacity, especially in the context of uncertainty around load growth, prices and load migration.

Provision for regular review of PPAs by supply companies is a welcome move. But the purpose must be to ensure efficient power procurement and better resource planning. The current practice of short-term focus and ensuring power resource adequacy is seriously flawed, and has resulted in the current surplus-power scenario. The proposed amendment seems to be endorsing the focus on energy adequacy, but missing the urgency of resource planning- plan to ensure the right mix of resources to meet demand in the least-cost manner.

- *We recommend rewriting Section 42 to emphasize the need for better resource planning and efficient power procurement by the supply licensee.*

## 6. Regulatory Oversight and Capacity

The amendment requires the Regulatory Commissions to determine the tariff in accordance with the NTP [Section 61(1)]. While some degree of coherence across the states is desirable, a binding NTP will not only weaken autonomy of ERCs, but also disregards the state-level political economy and need for flexibility.

The amendment has suggested major changes in composition of selection committees for SERCs, where the Centre will have five representatives and the states will have one representative [Section 85]. This change will provide the Centre additional powers and influence over vital state institutions.

Provisions for stronger review mechanisms and accountability channels for ERCs are useful. However, multiple procedures will over-burden the ERCs who are under-staffed and multiple lines of accountability will reduce their autonomy. For instance, the amendments require a review of ERCs every three years by the Forum of Regulators [Section 109(A)]. There are additional provisions for self-reporting by Chairpersons of ERCs to the concerned governments on a quarterly basis [Section 79(5) & 86 (5)]. Furthermore, the ERCs will continue to submit annual reports to respective legislatures [Section 105].

- *The proposed amendments to Section 61(1) must be removed, keeping NTP as a guiding policy.*
- *The rationale behind the significant changes to Section 85 is unclear and it should either be clarified or the changes should be removed.*
- *The need for additional reviews by FoR [Section 109(A)] and quarterly reporting to concerned governments [Sections 79(5) & 86(5)] is not clear. This should be clarified or the respective provisions should be removed.*

## 7. Federal Politics: State vs. Centre

With a range of new provisions, the amendments provide the Central government a great deal of control over the sector. Be it appointment to ERCs, determination of RPO & RGO, oversight on generation capacity addition, mandatory tariff policy compliance and accountability of SERCs, the Centre will wield more power in the sector. There is no doubt many of the states and their agencies have failed to improve electricity. But the solution is unlikely to rest in transfer of powers and controls to the Centre.

While the broad goal of improving electricity is shared by Indian states, the approach needs to be state specific. The interventions designed at the Centre tend to treat the state-level electricity systems uniformly, without any attention to state-specific political and economic forces that constrain and shape choices of state governments. Consequently, the experiences and capacities of states are not uniform. Therefore, there is a need to devise state-specific pathways to improve electricity. To do so, the states and their agencies must be empowered and reform approaches must be based on state level political economy and links between electricity and politics.

The Centre must continue to set broad targets, provide guidelines and facilitate coordination between states. In addition, it must play the crucial roles in grid integration, market integration and transmission planning.

- *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.*

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