Fixing distribution is key

Bailouts will not help, reforms to make power production and purchase viable are a must

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In order to provide a thrust to the economic growth of India, it is critical that power sector reforms are fast-tracked. Noting the rapidly increasing gap between electricity demand and generation capacity, the government of India is striving to attract increased private sector participation in generation, transmission and distribution. While there have been some movements towards attracting investments in the generation segment, there is a pressing need for reform in other aspects of the power value-chain including the distribution segment. Until this is done, the power sector will not be able to attract sufficient investments as it is plagued by many hurdles and process delays.

The Power Finance Corporation's (PFC) September 2013 report, *The Performance of State Power Utilities for the years 2009-10 to 2011-12*, underlines the immediate need for making the distribution sector financially viable. The report highlights the key issues in the distribution sector including tariffs being kept artificially low, high level of receivables from the sale of power, operational inefficiencies, and insufficient investments in infrastructural improvements, amongst others. Though initiatives such as the continuation of the R-APDRP scheme (Restructured Accelerated Power Development and Reform Programme) to incentivise the utilities for sustainable reduction in losses have been adopted, and the financial restructuring plan of state distribution companies has been notified to bail out the cash-strapped discoms, much more needs to be done to accelerate distribution reforms, as this would have a direct impact on the sector's commercial viability and ultimately affect the consumers and generators. The public private partnership (PPP) model or the distribution-franchisee model is a good route to bring private investments in the distribution business and should be implemented across states.

This is the second time in a decade that there will be a bailout for the discoms and it is a matter of grave concern as the bailout will negatively impact the sector as it does not address the actual issues confronting it. It may also be noted that the first bailout did not prod the state governments to act.

This is the time to strengthen the distribution segment instead of offering bailouts. The sector has been plagued by high distribution losses (as high as 35-40%) and low billing recovery, which has resulted in poor financial health of the utilities. As per the PFC report, the aggregate losses (without accounting for subsidy) for all the utilities increased from ₹64,463 crore in the year 2009-10 to ₹74,291 crore in 2010-11 and to ₹92,845 crore in 2011-12.

We believe that at least 25% financial savings can accrue if there is immediate reduction of AT&C losses. This can help offset increase in fuel and energy costs. Attempts should be made to reduce AT&C losses through metering, feeder separation, introduction of HVDS, metering of distribution transformers and strict anti-theft measures. PPP in distribution and ESCO-based structures should be considered for efficiency improvement. Unbundling needs to be carried out on priority basis and open access to transmission should be strengthened. Timely nominal tariff increase to offset the cost of the power generation is the only step forward to ensure sustainability and growth in the sector, and is directly linked with the development and growth of the nation. Alternate models of distribution, particularly decentralised generation using renewable energy sources, could be effectively used to address the needs of the country's rural and semi-rural areas. Concurrently, the managements of distribution companies have to be made accountable for 24x7 reliable supply and fiscal management.

The PFC report also highlights the role of the ultra mega power projects (UMPPs), an initiative of the government of India with the ministry of power being the 'facilitator' for their development and the Central Electricity Authority (CEA) being the 'technical partner', in building a brighter future for India's energy needs.

For instance, India's first UMPP at Mundra set up by Tata Power meets around 2% of India's energy needs. The report also highlights that so far 13 special purpose vehicles (SPVs) have been established by PFC for these UMPPs, to undertake preliminary site investigation activities necessary for conducting the bidding process for these projects and that only four have been successful so far.

While the Mundra UMPP is fully operational and functional, and is generating 4,000 MW of power for five beneficiary states, the other three are at different stages of development.

Though the industry has participated enthusiastically in the bidding process, the UMPPs are engulfed by various challenges. In the case of the fully functional Mundra UMPP, the government needs to urgently look into the larger issue of dealing with imported fuels and evolve a mechanism to compensate producers for losses arising due to price fluctuations on imports of coal and gas, and a plan for a more flexible tariff structure.

The Mundra UMPP is at the brink of becoming unviable and may even be forced to shut down. In such a situation, the ultimate sufferers will be the end-users of power who will not only lose out on uninterrupted supply but will also be forced to pay more for it in the process. Though the CERC has ordered for a compensatory tariff to be paid to Mundra, and though the CERC-appointed committee has recommended a compensatory tariff formula, this is still to be implemented.

The indicative compensatory tariff (ranging between ₹2.90 to ₹3.10 per unit) is much lower and competitive in comparison to the average purchase price of all five states (₹3.20 per unit and above) and is substantially lower than the current market rate for providing replacement power (₹4.10 to ₹4.50 per unit), which could leave all five states prone to load-shedding.

It is pertinent to note that, in the future, electricity contracted by most of the distribution companies is going to be priced above ₹3.50 per unit (average power purchase cost for all states) and the average price of power from almost all recently commissioned plants averages at ₹4.50 per unit. If the Mundra UMPP were to be rendered unviable, the cost of purchasing replacement power would mean tariffs higher by at least ₹1 for the states.

While the power sector in India has witnessed a few success stories in the last 4-5 years, the road that lies ahead of us is dotted with innumerable challenges resulting from the gap between what was planned and what the power sector has been able to deliver. Though the power generation did take off, the pace of key attributes that propel greater implementation of the projects remains slow. Projects announced by various players are moving at a snail's pace as land acquisition and regulatory clearance have not been facilitated in a manner the industry would like them to happen.

At the moment, the country is also burdened with an overall power shortfall of about 11% and is at a situation where the distribution framework is almost on the verge of collapse.

The government's commitment towards reform in terms of political will, support and implementation capacity is the need of the hour towards strengthening the power sector.

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