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MERC (MULTI YEAR TARIFF) (FIRST AMENDMENT) REGULATIONS, 2017

STATEMENT OF REASONS

Date: 29 November, 2017

1. The Maharashtra Electricity Regulatory Commission (MERC) (Multi Year Tariff) Regulations ('MYT Regulations'), 2015 were notified on 8 December, 2015 for the 3rd Control Period (FY 2016-17 to FY 2019-20). In pursuance of these Regulations, the Commission has issued MYT Orders for Generation Companies, Transmission and Distribution Licensees, and the Maharashtra State Load Despatch Centre (MSLDC).

2. Subsequent to notification of the MYT Regulations, 2015, there have been some developments which have a bearing on some of their provisions. Several Utilities and others have also raised certain concerns, particularly on the provisions for Operation and Maintenance (O&M) expenses, during the tariff determination process and through separate Petitions, and sought relaxation or amendment in the specified norms.

3. The Commission initiated a study on these issues. Based on this study, the Commission prepared draft Regulations for amending the provisions relating to the applicable interest rate and the O&M expenses. Accordingly, a Public Notice inviting suggestions and objections on the MERC (MYT) (First Amendment) Regulations, 2017 was published in four daily newspapers (Times of India and Indian Express in English, and Maharashtra Times and Loksatta in Marathi) on 26 October, 2017. The draft Regulations were made available on the Commission's websites along with an Explanatory Memorandum. The last date for receipt of comments was 17 November, 2017.

4. The Commission has received 10 responses (list annexed), including from Generation Companies, Licensees, consumers and Authorised Consumer Representatives. The main issues raised and the Commission's analysis and decisions which underlie the Regulations as finally notified are set out below:

    4.1. <u>Interest Rate:</u>

    In the MYT Regulations, 2015, Base Rate has been defined as the Base Rate of the State Bank of India (SBI). Under the Regulations, the rate of interest to be allowed on Interest on Working Capital (IoWC), carrying cost/holding cost and Security Deposit is the SBI Base Rate plus 150 basis points. However, subsequent to the Reserve Bank of India (RBI) Guidelines dated 3 March, 2016, Banks are sanctioning new loans only on the basis of Marginal Cost of Funds-based Lending Rates (MCLR). Hence, the draft amendments proposed the 1-year SBI MCLR as the Base Rate.

Maharashtra State Electricity Distribution Co. Ltd. (MSEDCL) has supported the proposed amendment. Other Utilities like Tata Power Co. Ltd. (TPC), Maharashtra State Power Generation Co. Ltd. (MSPGCL), Maharashtra Eastern Grid Power Transmission Co. Ltd. (MEGPTCL) and Adani Transmission (India) Ltd. (ATIL) have referred to the Central Electricity Regulatory Commission (CERC) Regulations and market conditions to suggest that the mark-up on the MCLR be increased to 200 to 350 basis points, and some have argued in this context that the SBI 1-year MCLR is the lowest among the financial institutions.

The Commission observes that, as against the SBI Base Rate of 8.95% (as revised on 1.10.2017), its 1-year MCLR is 7.95% (as revised on 1.11.2017). All new loans are being provided by Banks on the basis of MCLR. As explained in the Explanatory Memorandum, Utilities have been able to obtain funds at rates which are lower than or around the SBI MCLR plus 150 basis points. These considerations have been elaborated in the Explanatory Memorandum. The Commission is of the view that no change is required in the proposed amendments on this point.

4.2. Operation and Maintenance Expenses

In its recent Orders on Petitions filed by some Utilities for revision in their approved O&M expenses, the Commission had stated its prima facie view that certain provisions of the MYT Regulations, 2015 in this regard need to be amended. In its Order dated 23 October, 2017 in Case No. 123 of 2016 on a Petition of MSEDCL, for instance, the Commission had stated that:

> *"9. The Commission is of the view that reasonable O&M Expenses should be allowed to the Distribution and other Licensees. The Commission notes the anomalous situation in which, even with the relaxed dispensation and higher escalation factor of 2.97% (consisting of the modified inflation index as adjusted by the efficiency factor) allowed in the MYT Order of MSEDCL, for instance, the O&M Expenses approved for FY 2019-20 (Rs. 6455 crore) are lower than the level approved for FY 2015-16 (Rs. 6533 crore).*
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> *10. The weightage of 40% to CPI and 60% to WPI specified in the MYT Regulations, 2015 is based on the Tariff Regulations of the Central Electricity Regulatory Commission (CERC), though the CERC has considered a 5-year average as against one year in the MYT Regulations, 2015. However, considering the issues raised by MSEDCL and other Licensees, the Commission is of the prima facie view that these weightages and certain other stipulations may require to be revisited depending on the characteristics of generation, transmission and distribution activities. The Commission is separately considering the need to amend the MYT Regulations, 2015 suitably,*

in which case MSEDCL and others would have the opportunity to provide comments during the public consultation process.”

Accordingly, for the determination of reasonable O&M expenses, the Commission proposed to amend the methodology for computation of Base Year O&M expenses and the inflation factor in the MYT Regulations, 2015, and set out the rationale for the proposed amendments in an Explanatory Memorandum. The comments received on this point in the public consultation process are addressed below:

a. Computation of Base Year O&M expenses:

As per the MYT Regulations, 2015, Base Year O&M expenses are determined by taking the 3-year average for the period from FY 2012-13 to FY 2014-15 and normalising that average by escalating it by 5.72%. The draft Regulations propose that the final trued-up O&M expenses be considered, after adding/deducting the sharing of efficiency gains/losses for FY 2015-16, as the Base Year expenses for determining the O&M expenses for the 3rd Control Period.

MSPGCL and MSEDCL support the change proposed. TPC, Brihanmumbai Electric Supply and Transport Undertaking (BEST) and Reliance Infrastructure Ltd. (RInfra) have suggested that the actual O&M expenses for FY 2015-16, without any adjustment for efficiency gains / losses, should be considered as the Base Year O&M expenses.

The Commission notes that O&M expenses are controllable expenses under the MYT Regulations. Further, the O&M expenses for FY 2015-16 will be allowed only after truing–up in accordance with the provisions of the earlier MYT Regulations, 2011 and the sharing of efficiency gain or losses. Hence, as proposed in the draft amendment Regulations, such O&M expenses approved for FY 2015-16 after sharing of efficiency gains or losses shall be considered as the Base Year O&M expenses.

b. Inflation Factor

Under the MYT Regulations, 2015, the escalation factor for O&M expenses for the 3rd Control Period is to be worked out based on the inflation factor considering 60% and 40 % weightage for actual point to point Wholesale Price Index (WPI) and Consumer Price Index (CPI), respectively, ‘in the previous year’, as reduced by a stipulated efficiency factor. Invoking its powers under Regulation 102 to remove difficulties, in the last MYT Orders the Commission had instead applied the 3-year average variation in WPI and CPI to arrive at the inflation factor for projecting O&M Expenses from FY 2016-17 onwards. Based on the analysis set out in the Explanatory Memorandum, the draft amendment Regulations proposed to apply different weightages of WPI and CPI for Generation (50:50), Distribution (30:70) and MSLDC

(20:80). They also proposed that the average of these indices for the preceding 5 financial years be applied as the basis for the inflation factor.

In its comments, MSEDCL has suggested a weightage of 20:80 to WPI:CPI for the inflation factor to be applied to Distribution Licensees since the actual ratio for MSEDCL works out to 21:79. BEST has proposed a CPI weightage of 76% instead of 70% proposed in the draft amendments. MSPGCL submitted that, instead of 50:50 proposed for Generation Utilities, a WPI-CPI ratio of 60:40 may be considered to reflect the realistic weightage for the computation of the inflation factor. MSEDCL and RInfra-D have also suggested that certain physical parameters be included in the inflation factor.

As discussed in the Explanatory Memorandum, the revised weightages to WPI and CPI for the inflation factor have been proposed considering the average weightage of these indices in respect of the Distribution Licensees and Generating Companies, respectively, regulated by the Commission. As the weightage in the case of the individual Distribution Licensees and Generating Companies is close to these averages, the Commission has concluded that no change is necessary in the weightages proposed in the draft Regulations.

c. O&M Expenses relating to Housing Colonies of Generating Companies

MSPGCL has suggested a re-wording of the provision excluding the O&M expenses of the housing colonies of its Generating Companies from the normative computations (these are to be allowed separately). The draft amendment re-words the existing provision to make it more clear that the O&M expenses to be allowed separately include the expenses on the operating staff of such colonies. The Commission finds no reason for any further change.

d. Efficiency Factor

The draft amendments did not propose any change in the Regulations relating to the efficiency factor of 1% for arriving at the escalation factor for projecting O&M expenses. However, in their responses, many Utilities have suggested that the stipulation of 1% in each year is unrealistically high considering the nature of their operations, and some have suggested that the concept of an efficiency factor be removed altogether from the allowable escalation of O&M expenses.

The Commission notes that an efficiency factor of 1% translates into efficiency improvement of 4% to be achieved over the Control Period. Efficiency improvement to this extent in O&M expenses may be difficult considering the increasing number of consumers, asset base and other elements that is likely. The Commission would take these considerations into account during the forthcoming Mid-Term Review proceedings and determine the efficiency factor to be applied, if at all, at that stage.

In this context, the Commission notes that, while the MYT Regulations, 2015 specify an efficiency factor of 1%, they also provide that a different efficiency factor may be stipulated by the Commission from time to time. Hence, the existing Regulations provide sufficient flexibility in respect of the efficiency factor to be applied, and no amendment is necessary in this regard.

e. Impact on Tariff

Chamber of Marathwada Industries and Agriculture (an Authorised Consumer Representative), Maharashtra Veej Grahak Sanghatana and Shri. Mahaveer Kumar Jain have opposed the proposed amendments on the ground that they would result in increase in tariffs and in the scope for operational inefficiencies. The Commission is of the view that a consequential increase in tariffs cannot be a reason for denying reasonable O&M expenses to a Utility if they are otherwise justified. Inadequate O&M funding may also affect continuity and quality of supply. The considerations underlying the proposed amendments have been elaborated in the Explanatory Memorandum.

5. Other Issues:

5.1. In their responses to the draft amendments, ATIL and MEGPTCL (both of whom are recent Transmission Licensees) have sought that separate norms be specified for them considering their O&M expenses. They have also suggested that the norms proposed for the Distribution Wires Business, which has similarities with transmission, could be considered for the Transmission Licensees also. However, the proposed amendments which were presented for public consultation did not include any revision in the O&M expense norms for Transmission Licensees. Hence, changes in these norms are outside the scope of the present exercise, and the Commission does not consider it necessary to revisit them at present.

5.2. The draft Regulations also did not envisage any amendment to the provisions of the MYT Regulations, 2015 relating to the sharing of efficiency gains and losses. However, in its responses, RInfra has suggested that these provisions also be amended to provide for sharing of efficiency gains in the ratio of 60:40 between the Utility and consumers, as in the CERC Tariff Regulations, instead of 1:2 in the Commission's MYT Regulations. However, this is entirely outside the scope of the present exercise, and the Commission does not consider it necessary to revisit the mechanism for the sharing of efficiency gains and losses at present.

6. In view of the foregoing, the Commission concludes that no change is required in the draft Regulations, and they are finalized accordingly.

Sd/-	**Sd/-**	**Sd/-**
(Deepak Lad)	**(Azeez M. Khan)**	**(Anand B. Kulkarni)**
Member	**Member**	**Chairperson**

Annexure

List of persons who have submitted comments and suggestions on draft MERC (Multi Year Tariff) (First Amendment) Regulations, 2017.

Sr.No.	Name of Person
1	Shri. Mahaveer Kumar Jain, Borivali (East), Mumbai
2	Maharashtra Eastern Grid Power Transmission Co. Ltd., Ahmedabad, Gujarat
3	Adani Transmission (India) Ltd., Ahmedabad, Gujarat
4	Maharashtra State Power Generation Co. Ltd., Prakashgad, Bandra (E), Mumbai
5	Maharashtra State Electricity Distribution Co. Ltd., Prakashgad, Bandra (E), Mumbai
6	Brihanmumbai Electric Supply and Transport Undertaking, Mumbai
7	Maharashtra Veej Grahak Sanghatana, Ichalkaranji, Kolhapur
8	Reliance Infrastructure Ltd., Borivali (W), Mumbai
9	Tata Power Co. Ltd., Mumbai
10	Chamber of Marathwada Industries and Agriculture, Aurangabad