No. MERC/Fran. for Elec. Distn./2007/1936 September 10, 2007

Principal Secretary (Energy)
Industries, Energy & Labour Department,
Government of Maharashtra,
Mantralaya,
Mumbai 400 032

Sub: Policy advice on 'Distributed Generation based Electricity Distribution Franchisee (DGBDF)'

Ref: The Commission's letter ref. no. MERC/ Fran. for Elec. Distn./2007/327 dated February 13, 2007

Sir,

This is with reference to the Commission letter no. MERC/ Fran. for Elec. Distn./2007/327 dated February 13, 2007 to the State Government, forwarding a copy of the Approach Paper regarding 'Distributed Generation based Franchisee for Electricity Distribution' for its perusal.

As mandated under Section 86 (2) of the Electricity Act, 2003, I am directed to forward herewith the Commission's advice on 'Distributed Generation based Electricity Distribution Franchisee'.

The Commission is of the opinion that the Government of Maharashtra's policies could be suitably formulated to promote distributed generation based franchisees for electricity distribution, which could result in better service to consumers prepared to pay 'cost reflective tariffs'. This will also help industrial areas and feeders to avoid a second suggested day of load shedding in times of severe demand-supply gap, as well as enable urban centres to get relief from load-shedding as in the city of Pune.

With Regards,

Yours faithfully,

(P.B.Patil)
Secretary, MERC

Encl: as above

Policy Advice to the Government of Maharashtra under Section 86 (2) of the Electricity Act, 2003, on Distributed Generation Based Electricity Distribution Franchisee

A. Background

1. The State of Maharashtra has been witnessing serious shortage of electricity with many parts reeling under long and severe power shortages. The gradual widening of the energy demand – supply gap has become a major challenge for the utilities in the State.

2. Realizing the necessity and importance of reform in the electricity sector, the Government has enacted the Electricity Act, 2003 (EA 2003) and notified the National Electricity Policy (NEP) and National Tariff Policy (NTP). Continuous and assured supply of electricity, and Open Access on the transmission and distribution network, are the crux of the above enactments. However, due to the prevailing supply shortage in the State and the transmission corridor constraints, additional supply is not coming into the State in a big way.

3. The Maharashtra State Electricity Distribution Company Limited (MSEDCL) has entered into a distribution Franchisee Agreement for Bhiwandi area and is in the process of appointing a Franchisee in a similar manner for three Divisions of Nagpur. These Franchisees are being appointed with the primary objective of facilitating reduction of distribution losses and improvement in collection efficiency.

4. The Commission is of the view that in Maharashtra, it is essential to increase electricity generation locally without overloading the existing transmission system in order to overcome the supply shortages, as the economic losses due to non-supply are very high. Based on the lessons derived from the 'CII-Pune model', the Commission is advising the State Government on 'Distributed Generation Based Electricity Distribution Franchisee' (DGBDF), as one of the options to mitigate the acute problem of widening electricity demand supply gap as well as to improve the reliability and efficiency of electricity distribution. The DGBDF can also help industrial areas and feeders to avoid a second staggered day of load shedding in times of severe demand-supply gap, as well as enable urban centres with the 'ability to pay' to get relief from load shedding. The surplus captive capacity lying idle may also get fully utilised on commercial terms.

B. Provisions of EA 2003

5. The Commission is advising the Government of Maharashtra under Section 86 (2) of the Electricity Act 2003, which provides for the State Commission to advise the State Government, as reproduced below:

   "The State Commission shall advise the State Government on all or any of the following matters, namely:-.

   i. *promotion of competition, efficiency and economy in activities of the electricity industry;*
   ii. *promotion of investment in electricity industry;*
   iii. *reorganization and restructuring of electricity industry in the State;*
   iv. *Matters concerning generation, transmission, distribution and trading of electricity or any other matter referred to the State Commission by that Government."*

6. The Commission is of the opinion that the Government of Maharashtra's policy could be suitably formulated to promote distributed generation based electricity distribution franchisee, which would result in better service to consumers prepared to pay 'cost reflective tariffs' and competition in the sector.

C. Process Flow:

7. The Commission, vide letter dated February 13, 2007, forwarded the Approach Paper on 'Distributed Generation Based Franchisee for Electricity Distribution' to the Government of Maharashtra for its perusal.

8. The Executive Summary of the Approach Paper and the detailed Approach Paper were made available on the Commission's website. A Public Notice was issued on March 8, 2007 on the Commission's website to invite suggestions and comments on the Approach Paper. The stakeholders were asked to submit their suggestions and comments to the Commission on or before March 30, 2007.

9. In response to the Public Notice, the Commission received a total of 11 suggestions/comments from the stakeholders, which have been summarized issue-wise in **Annexure 1,** along with the Commission's analysis of the same, while the list of persons who have submitted suggestions/comments is given in **Annexure 2**.

Policy Advice to Government of Maharashtra on Distributed Generation based Electricity Distribution Franchisee

1. Distributed Generation based Electricity Distribution Franchisee (DGBDF) could result in public-private participation, with the ownership of the system remaining with the Distribution Licensee, while inviting the private sector to manage the distribution more efficiently and bridge the demand-supply gap with its own resources in an innovative manner.

2. The DGBDF option envisages the addition of generation capacity in the State, coupled with a more focused management of the distribution system at localized levels. The Franchisee will be able to procure power from other sources in the interim period till such time as the generation facilities are established.

3. The DGBDF can also help industrial areas and feeders to avoid a second staggered day of load shedding in times of severe demand-supply gap, as well as enable urban centres with the 'ability to pay' to get relief from load shedding.

4. The surplus captive capacity lying idle may also get fully utilised on commercial terms under the DGBDF concept.

5. DGBDF concept is intended for application in the entire State, and not only for the MSEDCL license area.

6. The Franchisee arrangement will primarily be governed by the Franchisee Agreement between the Distribution Licensee and the Franchisee.

7. Franchisee will be required to supply electricity as per the tariff approved by the Commission. The Generating Company, a part of Franchisee, will sell electricity to the distribution division, by way of transfer pricing.

8. The Franchisee will be selected based on a competitive bidding process undertaken by the licensee.

9. The criteria for selection of the Franchisee would be stipulated by the Licensee, and could include the quantum of generation capacity addition committed by the Franchisee and the time frame for the same, highest price quoted by the

Franchisee for energy to be purchased from the Licensee, performance improvement trajectory, etc.

10. The DGBDF concept will work best in areas where the distribution losses are low, and the collection efficiency is high, as the primary objective is to bring in additional generation capacity into the system on a war footing. In areas where the distribution losses are high and/or the collection efficiency is low, the Franchisee could be asked to reduce the losses as well as bring in additional generation capacity, under this Model. However, in such cases capacity addition will depend upon the willingness of the consumers in that area to pay the full cost.

11. The distribution Licensee will not only permit the Franchisee to utilise the distribution assets of the Licensee located in a designated area (which is electrically demarcated) but will also expect the latter to undertake network upgradation. Staff of the Licensee selected by the Franchisee can be deputed to the Franchisee to support the electricity distribution and supply operations in the designated area. The Franchisee will organize balance staff required for electricity generation activity as well as for the distribution and supply function (complementary staff).

12. The Franchisee will maintain all the records with respect to the transfer price for electricity generated and supplied to consumers through the distribution system of the Licensee under its operational control, which will be required by the Licensee for its periodic tariff related and other filings before the Commission.

13. The Licensee is required to follow Standards of Performance Regulations stipulated by the Commission. In turn, the Franchisee will be required to follow Standards of Performance as stipulated by the Licensee.

14. As the Franchisee cannot engage in trading of electricity, i.e., purchase and sale of energy, for the purposes of energy balance of the licensee, the generation by the franchisee and/or purchase from other sources for sale within the franchisee area, will be considered as ‘deemed power purchase’ by the licensee, and the sale to the Franchisee by the licensee, will include this quantum in addition to the energy supplied by the licensee. Hence, the Franchisee will not require a trading license for the purpose.

15. For the quantum of generation by the franchisee and/or purchase from other sources for sale within the franchisee area, the Commission will determine the

transfer price of the same for transfer of the same to the licensee, and will also determine the reliability surcharge to be levied on the consumers in the franchisee area to recover the cost of this additional energy, on a case-to-case basis.

16. There will not be any applicability of wheeling charges on the energy generated by the Franchisee and used for supply to the Franchisee area, as the energy is being sold to the licensee under the ‘deemed power purchase’ route.

17. The quantum of generation capacity addition in a specified time frame, rate of transfer of electricity by the licensee to the franchisee, the minimum revenue expected from the franchisee area, the distribution losses, collection efficiency, etc., will have to be mutually agreed upon between the licensee and the franchisee under the Franchisee Agreement.

18. Franchisee would be expected to undertake the DSM activities in the designated area, on behalf of the Licensee.

19. Powers of disconnection would be given to the Franchisee. However, the Franchisee needs to undertake sufficient due diligence while exercising this authority. Necessary legal safeguards may be incorporated in the Franchisee Agreement.

20. The Schedule of Charges approved for the licensee area would be applicable in the Franchisee area as well.

21. In case of any subsidy from the State Government, the entire subsidy for the respective consumers in the Franchisee area will have to be handed over to the Franchisee by the Licensee, to compensate the Franchisee for the reduced revenue from tariffs due to the subsidy being provided by the GoM.

22. The Commission will not approve the ARR of the Franchisee, and the expenses and revenue from the Franchisee arrangement would be considered under the Licensee’s operations, though indicated separately.

Annexure 1

Salient Features of the Approach Paper on Distributed Generation based Electricity Distribution Franchisee, Stakeholders' Comments and Commission's Analysis

1. Context

The State of Maharashtra has been witnessing serious shortage of energy resources with many parts reeling under long and severe power shortages. The peak electricity shortage has increased from about 1,000 MW in 2001-02 to about 5300 MW in 2006-07. This has resulted into longer hours of load shedding in the MSEDCL license area. Even the Mumbai license area has been managing to prevent load shedding till date by procuring costly power on a short-term basis. The gradual widening of the energy demand – supply gap has become a major challenge for the Utilities in the State. It is important to note that in Maharashtra, it is essential to increase electricity generation locally without overloading the existing transmission system. In order to tide over the crisis, '**Distributed Generation based Electricity Distribution Franchisee' (DGBDF)** option needs to be explored at least in Urban/Semi-urban areas or for select industrial feeders, where ability to pay higher tariff exists.

Further, innovative approaches such as CII-Pune Captive Model have yielded positive response from consumers as well as captive power industry in the recent past. Thus, to increase electricity generation locally without overloading the existing transmission system, it is essential to identify an appropriate model, which would allow local (distributed) generation and distribution of power with the involvement of private sector and other agencies like co-operative societies, etc.

In this context, an Approach Paper has been developed to outline broad framework for operationalising DGBDF scheme. The Approach Paper discusses appointment of Franchisee by Distribution Licensee to distribute the electricity to consumers in the allocated area as per the tariff approved by the Commission and to generate the electricity corresponding to the demand-supply gap. The model envisages the installation of grid connected short-gestation generation capacity either in form of conventional sources or non-conventional sources, to make more generation available as well as reduced technical losses as the Franchisee generates electricity locally near load centre. The Franchisee will have to manage all technical and commercial functions of Licensee's distribution system. The proposed concept promotes the participation from private sector and others like co-operative societies at the local level to improve efficiency of distribution operations.

Considering that distributed generation is likely to be more expensive than average power purchase cost of the utilities, cost reflective tariffs for such supply are bound to be higher than the average tariffs of the utilities. Therefore, such an arrangement would primarily suit urban and semi-urban areas, as well as dedicated industrial feeders, where ‘ability to pay higher tariffs’ exists. However, the same concept can also be suitably adopted for rural areas, if beneficiaries demonstrate willingness to pay appropriate ‘cost reflective tariffs’ or the State Government provides the necessary subsidy concession.

This Approach Paper is an attempt to analyse and discuss the framework for the Franchisee arrangement and the roles of the Licensee and Franchisee as also the issues related to distribution management and generation. The purpose of the Paper is to invite comments and suggestions from utilities, consumer groups and other stakeholders with a view to developing a workable and effective framework.

1.1 Stakeholders’ comments and Commission’s Analysis:

Thane Small Scale Industries Association (TSSIA) and Chamber of Small Industry Associations (COSIA) submitted that the Franchisee model would be useful only when industries are given continuous supply without any load shedding including the staggering day. The consumers should be given quality power supply for all 24 hours of the day throughout the year. TSSIA further submitted that the Franchisee must also be in a position to supply electricity to new consumers, in addition to the increasing demand of existing consumers and added that the Franchisee should compensate the losses of the industries if it fails to provide uninterrupted supply.

Maharashtra Industrial Development Corporation (MIDC), vide its affidavit dated March 26, 2007, submitted that it has planned many Special Economic Zones (SEZ’s) and new industrial areas in Maharashtra in addition to a large number of existing industrial areas already developed and maintained by it and it is in the process of obtaining an Inter State Power Trading License to purchase power from merchant power plants or other sources as well as developing power generating SEZ’s. MIDC also expressed its interest to undertake DGBDF in industrial/SEZ’s.

Shri N. Ponrathnam pointed out that the biggest problem faced by MSEDCL is the higher distribution losses, to the extent of 35% for FY 2006-07 and mentioned that the Commission has directed MSEDCL to reduce the distribution loss, but no significant progress is achieved by MSEDCL. He further submitted that the rural areas should not be left out as electricity is acknowledged as a basic necessity for improving the standard of living and added that Agriculture and Cottage industries are dependent on electricity as source of energy. Shri N. Ponrathnam submitted that

DGBDF is not the solution to the problem of shortfall of power; instead, the Distribution licensee should generate electricity more than the demand.

Bombay Small Scale Industries Association (BSSIA) submitted that the consumers should be assured of better quality of service and reliable power supply at reasonably lower tariffs and stated that the Approach Paper does not substantiate the comment on failure of MSEDCL's Internal Reforms Programme (IRP). No data has been provided on the implementation of IRP, and hence, it is not prudent to judge the success or failure, in the absence of any information. BSSIA further submitted that detailed write up on MSEDCL's IRP is required which would help in evaluation of reasons for the failure (if at all) so that the same pitfalls would be avoided in the Franchisee route. They added that Approach Paper is misleading in view of the fact mentioned that IRP of MSEDCL is a complete failure and mentioned that Approach Paper would like the reader to jump straight into believing that DGBDF is the only one viable source to mitigate the demand-supply gap. BSSIA submitted that in the Approach Paper, it is mentioned that DGBDF is an optimum option to mitigate the acute problem of widening electricity demand supply gap as well as to improve reliability and efficiency of electricity distribution, which is applicable only for "inefficient" distribution systems.

Madhav Capacitors Pvt Ltd. proposed that the Franchisee should achieve reduction of T&D losses from present level of 35% on MSEDCL network by the use of capacitors, voltage regulators, and booster transformers.

Maharashtra State Electricity Distribution Co. Ltd. (MSEDCL) vide its email dated April 10, 2007, requested the Commission to thoroughly evaluate the financial viability of Franchisee model, based on the area in which it is proposed to be implemented considering the consumer mix, load pattern, etc. MSEDCL further submitted that GoM has already notified rural areas (Proviso 8 of Section 14 of EA 2003) wherein no license is required to distribute electricity and hence, the arrangement of Franchisee may not be required if generation and distribution is undertaken in such notified rural areas. MSEDCL pointed out that the Commission has issued separate Orders for projects based on Wind, Small Hydro, Biomass and Municipal Solid Waste, etc.

The Commission agrees with the view expressed by some stakeholders that the Franchisee should be in a position to supply electricity for 24 hours of the day throughout the year, i.e., there should be no load shedding. The Franchise should also be in a position to cater to the projected increase in demand and consumption.

However, this would depend on the quantum of additional supply that the Franchisee is able to arrange, either through own generation or from other sources, which would get reflected in the Reliability Surcharge to be charged by the Franchisee from the consumers in the region, who will be benefiting from the reduction in load shedding.

In the context of the comment of the stakeholder that the real solution is in generating more electricity than the demand, rather than Franchisee, the Commission is of the opinion that the real problem faced by the distribution licensees, apart from their inability to reduce the distribution losses significantly, has been the lack of addition of generation capacity in the State. The Franchisee option envisages the addition of generation capacity in the State, coupled with a more focused management of the distribution system at localized levels.

The Maharashtra State Electricity Distribution Company Limited (MSEDCL) has entered into a distribution Franchisee Agreement for Bhiwandi area and is in the process of appointing a Franchisee in a similar manner for three Divisions of Nagpur. These Franchisees are being appointed with the primary objective of facilitating reduction of distribution losses and improvement in collection efficiency. The Commission is of the view that in Maharashtra, it is essential to increase electricity generation locally without overloading the existing transmission system in order to overcome the supply shortages, as the economic losses due to non-supply are very high. Based on the learning from the CII-Pune model, the Commission is advising the State Government on 'Distributed Generation Based Electricity Distribution Franchisee' (DGBDF), as one of the options to mitigate the acute problem of widening electricity demand supply gap as well as to improve the reliability and efficiency of electricity distribution.

The DGBDF can also help industrial areas and feeders to avoid a second staggered day of load shedding in times of severe demand-supply gap, as well as enable urban centres with the 'ability to pay' to get relief from load shedding. The surplus captive capacity lying idle may also get fully utilised on commercial terms.

The Commission's comments on the lack of success of MSEDCL's Internal Reforms Programme (IRP) are based on the apparent slow pace of reduction of distribution losses, and are not based on any data submitted by MSEDCL on their IRP. If the stakeholder desires for data on MSEDCL's IRP, they may approach MSEDCL for the same. Further, it is incorrect to state that the Commission has proposed the DGBDF as the only solution for mitigating the demand-supply gap, rather, it has proposed the DGBDF as one of the options available to the State for improving the efficiency of the distribution function while at the same time, bringing in additional generation capacity into the State.

As regards MSEDCL's submission that the Commission should evaluate the financial viability, based on the area and its consumption mix, etc., the Commission is of the opinion that it is upto the Franchisee to assess the viability of its operations based on its cost structure, consumption mix of the area, distribution losses, etc., and the Reliability Surcharge that would need to be levied on the consumption, in order to recover the cost of additional generation or costly power purchase, as the case may be. As regards MSEDCL's contention that a Franchisee arrangement may not be required in areas notified by the Government of Maharashtra (GoM) as rural areas under the EA 2003, the Commission is of the opinion that the Franchisee arrangement will work in areas where the MSEDCL has the distribution licence. For notified rural areas, the distribution licence itself is not required. Moreover, some Agreement will be required between the MSEDCL and the person undertaking distribution activities in these areas, which will set out the duties, rights and obligations of MSEDCL and the agency in these areas.

The DGBDF concept will work best in areas where the distribution losses are low, and the collection efficiency is high, as the primary objective is to bring in additional generation capacity into the system on a war footing. In areas where the distribution losses are high and/or the collection efficiency is low, the Franchisee could be asked to reduce the losses as well as bring in additional generation capacity, under this Model. However, in such cases capacity addition will depend upon the willingness of the consumers in that area to pay the full cost.

2. Regulatory Framework

The Electricity Act 2003 (EA 2003) has created pathways to reform the electricity sector. The different provisions under the EA 2003 are expected to result in improving efficiency and reliability of electricity supply to all parts of the country.

'Franchisee' has been defined in EA 2003 as follows:

"Franchisee means a person authorised by a distribution Licensee to distribute electricity on its behalf in a particular area within his area of supply".

The Franchisee arrangement will, primarily, be governed by the Franchisee Agreement between the distribution Licensee and the Franchisee. It follows that the Franchisee will be required to supply electricity as per the tariff approved by the

Commission. At the same time, the generating company, a part of the proposed Franchisee, will sell electricity to the distribution division, by way of transfer pricing. Principles of efficiency and competition will be adopted by the distribution Licensee (MSEDCL in this case), and all organizations bidding for the proposed Franchisee arrangement will compete with each other. MSEDCL will purchase electricity from the selected Franchisee to meet a shortfall in the area of Franchisee. It may be noted that a generating company can supply electricity to any consumer under the Open Access regime. However, under the proposed Franchisee arrangement, electricity shall be supplied to the distribution Licensee for supply to consumers located only within the area assigned to the Franchisee.

The National Electricity Policy 2005 (NEP 2005) has given the following directions to improve electricity distribution:

a. Proper restructuring of distribution utilities essential for achieving efficiency gains.
b. Adequate financing support to utilities. Such support could be provided with conditions to achieve pre-determined efficiency gains and for reducing cash losses.
c. Appropriate governance structure to be in place to insulate these organizations from extraneous interference as also to ensure transparency and accountability.
d. Private sector participation in distribution to reduce transmission and distribution losses and for improving services to customers.

The proposed Franchisee concept will aid in achieving the objectives outlined by the NEP.

The Commission has notified various Regulations, inter-alia:

§ MERC (Terms and Conditions of Tariff) Regulations, 2005
§ MERC (Standard of Performance) Regulations, 2005
§ MERC (Electric Supply Code and Conditions of Supply) Regulations, 2005, etc.
§ MERC (Standard of Performance) Regulations, 2005

The provisions of these Regulations will have to be incorporated in the Franchisee Agreement.

2.1 Stakeholders’ Comments and Commission’s Analysis:

CLP Power India Pvt Ltd. submitted that the Franchisee should be protected against any change in Regulatory framework, which would have any financial implication. They further submitted that the issues related to Tariff Bidding Guidelines issued by Ministry of Power should be explored by the Commission.

Madhav Capacitors Pvt Ltd. opined that the franchisee having an exclusive distribution right over its area continues the monopolistic way of electricity business, which is against the principles and spirits of EA 2003.

MSEDCL submitted that the Distributed Generation based Distribution Franchisee should be taken up only on pilot scale. MSEDCL further enquired about the eligibility to allocate specific area under Franchisee and requested for clarification in cases where a consumer falling under the Franchisee area does not opt for supply from the Franchisee and continue to source from the licensee.

The Commission is of the view that the Franchisee would be selected based on a competitive bidding process to be followed by MSEDCL. The eligibility criteria for the same would have to be decided by MSEDCL. The Commission fails to understand MSEDCL's request for clarification in the context of a consumer opting for supply from the licensee rather than the Franchisee, as the Franchisee will effectively be an agent of the licensee, supplying electricity on its behalf, unlike the case of a parallel licensee, wherein the question of consumer choice would arise.

It is clarified that there is no bar on any application for a parallel license in the area of the Franchisee, and there is no monopolistic right being granted to the Franchisee under this scheme.

Similarly, the Open Access provisions of the EA 2003 and the Commission's Regulations would continue to be applicable, even in the Franchise area, as the Franchisee is only an agent of the licensee, and all the license obligations will continue to vest with the Licensee.

3. Distributed Generation and Franchisee Model

Distributed Generation includes small, modular technologies for electricity generation, located close to the load. DG technologies are used both in stand-alone mode as well as in grid parallel mode. Conventional electricity generating stations are typically located close to the fuel source and away from the loads, and electricity generated is conveyed through the transmission system to the load centre, which often requires large investment. Transmission and distribution costs account for about 30 per cent of the cost of delivered electricity. DG technologies obviate the need for an expensive transmission system and minimise transmission and distribution losses. The typical timeframe for getting a new DG station on stream varies from 1 year to 3 years depending on the technology.

Franchisee Concept:

Distribution Licensee and Franchisee would enter into a Franchisee arrangement under which the Franchisee will manage the electricity distribution function in the designated area within the license area of the distribution licensee. The main elements of such an arrangement would include:

a. Distribution Licensee will supply electricity to the Franchisee at a pre-determined price as per the Franchisee Agreement.

b. The Franchisee will supply electricity to consumers of the Licensee in the allocated area (a part of the total area of supply of licensee) as per the tariff (including reliability surcharge) approved by the Commission.

c. The Franchisee will manage the electricity distribution system of the Licensee in the allocated area. The Franchisee will not only undertake maintenance of the distribution system, but also upgrade and strengthen the distribution system as per the requirements of the Licensee, with its approval.

d. The Franchisee will manage metering, billing and collection with the help of the existing staff of the licensee (in addition, Franchisee will be required to add its own staff to manage any increase in business).

e. Franchisee will remit a pre-determined share of the revenue collection at regular intervals to the Licensee, as per the Franchisee Agreement. The Franchisee will retain a portion of the revenue collection from consumers after deducting amount payable/paid to the licensee.

f. Franchisee will operate under the overall guidance of the Licensee.

g. The Franchisee will also generate electricity locally to meet any shortfall (i.e. demand supply gap) in its designated area, under the proposed scheme of ‘Distributed Generation (DG) based Electricity Distribution Franchisee’.

The Franchisee will be required to offer (and commit) the following benefits:

- Improved reliability (lower number of outages) and quality (lower voltage and frequency fluctuations, etc.) of electricity supply. With distributed generation, availability is expected to improve, thereby reducing incidence of load shedding.
- Improved electricity distribution function will lead to:

- Lower T&D losses: Locally generated electricity will obviate the need for transmission over long distances. Extent of unaccounted electricity will reduce due to improved metering and better practices.
    - Better and reliable metering, accurate billing and improved collection
    - Better overall maintenance of distribution system (by adopting good management practices)
- Upgradation and expansion of distribution system: The Franchisee will modernise and upgrade key components of the distribution system. The Franchisee will also strengthen the existing distribution system to accommodate any increase in business (in terms of number of consumers as well as in terms of energy supplied).
- Improved customer relations (reduction in number of complaints and grievances). Better and trained staff of Franchisee along with the existing staff of the Licensee suitably retrained and oriented towards consumers will help in improving customer relations.

Scheme Of Operation:

The proposed scheme of Franchisee operation is based on the principles of 'Public Private Partnership'. The distribution Licensee will permit the private sector organization, Government agencies, or other agency such as co-operative societies to utilise the distribution assets of the Licensee located in a designated area (which is electrically demarcated). Existing staff of the Licensee in that designated area can be deputed to the Franchisee to support the electricity distribution operations. The Franchisee will organize balance staff required for electricity generation activity as well as for the distribution function (complementary staff). The principal elements of the operating scheme include:

- Power purchase from Licensee
- Electricity generation by a division of the Franchisee
- Compliance with standards relating to connectivity and reporting requirements of Franchisee (being a generating company)
- Transfer pricing to its electricity distribution division
- Distribution of electricity to consumers
- Metering, billing and collection
- Tariff of the Licensee as regulated by the Commission

As the generation of electricity using DG technology option will be the responsibility of the Franchisee, Licensee may not be required to have separate power purchase agreement with the Franchisee. The Licensee will be required to submit diverse information to the Commission under the present Regulations, whilst the Commission will have no direct interaction with the Franchisee. The Franchisee will enter into all the arrangements with respect to fuel supply, Engineering, Procurement & Construction (EPC) and financing of generation project. The generation division of the Franchisee will oversee day-to-day operations of the generating station which will be synchronized with the grid of Licensee. The generation, by and large, is expected to be connected at 33/22/11 kV level.

The Franchisee will maintain all the operational, technical, and other records for electricity generated and supplied to consumers via the distribution system of the Licensee under its operational control. These records will be required by the Licensee for filing such information in respect of Licensee's operation before the Commission. This information will be required by the Regulator to determine the distribution tariff, reliability surcharge and other charges proposed to be stipulated.

The Franchisee will be required to follow Standards of Performance as stipulated by the Licensee. The Licensee can ask the Franchisee to form a Consumer Grievance Redressal Unit/ Forum at the office of the Franchisee to address consumer grievances. The Franchisee will also manage the metering at the consumer end, the details of which are elaborated in subsequent sections. However, the licensee shall be statutorily responsible for all its obligations under the EA 2003 and MERC Regulations.

3.1 Stakeholders' Comments and Commission's Analysis:

Chamber of Small Industry Associations (COSIA) submitted that the industrial sector is located in specified areas and needs uninterrupted power supply for production and can afford to pay slightly higher charges for the same. COSIA suggested that the Feeder Franchisee concept would be a practical solution to mitigate the deficit in electricity generation and to control the distribution losses and hence, should be immediately commenced in all MIDC and other industrial areas in Maharashtra.

Thane Small Scale Industries Association (TSSIA) proposed that the industrial feeders should be kept separate by the Franchisee, and connections to consumers other than industry should not be given from these feeders.

Maharashtra chamber of Commerce, Industries and Agriculture (MCCIA) opined that the Distributed Generation based franchisee approach would not suit all the areas across the State; instead the privatization route should be adopted for the urban zones where the consumer density and demand for electricity is high. MCCIA further added that DG based franchisee approach is not in line with the White Paper published by Government of Maharashtra, dated August 28, 2002. The relevant portion of the clause 6.3.4 of the White Paper is reproduced below:

> *"…the distribution companies would initially be owned by Govt and will be privatised in phased manner. Substantial internal reforms need to and can be done under the ownership of state govt. However, to make these changes sustainable, privatisation is essential. Introduction of private sector in distribution would importantly bring in the capital, and result in medium to long term in supply of better quality power to consumers at reasonable prices…It is expressed that unbundling followed by privatisation will lead to employees getting new opportunities to undertake greater responsibilities, be accountable for delivering results and get attractive career opportunities."*

MCCIA submitted that the Commission should look into the choice and applicability of Section 5.4.7 and 5.8.9 of NEP in terms of multiple licenses and license to private sector body. MCCIA submitted that the DG based Franchisee approach may be suitable for rural areas where the open distribution license provision exits and stated that organisations like SEZs and MIDC that can bring in the investments, should be given the opportunities for Generation and Distribution in the region.

Reliance Energy Ltd (REL) submitted that, as mentioned in the Approach Paper, the Franchisee would purchase power from the distribution licensee and sell such power to consumers in its allocated area, however, as per the definition of Franchisee mentioned in EA 2003, Franchisee is a person authorized by the Distribution Licensee to supply electricity on its behalf to a particular area in its area of supply and thus, Franchisee does not trade in electricity. REL stated that the Franchisee can only act as a conduit for supplying power, taken from distribution licensee, to the consumers in its allocated area, which is the part of licensed area of supply of Distribution licensee.

Reliance Energy Ltd (REL) added that since it is the responsibility of the Distribution Licensee to meet the load requirement of its consumers, even though the energy generated by Franchisee is directly sold to the consumers of the Distribution Licensee, the generation of the Franchisee supplied to the Distribution Licensee should be considered as a "Deemed Power purchase" for the purpose of ARR of the Distribution Licensee for power generated and/or procured from outside by the

Franchisee at a transfer price determined by the Commission. REL further added that from the Approach paper, it appears that only a part of the supply will be generated locally by the Franchisee. The connectivity to the transmission system is unavoidable; therefore, the process of sharing of Transmission charges by the Franchisee needs to be discussed in the Approach paper.

Maharashtra Industrial Development Corporation (MIDC) expressed its interest to act as Franchisee and submitted that the power distribution in their allocated area would be managed by Franchisee team, distribution licensee staff and through ‘A’ class electrical contractors/competent agencies capable of handling the O&M work of power distribution. MIDC stated that the ownership of distribution network in existing Industrial areas/SEZs would remain with the existing licensee and wheeling charges in addition to the bulk supply tariff would be payable to the licensee.

Bombay Small Scale Industries Association stated that the Approach Paper has certain inherent flaws in the basic approach itself. It is not clear whether the Approach Paper is only for application to MSEDCL or even for other licensees. They further proposed that there must be some basic parameters laid down for the licensee to be ‘eligible’ to follow the Franchisee route, and opposed open permission for any Licensee to adopt Franchisee arrangements for their licensed supply areas. They presented that if the real benefits of private participation are to be enjoyed by the State and the consumer, then more than one private party should be allocated the same area.

Madhav Capacitors Pvt Ltd. submitted that the distributed generation in the form of wind energy has many deficiencies in the context of the stated objectives in the Approach Paper, as the wind generation would not be always available in the peak load period. Also the problems of connectivity and synchronization would exist at number of places.

MSEDCL submitted that the Commission/GoM should look out for CII-Pune type model for other cities/towns in Maharashtra using available surplus capacity from CPPs. MSEDCL further submitted that with the approval of the Commission, it would take necessary steps to tap the surplus capacity in Maharashtra to alleviate the load shedding in Maharashtra to some extent.

CLP Power India Pvt. Ltd, vide its letter dated March 30, 2007, expressed its interest to act as DG based Distribution Franchisee in a selected area and submitted that the Electricity generation should be carried out by the same entity and not through a separate division of Franchisee, as it would require another set of agreements and approvals.

MSEDCL submitted that clear guidelines on quantum and source of funding for maintenance and up-gradation of the Distribution network must be ensured. MSEDCL further stated that the procurement of power from outside the State to meet the demand by the Franchisee should be regulated to control the cost of supply.

With reference to the sale of surplus power to the grid, MSEDCL enquired about the concerned authority that would determine the price for the same. Other suggestions made by MSEDCL are listed as below:

- Efficient mechanism for auditing should be implemented to avoid any malpractice by the Franchisee in metering, billing and collection levels.
- The Licensee should incentivise the Franchisee for achieving the predefined parameters like reliability, collection efficiency, customer relations, etc.
- The licensee should ensure that the staff recruited by the Franchisee is technically competent.

MSEDCL enquired about the competent authority that would resolve the issues arising between the licensee and Franchisee.

The DGBDF concept will work at feeder level also, and the feeder franchisee approach can also be attempted. However, the pre-requisite for the feeder franchisee concept to be successful would be mapping of all consumers connected to the feeder and appropriate metering arrangements. The observation that the licensee should not connect other consumer categories through industrial feeders is logical and follows prudent utility practice, and hopefully has been followed by the licensees, baring exceptional circumstances.

It should be noted that the DGBDF concept does not preclude other forms of private participation, including privatisation of the distribution license areas. The proposal for DGBDF is an attempt to come up with innovative solutions to the prevailing energy crisis in the State and involve more agencies with local expertise to bring additional generation capacity into the grid as well as improve the operational efficiencies. Moreover, as clarified in the Approach Paper, though the concept of DGBDF has been envisaged for urban areas with the capacity to pay additional Reliability Surcharges, there is no bar on implementing the concept in rural areas also, provided the concerns regarding ‘capacity to pay’ are resolved.

As regards the comment on accounting for the energy generated by the Franchisee or arranged from other sources, as ‘deemed power purchase’ by the Licensee, the Commission is of the opinion that the Franchisee, being only an agent of the licensee, cannot buy and sell energy, which will amount to trading in electricity, is the function of the licensee. Hence, for the purposes of energy balance of the licensee, the generation by the franchisee and/or purchase from other sources for sale within the franchisee area, will be considered as ‘deemed power purchase’ by the licensee, and the sale to the Franchisee by the licensee, will include this quantum in addition to the energy supplied by the licensee. Accordingly, the arrangements will have to be entered into between the Licensee, Franchisee, and generator/power seller, if any. The Franchisee will hence, not be required to have a trading license, since the power is being effectively procured by the licensee.

For the quantum of generation by the franchisee and/or purchase from other sources for sale within the franchisee area, the Commission will determine the transfer price of the same for transfer of the same to the licensee, and will also determine the reliability surcharge to be levied on the consumers in the franchisee area to recover the cost of this additional energy. However, since the energy is being sold to the licensee under the ‘deemed power purchase’ route, there will not be any applicability of wheeling charges. The rate of transfer of electricity by the licensee to the franchisee, the minimum revenue expected from the franchisee area, the distribution losses, collection efficiency, etc., will have to be mutually agreed upon between the licensee and the franchisee under the Franchisee Agreement.

It is clarified that the DGBDF concept is intended for application in the entire State, and not only for the MSEDCL license area, though the rationale for proposing the DGBDF was the ever-increasing supply shortages in the MSEDCL license area, and the need for increasing the efficiency of operations. The stakeholders should realize that this is only a concept being floated, and it is up to the respective licensee to seek such interested parties to become its franchisee, if it desires to do so. There is neither any compulsion nor any bar on any licensee to enter into franchisee agreements, if it thinks fit, and ensures that its commercial interests as well as the consumer interests are protected. It should be noted that the licensee is solely responsible for its obligations as a licensee in all its areas, including any areas given to the franchisee, and merely handing over any area to a franchisee does not absolve the licensee of its statutory obligations, duties and responsibilities.

As regards the comment that the DGBDF concept will not work with wind generation facility, the Commission is well aware of the seasonality of wind generation, and has not proposed that wind generation would be specifically involved under the DGBDF scheme. However, wind generation could also be involved in this scheme, if it is coupled with any other source of generation under a hybrid scheme to overcome the seasonality of wind generation.

MSEDCL's comment that the Commission or the Government of Maharashtra should look for Pune-type models is improper. The Commission is attempting to lay down a framework for bringing in additional generation capacity and improve the operational efficiency of the distribution system, by the proposed DGBDF, on which it is advising the State Government. However, it is the responsibility of the licensee to find out areas where such schemes can work and undertake the appropriate process for appointing franchisees. The Commission cannot be expected to undertake this activity on behalf of the licensee. As regards MSEDCL's submission that it will take necessary steps to source additional generation capacity to alleviate the load shedding in its license area, after the Commission's approval for the same, the Commission clarifies that all necessary approvals and directives have already been given to MSEDCL to arrange for the necessary supply on long-term basis to the extent possible, to alleviate the load shedding.

As regards MSEDCL's submission that clear guidelines on quantum and source of funding for maintenance and upgradation of the network need to be ensured, it is up to the licensee to ensure the same as a part of the Franchisee Agreement, as the capital expenditure being undertaken by the franchisee will be a sub-set of the capital expenditure proposed by the Licensee for that area. Since the franchisee will be selected after a competitive bidding process, it is expected that the quantum and sources of funding will be appropriately identified by the Franchisee. As regards the regulation of the power procurement from outside the State, the cost of the same will have to be recovered through the Reliability Surcharge, which will be determined after a public process involving the affected consumers, and if the cost of power procurement is high, it will reflect in the reliability surcharge to be levied.

It is clarified that since purchase of power by MSEDCL is being undertaken either through the contractual route or the competitive bidding route, if the Franchisee has any surplus power, which it desires to supply to the licensee's grid, the same would also be subject to the same regulations. The other points raised by MSEDCL have to be addressed in the Franchisee Agreement between MSEDCL and the Franchisee, viz., auditing mechanism, dispute resolution, etc., and the Commission has no role to play in these activities. Moreover, as MSEDCL has already entered into a Franchisee Agreement for Bhiwandi and has also initiated the competitive bidding process for selection of Franchisee for three Divisions of Nagpur Urban Circle, it is expected that these issues would already have been resolved by MSEDCL, with the necessary monitoring mechanisms.

The suggestion that the electricity generation could be taken up by the Franchisee itself, rather than another Division of the Franchisee, is acceptable, as long as the accounting is correct and transparent. It is not compulsory for the generation activity to be taken up by another Division.

4. Role of Distribution Licensee

Prior to signing of Franchisee Agreement, a Licensee needs to initiate steps (a) selection of areas to offer to Franchisee organisations; and (b) bid document preparation and bid process management. The Licensee will have to initiate the exercise of gathering data related to each distribution circle or each of the feeders. Criteria for selecting candidate feeders include:

- Electrical separation of designated area of supply under consideration
- Composition of load and consumers
- Nature, composition and quality of assets
- Ease of establishing baseline

The Licensee would invite bids for the Franchisee operations on the basis of bid documents. The Bid Document related to designated area of supply will provide all the information in respect to the area, inter-alia:

- Geographical area;
- Description of the existing electricity distribution system (length of HT/LT lines in circuit kilometres, number of distribution transformers, number of poles, substations, etc.), schematic diagram and other related drawings;
- Load data, load profile, load duration curve, annual energy input (in MU), consumer categories and classification;
- Metering status, billing history, distribution loss, and collection efficiency.

4.1 Stakeholders’ comments and Commission’s Analysis:

CLP Power India Pvt Ltd suggested that the initial power requirement of Franchisee area should be met by the licensee on a firm commitment basis as the establishment of distributed generation would require some time period.

MSEDCL suggested that the distribution licensee should design key performance indicators to judge the performance of the Franchisees. MSEDCL further stated that proper meters must be installed at all the crossover points to achieve proper electrical separation of the designated area. MSEDCL however, opposed the suggestion of awarding industrial feeders to the Franchisees, as the same are sources of high revenue with lower distribution losses.

The DGBDF concept has been proposed in the context of the prevailing demand-supply gap and the Licensee’s inability to supply the entire energy requirement to its consumers. Hence, it may not be practical to insist that the licensee be required to supply the entire initial energy requirement on a firm commitment basis. However, it is envisaged that the Franchisee will be able to procure power from other sources in the interim period till such time as the generation facilities are established.

As regards MSEDCL’s observations regarding KPIs and adequate metering at cross-over points, it is the licensee’s responsibility to undertake the same, as outlined in the Approach Paper. As regards MSEDCL’s opposition to giving out industrial feeders under the Franchisee route, it is entirely upto MSEDCL to identify areas/feeders that it desires to franchise out.

5. Role of Distribution Franchisee

Responsibilities of Franchisee are as follows:

- Supply of electricity to consumers of the Licensee
- Proper operation and maintenance of assets of the Licensee
- Set up a generating station using DG technology option
- Undertake projects to upgrade distribution infrastructure
- After retaining agreed percent of the revenue as per the Franchisee Agreement, the balance amount would be credited to the Licensee periodically. The Franchisee will be provided with certain powers to disconnect electricity supply of defaulting consumers. The Franchisee will take all efforts to reduce and prevent incidence of electricity theft. The Franchisee will undertake

periodic testing of all meters to check the accuracy and reduce the incidence of slow/tampered meters.

- Demand Side Management
- Franchisee will manage the metering aspect at the consumer end, which includes:
    - Replacing defective meters and also introduce static energy meters, as well as time of the day meters for specific categories of consumers.
    - Manage metering, billing and collection functions in the designated area of supply in accordance with the appropriate billing cycle.
    - Ensure billing accuracy in order to ensure revenue in proportion to electricity consumed.
- Franchisee has to follow grid code while drawing power from the licensee.
- Franchisee will employ its own staff and also utilize existing staff on deputation from the Licensee for managing operations in the designated area of supply. The Franchisee will have the right to accept or reject the staff opting for deputation from the Licensee and to take existing interested staff on deputation from Licensee.

Key Concerns:

- <u>Data used for Baseline Estimation</u>: Accuracy of the baseline data is of crucial importance for ultimate success of the proposed scheme. The Licensee should make all efforts to establish correct and accurate baseline, on which it will evaluate the performance of the Franchisee. Errors and inaccuracies in data is a concern, and must be addressed appropriately.

- <u>Service to consumers</u>: Often the service to consumers deteriorates when margins of a Franchisee come under pressure. The Franchisee starts cutting corners in order to save on certain costs, which ultimately result in lower service standards. These facts have to be taken into consideration by the Licensee. The Licensee can institute an appropriate monitoring process to address these aspects.

- <u>Ability to generate adequate revenue to sustain operations</u>: Under circumstances where Franchisee management has a shortsighted approach, its operations suffer in the long run. Operations suddenly become un-sustainable due to negative growth in business. Many a time, high incidence of interest costs and other financial commitments can have effect on the operations of Franchisee.

5.1 Stakeholders' comments and Commission's Analysis:

TSSIA and COSIA stated that the Franchisee should strictly follow the SOP norms stipulated under EA 2003 and the Commission's SOP Regulations.

COSIA suggested that the Franchisee should submit periodic reports of its load research, efficiency improvement and DSM projects to MSEDCL. COSIA added that the Franchisee should be directed to interact with the Industrial Organizations to get an idea of requirements of the Industrial sector.

CLP Power India Pvt Ltd submitted that the revenue sharing with licensee may not be a good concept, as it would require agreement on cost and expenses and also agreements on accounts; instead Franchisee should either pay a predetermined Input Rate to the Licensee or the Commission should fix the bulk supply tariff for the energy supplied by the Licensee. They added that the Franchisee Agreement should not restrict the Franchisee to Distributed Generation, but should allow for procurement from trader or merchant plant. They further suggested that the Commission should advice the Government for providing necessary services/support from security/police force to deal with the theft of electricity. Authorization as available to the Licensee under Section 126, 135 and 152 of EA 2003 to deal with theft of electricity should be made available to the Franchisee.

MIDC submitted that the shortfall or balance power requirement of the allocated area would be arranged by MIDC (as a Franchisee) through its proposed Power Trading Arm/ Power SEZ's/ Merchant power plants, etc.

Shri N. Ponrathnam pointed that the Franchisee would arrange to reduce the distribution losses, which would benefit the licensee and franchisee, but not the consumers. He opined that the consumer would be at the mercy of the Franchisee for reliability and price. He submitted that the Franchisee concept should achieve higher reliability and quality at cheaper tariff and stated that the monopoly of the Licensee should be terminated with introduction of competition in the power sector, which would result in good service quality at lowest possible tariff.

MSEDCL raised certain queries as given below:

a) In case of damage of assets by third party or natural calamities, who will be responsible for maintenance?

b) In case of expansion and up-gradation by franchisee, who will own the assets? Is Franchisee liable to get the depreciated value at the time of hand over of all the assets?

c) Is Franchisee mandated to undertake the existing DSM activities of licensee?

MSEDCL submitted that the baseline data is very crucial for judging the future performance of the franchisee; and hence, the licensee should get this data audited before freezing it.

The Commission is of the opinion that the Franchisee Agreement could have various alternatives, including payment of pre-determined Input Rate or share of revenue, or any other method. The Approach Paper only attempted to indicate some of the methods possible to achieve the objective. The Commission has already clarified that the Franchisee can also procure power from other sources till such time the generation facilities are set up. As regards the suggestion that the Franchisee should be able to exercise the powers given to the Licensee under Sections 126, 135 and 152 of the EA 2003, it is for the Licensee to incorporate appropriate clauses in the Franchisee Agreement, with adequate safeguards, to achieve the desired objective. The concern raised that reduction of distribution losses will not benefit the consumers is totally misplaced, as reduction in distribution losses will reduce the energy requirement or increase the billings, or a combination of both, which will eventually result in reduction in consumer tariffs.

The issues raised by MSEDCL are clarified below:

(a) It is not clear whether MSEDCL is seeking clarification on the replacement of the assets or the maintenance of the assets, under a circumstance wherein the licensee's assets are damaged due to natural calamities. It is obvious that the replacement of the assets under such circumstances will have to be undertaken from the contingency funds available with the licensee, and from the insurance on the assets taken by the licensee. The maintenance of the assets will obviously be the Franchisee's responsibility under the Franchisee Agreement.

(b) The ownership of the assets added by the Franchisee and the value at which it will be compensated after the expiry of the Franchisee Agreement, has to be addressed under the Franchisee Agreement between the Licensee and the Franchisee, based on mutual discussions.

(c) The Approach Paper clearly mentions that the Franchisee would be expected to undertake the DSM activities in the designated area, on behalf of the Licensee.

(d) MSEDCL's proposal that the Licensee should get the base line data audited before finalising the same, is welcome, and Licensees should ensure the same in all the Franchisee Agreements it proposes to enter into.

6. Regulatory and Tariff Mechanism

The Franchisee will have to meet capital expenditure over and above operating expenses related to the electricity distribution system. Electricity from the new generating station will certainly be expensive as compared with the electricity purchase price from the distribution Licensee. This incremental cost will have to be compensated to the Franchisee, which will ensure reliable electricity supply. This incremental charge will be determined by the Commission based on the information submitted by the Licensee for each Franchisee area. The Commission may authorise the Licensee to allow its Franchisee to recover this incremental cost by way of a Reliability Surcharge from specific category of consumers and in a manner stipulated by the Commission.

6.1 Stakeholders' comments and Commission's Analysis:

Thane Small Scale Industries Association (TSSIA) submitted that the tariff rate should be affordable to keep intact the competitiveness of SSI sector. They added that there should not be frequent variations in tariff due to change in fuel cost or other incidental charges.

Chamber of Small Industry Associations submitted that if at all, the Commission permits any Reliability Surcharge through its tariff; it should also include the penalty and refund clauses to take care of consumer's interests. COSIA further stated that the Franchisee should compensate the losses of the industries in case of poor quality supply and power failure attributable to any human or technical reason. COSIA submitted that the Franchisee should arrange to reduce the distribution losses to minimum within a stipulated period of two years in its allocated area of power supply to the industries and any failure to reduce the distribution losses should be dealt with penalties like reduction in tariff.

CLP Power India Pvt. Ltd submitted that the rate at which surplus power would be sold to Licensee, basic terms like tariff and adjustments in tariff on account of escalation should be well defined and pre-agreed. They requested the Commission to consider the incentive in the form of handing over the distribution network to

Franchisee, provided the franchisee performs beyond certain average level of performance criterion as the same would encourage the Franchisee to keep a long-term interest and serve the consumer better. They further submitted that the principle for wheeling and banking and recovery of cost for the power generator by the Franchisee through Reliability Surcharge should be in place which would include the mechanism for increase or decrease in Reliability Surcharge due to change in commodity prices and escalation.

REL proposed that charges payable by the distribution Licensee to the Franchisee should be linked to the energy supplied and the rate of such energy supplied should be mutually agreed between the Distribution Licensee and the Franchisee for the purpose of calculating the fees/charges if the same is linked to the revenue collected by the Franchisee. REL added that the fees/charges payable by the Distribution Licensee to the Franchisee would form a cost element in ARR. The revenue from the energy sold to the consumer would also form part of the ARR of the Distribution Licensee.

REL submitted that the Franchisee would incur a huge cost on capital expenditure for upgradation of distribution system and enquired whether the consumers in its allocated area, seeking Distribution Open Access, would be required to pay higher wheeling charges or not. REL further enquired whether the Commission would determine area wise wheeling charges.

REL submitted that the Approach Paper does not highlight the sharing of cost of generation in the situation of power surplus in the Franchisee area and suggested that the incentives and penalties should be made applicable to the Franchisee based on its performance, which would motivate the Franchisee for better performance. REL further stated that the service standards should not be affected due to margin of sharing of revenue and submitted that the Approach paper should include below mentioned issues:

§ Energy accounting
§ Scheduling, settlement and applicability of UI charges which would arise after implementation of Intra-state ABT regime
§ Payment of Wheeling charges, cross-subsidy surcharge and additional surcharges that would arise when a consumer in Franchisee area would opt for Open Access.

MIDC suggested that the Franchisee should be billed with bulk supply tariff at a single point and requested the Commission to decide the tariff on the basis of ARR of the Franchisee.

Bombay Small Scale Industries Association submitted that below referred points should be taken care of and given due credence before finalizing any formal policy on the Franchisee route:

§ The scope should not exceed any scope already laid down by the Government
§ Franchisee agreement should not have any clause violating existing Laws and/or Regulations.
§ Licensee would be liable for any violation by the Franchisee, of any statutory laws, enactment or Regulations.
§ No partner/director/relative or interested person of the Licensee should be the owner or partner/director/relative/related person in the Franchisee company. An Undertaking should be taken from both the parties to this effect.
§ All Franchisee Agreements should be open to public scrutiny.
§ The Commission should have all rights to interact directly with the Franchisee also.
§ No transfer of Licensee's own rights and/or assets to be done, to the Franchisee. An Undertaking to be taken from both the parties to this effect.
§ Licensee to make public its proceedings on tendering.
§ Criterion for finalizing Franchisee should be "lowest tariff".
§ Performance criteria should be established even before the tenders are floated. These have to be agreed to and public hearing should be held for these.
§ Public should be included in the bidding process. Copies of all the bids should be displayed on the website of the Commission and the Licensee.
§ Appropriate reduction in the Licensees' own expenses should be reflected transparently in subsequent ARR/APR.
§ Social aspects such as reduction in employment should be considered if any Licensee wishes to reduce the staff.
§ If the Franchisee also generates electricity, all norms laid down and applicable for other generating companies should be followed.
§ Transmission loss must be below 4.85%

- § Franchisee should not claim any reasonable return as permitted by EA 2003.
- § Franchisee should submit periodic reports to the Commission and the Licensee and these should also be made available to public.
- § Franchisee's investment plans should not be a part of Licensee's investment plans.
- § Franchisee cannot be granted the powers for disconnection as per Section 56 of EA 2003. Disconnection would be the prerogative of Licensee only.
- § Consumer tariffs should be same or lower than the Licensee's tariff. No other costs or extra charges should be permitted on any count. Reliability surcharge should not be allowed. If at all any surcharge is to be paid, it must not exceed a specified percentage of the energy charge.
- § All the charges should be as per approved Schedule of Charges of the Licensee.
- § Licensee should not ask for increase in tariff in subsequent ARR/APR, quoting minimum percentage to be given to Franchisee.

Madhav Capacitors Pvt Ltd suggested that the Commission should allow co-operatives or group of consumers to freely purchase electricity from any supplier and sell it non-exclusively within their structure, subject to fair price practices sanctioned by the Commission.

MSEDCL raised the following queries:

a) Would the fuel be specified in bidding for the area/feeder selected for such franchisee?
b) What is the alternative if the reliability surcharge works out to be unaffordable to consumers?
c) What is the alternative if the franchisee bids higher than the notified prices in case of the bio-mass/wind/hydro/CPP for which MERC orders already exists?

MSEDCL submitted that the load factor of the generator would be less if the plant is run only for 4/5 hours to meet the shortage and would not give considerable returns to the Franchisee. MSEDCL requested the clarification whether the Franchisee would generate only to the extent of the shortage or entire power requirement to meet the demand of the particular area or feeder.

The Commission has already clarified that the reliability surcharge would be determined based on the computations provided by the Franchisee and after due public process. In case the general opinion is not in favour of levy of reliability surcharge in return for reduction/elimination of load shedding, then the reliability surcharge will not be imposed and the consumers of the Franchisee will continue to be subjected to the existing load shedding protocol. If the reliability surcharge is being levied, there needs to be a provision for adjustment of the reliability surcharge on a periodic basis for upward/downward revision in relation to the variation in fuel prices.

The compensation for the losses on account of poor quality of supply would be governed by the Commission's Supply Code and the Standards of Performance, with the obligations and responsibilities of the Licensee and the Franchisee being clearly outlined in the Franchisee Agreement. As stated in the Approach Paper, the Franchisee Agreement would also need to include trajectory of performance improvement for different identified parameters, such as distribution losses, metering efficiency, collection efficiency, etc., with specific clauses for steps to be taken and compensation for non-achievement of the performance trajectory agreed upon.

The Commission is of the opinion that treatment of surplus power with the Franchisee, if any, including the terms and conditions for sale of the same to the Licensee or any other third party, payment of wheeling charges where applicable, etc., would have to be agreed upon under the Franchisee Agreement. The request that the Franchisee should have an incentive for good performance in the form of an undertaking that the distribution network in the identified area will be handed over to the Franchisee, is beyond the scope of the Franchisee arrangement.

The Commission is of the opinion that the suggestion that the Licensee's income from the Franchisee Area and the Licensee's expense on the Franchisee Area in the form of payments made to the Franchisee, if any, should be considered in the ARR of the Distribution Licensee, is in order. However, it is the duty of the distribution licensee to ensure that the Franchisee Agreement does not result in net losses to the licensee, and the Licensee should ensure that there is a net gain to the Licensee in the form of additional net revenue on account of giving out certain areas to Franchisees, which can be used to reduce the tariff for all the consumers of the Licensee.

As regards the issue of whether the consumers in the Franchisee area and seeking distribution open access will have to pay higher wheeling charges, the Commission is of the opinion that as the wheeling charges are dependent on the revenue requirement of the wires business of the Licensee, the higher capital expenditure by the Franchisee will not be reflected under higher wheeling charges, as the newly added assets would not be transferred to the Licensee, till the termination of the Franchisee Agreement. Voltage-wise wheeling charges would continue to be determined for each licensee, as determination of area-wise wheeling charges would result in pan-caking of the wheeling charges, this defeating the concept of Open Access.

The issues related to energy accounting and treatment of wheeling charges, cross-subsidy surcharge, etc., would have to be addressed under the Franchisee Agreement. The Commission's opinion on these issues is given below:

- Since the Franchisee area is a part of the Licensee area, the energy input into the Franchisee area, the sales in the Franchisee area, and the distribution losses, would have to be accounted for under the Licensee's energy balance. The generation/power purchase from other sources by the Franchisee for sale in the Franchisee area would be considered as 'deemed power purchase' by the Licensee. For sake of clarity, while indicating its energy balance, the Licensee should indicate the energy input into the Franchisee area, sales of the Franchisee area, and deemed power purchase separately, under different sub-headings, within the respective broader heads of power purchase, sales, and distribution losses.
- The scheduling, settlement and applicability of UI charges for Franchisee would depend on the Franchisee Agreement. However, it is envisaged that as the Licensee is finally responsible for the above activities in its license area, the Licensee would have to include the Franchisee area in all its schedules and settlement would have to be made accordingly or as agreed under the Franchisee Agreement.
- In case of distribution open access consumer in Franchisee area, the wheeling charges and additional surcharge that would be payable are the same as that payable by distribution open access consumer in other areas of the Licensee. The Commission has already stipulated that the cross-subsidy surcharge is 'zero' for all the Licensees, in their respective Tariff Orders, on account of the high cost of marginal power purchase.

The suggestion that the Commission should determine the Bulk Supply Tariff payable by the Franchisee on the basis of the ARR of the Franchisee, does not have any merit, as the rate payable would most likely be a bidding parameter, during the process of selection of the Franchisee. Moreover, the Commission will only determine the ARR of the Licensee, and will not determine the ARR of the Franchisee, who is only an agent of the Licensee.

The Commission's views on the issues raised by BSSIA are given below:

§ The Franchisee Agreement envisaged herein does not violate any of the existing Laws or Regulations

§ The Licensee is responsible for any violation by the Franchisee, of any Laws or Regulations, and the Licensee may incorporate suitable safeguards in the Franchisee Agreement

§ The issue of Partner or Director of Licensee being involved in the Franchisee, is a matter of Corporate Governance, to be resolved suitably between the Licensee and the Franchisee

§ Since the reliability surcharge and deemed power purchase are matters under regulatory jurisdiction, the pertinent commercial terms would be available in the public domain.

§ The Commission would generally not interact directly with the Franchisee, and it would be preferred that any communication, if necessary, is undertaken through the Licensee

§ Transfer of Licensees' rights/assets to the Franchisee is not envisaged under the Franchisee Agreement, and the Franchisee will only have the right to use the assets of the Licensees, with attendant obligations of maintenance, etc., during the pendency of the Franchisee Agreement.

§ Tendering process could be 'public' or 'limited' as considered prudent and suitable by the Licensee, with the underlying objective of protecting the consumers of the Licensee

§ The criteria for finalising the Franchisee cannot be forced on the Licensee, which has to take its own decision in the matter. The Commission has only given alternative options in the Approach Paper, and these are not intended to be comprehensive or compulsory.

§ There is no need to hold a public hearing to finalise the performance criteria before the tenders are floated. The performance trajectory has to be specified by the Licensee in the Bid Documents, and it is for the Bidders to agree/disagree with the trajectory proposed. In case no bids are received, then obviously, no Franchisee can be appointed under that particular Bid Document, and if several bids are received, then the Licensee would obviously select the best bid received, which would be evaluated on the basis of pre-specified bid evaluation criteria.

- The bids received are confidential process and there is no merit in the suggestion that the public should be involved in the bidding process and that copies of all the bids should be displayed on the website of the Commission and the Licensee.
- The impact of giving out an area under the Franchisee route would need to be separately indicated in the Licensee's ARR/APR, under the heads of increase in revenue or reduction in expenses
- The Franchisee would be free to select identified staff of the Licensee, who would work for the Franchisee on deputation, as well as appoint its own staff, to augment the resources and skill sets
- The same transmission loss is applicable throughout the State, under the existing Orders of the Commission
- The mechanics of the Franchisee's bid, i.e., whether RoE is included or not, is not an aspect of discussion of the Approach Paper, and would depend on the bid value of the Bidder
- Periodic reports given by the Franchisee to the Licensee, would need to be forwarded to the Commission
- The Franchisee's capital investment plans would form a sub-set of the Licensee's investment plans
- For the Franchisee scheme to be successful, it is necessary that the powers of disconnection are given to the Franchisee. However, the Franchisee needs to undertake sufficient due diligence while exercising this authority. Necessary legal safeguards may be incorporated in the Franchisee Agreement.
- The retail tariffs applicable in the Franchisee area would be the same as that applicable in the remaining License area. In addition, reliability surcharge may also be levied in the Franchisee area, to recover the cost of additional own generation by the Franchisee or purchase from other sources, after due regulatory process.
- The Schedule of Charges approved for the licensee area would be applicable in the Franchisee area as well.

As regards MSEDCL's queries, the Commission does not see any rationale in specifying the fuel for bidding purposes, as it the responsibility of the bidder to ensure the necessary environmental clearances and fuel linkages. Moreover, the generation cost has to be optimised, else the consumers in the Franchisee area may not agree to the levy of corresponding reliability surcharge, and the load shedding would continue as before. Moreover, the scenario wherein the generation tariff works out higher than the tariff approved by the Commission for specific fuels, has already been addressed in the Pune model, wherein the generation costs are much higher. These costs have to be internalised within the Franchisee area depending on acceptability of the same to the affected consumers, and hence, this model addresses this issue clearly. It is also clarified that the model envisages that the Franchisee would not generate the entire requirement of power for the Franchisee area, and it is intended that the Franchisee will generate only the balance requirement to make up for the shortfall in supply, and ensure continuous supply of electricity. If there is any surplus generation with the Franchisee, the same can be sold to the Licensee or any other party under a separate Agreement.

7. Franchisee Agreement

Some of the features of the Agreement are as follows:

a. Performance delivery/Performance Parameters: The Franchisee Agreement shall spell out all the performance parameters and terms of supply of electricity to the Franchisee. The Agreement will also have specific mention of electricity Supply Code and Standards of Performance to be maintained by the Franchisee.

b. Assets listing: Existing electricity distribution infrastructure/assets of Licensee in the designated area will be listed in the Agreement. Report of the approved valuation consultants will be provided in the appendix to the Agreement. The Licensee will adequately insure all the assets and a clause to that effect will be included.

c. Ownership of Assets: The Agreement will also define the ownership of the assets (both existing and additional). The Agreement will also provide guidelines for maintenance of the assets and asset register. The Franchisee will also have to report to Licensee any loss or damage to the assets during the currency of the Agreement.

d. Investment plan: The Agreement will include duly approved year-wise investment plan for addition of assets to cater to the estimated increase in consumer base and load growth.

e. Wheeling charges: In the event of procurement of electricity from sources other than the Licensee, the Franchisee will have to pay wheeling charges to the Licensee for using its network.

f. Frequency and mode of payment: The Franchisee will pay charges to the Licensee periodically or, as per the billing cycles. The Agreement will define terms and mode of payment by the Franchisee to the Licensee, and conditions for delayed payment charges. The conditions for invoking the Bank Guarantee in the event of default will be spelt out.

g. Default conditions: The Agreement will also define the conditions under which the Agreement could be terminated.

7.1 Stakeholders' comments and Commission's Analysis:

Mahratta Chamber of Commerce, Industries and Agriculture (MCCIA) presented that the local monitoring groups working for consumer protection should be considered for supervising the Franchisee performance.

CLP Power India Pvt Ltd submitted as under:

§ Term of Franchisee period should be long enough to enable Franchisee to recover the capital expenditure into the system and investment made for the generating assets. Franchisee should provide indicative figures on capital expenditure requirement for reduction of losses for entire period of agreement.

§ Franchisee Agreement should also include some standard clauses like, Change in Law, Dispute Resolution, Force Majeure, Indemnification, Metering issues, Event of Default, Termination, etc.

§ Asset verification, valuation and listing should be done by certified Auditors.

REL enquired about the actual period of start of distribution operation by the Franchisee in view that it would take minimum 3 years for actual generation of power to commence. REL further submitted that the Franchisee Agreement should include some features like:

§ Performance linked incentive and penalty
§ Specification of equipments and associated facilities used in the distribution system
§ Operational issues like day ahead scheduling, accounting, etc.
§ Sharing of risk and margin between the Licensee and Franchisee
§ Sharing of CDM benefits
§ Dispute resolution
§ Duration of Franchisee agreement.

MSEDCL suggested that the following aspects should be incorporated in the Franchisee Agreement:

1. Performance guarantee
2. Arrears collection
3. Liabilities and obligations
4. Technical and commercial duties and responsibilities
5. Obligation to connect consumers
6. Metering system
7. Provision for subsidy
8. Reporting
9. Dispute resolution
10. Force Majeure
11. Miscellaneous provisions

MSEDCL also raised the following queries:

1. What will be the period of Franchisee Agreement?
2. Considering the timeframe, the Franchisee will come into operation only after 4-5 years. What in case there is surplus after 5-6 years considering MSPGCL's projects and development of Ultra Mega Power Projects?
3. Will the consumers pay the reliability surcharge?
4. If MSEDCL decides to terminate the Franchisee Agreement in the interest of consumers, how the franchisee recover its investment?
5. Who will share the cross subsidy surcharge and open access charges generated from the area/feeder under Franchisee?
6. How would the subsidy be shared in case of area/feeder having consumers who are subjected to discounted/reduced tariff?
7. How would the Agreements entered into by the Licensee with contractors/sub-contractors (meter reading, annual maintenance contracts) be dealt with?

The Commission has reconsidered the issue of applicability of wheeling charges on electricity procured from other sources, and is of the considered opinion that as the electricity procured from other sources or own generation by the Franchisee will be considered as 'deemed power purchase' by the Licensee, the wheeling charges and wheeling losses will not be applicable in this case. However, transmission charges and losses, as applicable, would be levied.

The duration of the Franchisee Agreement is an aspect that has to be resolved between the Licensee and the Franchisee. However, the Commission is of the view that in order to incentivise the Franchisee to invest adequately in the capital expenditure, it may be necessary to have a reasonably longer period of around 10 to

15 years for the Franchisee Agreement. As regards the issue of need for Franchisee after a period of 5 to 6 years, given the projected addition to generation capacity, the Commission clarifies that the commencement of Franchisee operations need not be linked to setting up of the generation facility.

The various standard clauses proposed for inclusion in the Franchisee Agreement by the existing Licensees and other stakeholders, such as Change in Law, Dispute Resolution, Force Majeure, Indemnification, Metering issues, Event of Default, Termination and compensation on termination, etc., may be considered for inclusion, as appropriate. As regards the issue of date of commencement of the Franchisee arrangement, given the gestation period for generation projects, the Commission has already clarified that the Franchisee arrangement need not be delayed on this count, and the Franchisee may arrange for power from other sources, till such time as its own generation facilities are in place and in a position to generate electricity.

The Commission’s views on the various open access charges payable in case of distribution open access consumer in Franchisee area have already been elaborated earlier in this Policy Advice document. As these charges are primarily for use of the Licensee’s assets, these charges will have to be remitted to the Licensee by the Franchisee. There is no question of sharing of subsidy, in case of consumers subjected to discounted/reduced tariff under GoM directives, and the entire subsidy for the respective consumers in the Franchisee area will have to be handed over to the Franchisee by the Licensee, to compensate the Franchisee for the reduced revenue from tariffs due to the subsidy being provided by the GoM. The treatment of sub-contract/service Agreements already entered into by the Licensee for the Franchisee area, such as meter reading, annual maintenance contracts, etc., would have to be agreed upon between the Franchisee and the Licensee, as the Franchisee would presumably desire to undertake these activities itself. Since MSEDCL already has the experience of Bhiwandi Franchisee, this should not be an insurmountable issue.

8. Selection of Franchisee

Distribution Licensee will select a Franchisee from among the qualified Bidders. The Licensee will evaluate Bidders on technical and financial parameters. Although detailed, area specific and licensee specific criteria need to be worked out and stipulated, the salient features of the selection criteria could be as below:

Technical parameters:

- Organizational Background can be evaluated by considering history of the company, business and operational performance (group sales turnover, existing asset base, financial performance of the group) for past three years, management team and major achievements in the existing business.
- Relevant Experience can be determined by length and nature of experience in electricity distribution or in retail operations, team leader background, value of projects executed in the past, value of contracts executed (if vendor/manufacturer of electrical equipment) and quality of service.

Financial Parameters:

- Growth in business targeted
- Investment planned for upgrading existing distribution system
- Transfer price of electricity generated
- Value Added in Distribution

In addition to these parameters, one of the following parameters can be used for evaluation of the bid and can have maximum weight.

Lowest Price quoted for electricity purchase from distribution Licensee: Franchisee will purchase electricity from the Licensee. Rate at which the Franchisee can purchase and sell the same to consumers finally (as per the tariff applicable) will depend upon the efficiency of managing distribution function and cost of electricity generated.

Lowest cost of operation: Bidders can be asked to furnish the cost of operations of the distribution system. Lowest cost of operation can indicate the optimum efficiency of electricity distribution system operations as well as generation operations. At the same time, trajectory of cost of operations projected in the business plan will also indicate the level of efficiency of operations.

Revenue collection and collection efficiency: Bidders can be asked to bid for the quantum of revenue willing to be shared by the Franchisee with the Licensee as well as parameters like collection efficiency.

8.1 Stakeholders' comments and Commission's Analysis:

MCCIA submitted that the Distribution Licensee should refer to the Rural Electricity Policy during selection and responsibility fixation of the Franchisee.

CLP Power India Pvt Ltd submitted that an independent party authorised by the Commission, should perform the assessment and prepare the baseline data. They stated that the selection of Franchisee should be based on highest price (Input cost) quoted by the bidders, instead of lowest price of electricity (for payment to licensee), as there would not be any incentive for franchisee to make improvement after taking over the area if the selection would be done through lowest cost of operation. They further suggested that the Franchisee should be allowed to file ARR before the Commission and then the Commission should fix the Bulk Supply tariff.

REL proposed that the bid document should be prepared addressing the financial ability of Franchisee to generate adequate revenue to sustain its operations.

The Commission has reconsidered the issue of having 'lowest price' for electricity procured from the distribution licensee as one of the bid criteria, and is of the considered opinion that the criteria should actually be the 'highest price' for electricity procured from the distribution licensee, else it will lead to losses for the distribution licensee.

As regards the assessment and preparation of base line data by an independent authority appointed by the Commission, the Commission is of the opinion that it is up to the interested bidders to assess the veracity of the base line data provided by the Licensee, through independent studies.

The Commission clarifies that it will not approve the ARR of the Franchisee, and the expenses and revenue from the Franchisee arrangement would be considered under the Licensee's operations. Further, the question of stipulating a Bulk Supply Tariff for supply of electricity from the Licensee to the Franchisee does not arise, as the primary bid criteria is likely to be the highest price of electricity bid.

Annexure II: List of Stakeholders who have submitted suggestions/comments

Sl.	Name
01	Thane Small Scale Industries Association (TSSIA)
02	Chamber of Small Industry Associations (COSIA)
03	Maharashtra Industrial Development Corporation (MIDC)
04	Shri. N. Ponrathnam
05	Bombay Small Scale Industries Association (BSSIA)
06	Madhav Capacitors Pvt. Ltd.
07	Maharashtra State Electricity Distribution Co. Ltd. (MSEDCL)
08	CLP Power India Pvt. Ltd.
09	Maharashtra Chamber of Commerce, Industries and Agriculture (MCCIA)
10	Reliance Energy Ltd. (REL)
11	Patni Energy Pvt. Ltd.