Draft Joint Electricity Regulatory Commission for the state of Goa and Union Territories (Generation, Transmission and Distribution Multi-year tariff) Regulations, 2021

JERC (Goa & UTs) issued a draft Generation, Transmission and Distribution Multi-year Tariff Regulation, 2021, and will be applicable to the state of Goa and Union Territories. The key highlights of the regulation are given below:

Particulars	***General Principles***	
	Existing	***Proposed***
Control Period	FY 2019-22	FY 2022-27
Mid Term Review	Tariff determination for 3rd year along with Mid Term Review	Post 2nd Year. True up for 2nd year & tariff determination for 4th year.
Tariff Determination	Annual	Annual
True-Up	Based on latest available audited account	T-2 Year
Pass through of gains or losses (Uncont'le)	As an adjustment in tariff.	As an adjustment in tariff.
Sharing of gains or losses (Cont'le)	**Gains** – 50:50 **Losses** – to be absorbed by utilities completely. For generating companies as per prevalent CERC tariff regulations.	**Gains** – 50:50 **Losses** – to be absorbed by utilities completely. For generating companies as per prevalent CERC tariff regulations.

1. **Capital Cost:**

Any gain or loss resulting from a shift in foreign exchange rates for the loan amount up to the date of commercial operation would be offset only against the foreign debt portion of the capital cost.
If actual capital cost is less than approved capital cost then actual capital cost shall be considered.
Expenditures on the replacement, renovation, modernisation or extension of life of old fixed assets, shall be measured as follows after deducting the net value of such replaced assets from the original capital expense.

2. **Additional Capitalization**:

In case of generating company or transmission licensee or distribution licensee, as the case may be, decapitalizes its assets, the original cost of the assets as of the de-capitalisation date is removed from the value of gross fixed asset, and the resulting loan and equity are deducted from outstanding loan and equity respectively, in the year de-capitalization takes place.

3. **Debt to equity**

In case of retirement or replacement or de-capitalisation of the assets, the share capital approved shall be reduced to 30% of the original cost.

For the new projects, it will be in the ratio 70:30 of the amount of capital cost for approved by the commission. If the actual equity deployed is less than 30% of the capital cost, the actual equity would be taken into account and if real equity exceed 30% of the cap expense, the excess equity shall be considered as a normative loan.

4. **Return on Equity:**
   - For distribution wire business, allowed on equity capital at post tax rate of return on equity (as per prevalent CERC tariff regulation for transmission system).
   - For retail supply business, allowed on equity capital @16%p.a.
   - RoE computed on average of the equity capital at the beginning and at the end of the year.

5. **Interest on Loan:**

Normative Loan = Gross Normative Loan - Cumulative Repayment

The loan repayment shall be considered from the first year of commercial operation of the project and shall be equal to the annual depreciation allowed.
Interest rate on the basis of the actual loan portfolio shall be the weighted average of interest rate.
Rate of interest will be allowed at SBI MCLR plus 100 bps.

6. **Depreciation**:

The salvage value of the asset shall be considered as 10% and maximum depreciation shall be allowed up to 90% of the capital cost.

Distribution Licensee are also entitled to advance against depreciation(AAD), which is the loan repayment amount subjected to a ceiling of $1/10^{th}$ of loan amount minus depreciation based on loan repayment tenure.

7. **Late Payment Surcharge:**

Transmission or Distribution licensee shall not consider Non-tariff Income in the delayed payment charge.

8. **Working Capital:**

Distribution Wire Business	**Retail Supply Business**
→ O&M expense for 1 month → Maintenance spares @ 40% of R&M for one month. → Receivables for two months of the projected revenue at the prevailing tariff **Less:** Any amount kept as security deposit from distribution system users under clause (b) of sub section 47 of the act, excluding security deposits held in the form of bank guarantees.	→ O&M expense for 1 month → Maintenance spares @ 40% of R&M for one month → Receivables for two months of the projected revenue at the prevailing tariff **Less:** → Power purchase cost for one month → Any amount kept as security deposit from distribution system users under clause (b) of sub section 47 of the act, excluding security deposits held in the form of bank guarantees.

Interest on working capital will be allowed at SBI MCLR plus 200 bps.

The Regulation can be accessed here.

CER Opinion –

Foreign Debt Component (Regulation 24.1):

The first proviso of the Regulation 24.1 (e) may be reworded as 'Provided that any gain or loss on account of foreign exchange rate variation pertaining to the loan amount availed up to the Date of Commercial Operation shall be adjusted only against the **foreign** debt component of the capital cost'.

Actual and Approved Capital Cost (Regulation 24.3):

The draft regulation proposes that "If actual capital cost is less than approved capital cost then actual capital cost shall be considered". A clarification is needed in case the actual capital cost is higher than the approved one.

Return on Equity (Regulation 28):

Capital Asset Pricing Model (CAPM), often used for calculating return on equity, provides an estimate of post-tax RoE. Thus, the RoE so derived should not be grossed up by the rate of effective tax. Adoption of such approach across the sector is erroneous, and provides excess return. This places additional burden on the tariff paid by the consumers.

Advance against Depreciation (AAD) (Regulation 31.8):

a) The concept of AAD should be discontinued as it discourages the regulated entities to negotiate a suitable loan repayment schedule with the lenders.

b) AAD also results in frontloading of ARR and thus imposes an additional burden on the consumers. While the ARR in future years will be reduced to the amount of AAD claimed in the previous years, it would likely happen after multiple years in future. During this time, the consumers would have been burdened with the additional tariff in the earlier years.

c) Even if the Commission decides to continue with this provision, the definition of depreciation should be adequately modified to reflect debit against any AAD claimed in the previous years.

d) This AAD should only be applicable for loan repayment on accounts of capital loans. Thus, this should exclude any loan taken to meet the revenue gap.

e) The draft regulation defines AAD as follows,

"AAD = Loan (raised for capital expenditure) repayment amount based on loan repayment tenure, subject to a ceiling of 1/10th of loan amount minus depreciation"

The above definition of AAD may suitably worded to avoid ambiguity highlighted below.

$$\mathbf{AAD} \leq \{\frac{\mathbf{1}}{\mathbf{10}}(\mathbf{Loan\ amount} - \mathbf{Depriciation})\} \text{ or;}$$

$$\mathbf{AAD} \leq \{(\frac{\mathbf{1}}{\mathbf{10}}\mathbf{Loan\ amount}) - \mathbf{Depriciation}\}$$

Interest rate on working capital (Regulation 32.4):

The draft regulation prescribes for interest rate on working capital as SBI MCLR + 200 bps. It is pointed out that working capital loans are generally of unsecured nature and may attract higher rate of interest. The Commission may like to further explore prevailing conditions in the banking sector and the general practices of the generation companies and the licensees, and then consider relatively higher margin for the interest cost towards working capital.

O&M Calculation (Regulation 42.3):

It is proposed to incorporate appropriate efficiency parameters in tariff as an incentive measure to encourage continuous improvement across cost components. For example, the current practice of approving norm based O&M Expenses adjusted by the appropriate price index should also incorporate an efficiency factor as explained below:

$$\mathbf{O\&M_t = O\&M_{t\text{-}1} \times \left(1 + \frac{Price\ Index_t}{Price\ Index_{t-1}} - X_t^{O\&M}\right)}$$

Where,

O&M: O&M expenditure norm;

Price Index: Consumer Price Index for Industrial Workers (Base year - 2016);

$X_t^{O\&M}$: Factor representing an annual target for efficiency improvement in O&M.

a) Determining the X-factor:

Appropriate benchmarking studies (for example, using Data Envelopment Analysis) should be conducted to set benchmark for efficiency improvement across individual 'controllable' cost parameters across the MYT control period. Since such studies take time, it is suggested that the regulation may incorporate the above suggested approach in principle, and specify a conservative factor keeping in view the actual norm set by the other ERCs. The X-factor should be linked to a target level of identified efficiency index. Such an index may be based on availability for generation and transmission, and reliability of electricity supply to consumers (Example - SAIDI/SAIFI).

An alternate approach may be adopted wherein norm for individual controllable and partially controllable cost parameters such as Employee cost, R&M and A&G. It is advisable that a trajectory for efficiency factor should ideally be provided in advance for each year of the MYT control period.

b) Index for O&M Expenses:

The Consumer Price Index, proposed for normalization of Employee cost should be explicitly defined as 'Consumer Price Index - Industrial Worker'.

For R&M expenses, Wholesale Price Index-All Commodity' may be more appropriate. In the case of A&G expenses, a composite index comprising of CPI (Urban) and CPI (IW), representing relative share of the administrative and managerial employee expenses, and expenses towards sub-contracts awarded for various activities.

Link for CPI (Urban) –

https://www.rbi.org.in/scripts/BS_ViewBulletin.aspx?Id=19857

Working capital (Regulation 53 & 64):

The draft regulation proposes following components of working capital:

a) O&M Expenses for one month

b) Maintenance spares @ 40% of R&M expenses

O&M Expenses already includes R&M expenses as one of its component, thus leading to double counting. The O&M Expenses includes salary and wages as one of the sub-component, which is paid at the end of the month and hence do not count towards working capital requirement. Similarly, A&G Expenses, which is another sub-component of O&M includes significant part of salary expense towards non-core operations are also payable at the end of the month. Furthermore, payment to sub-contractors is also paid at least couple of weeks after the invoice generation. Figure 1further explains the existing anomaly and the need for modification thereof.

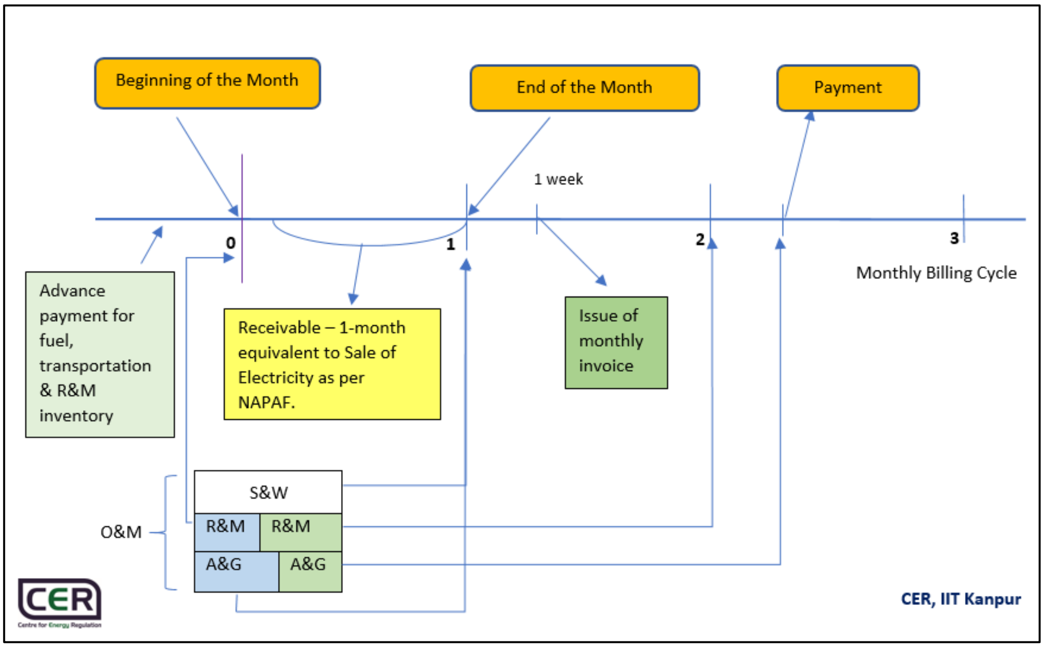

Figure 1: Cash Flow diagram for Working Capital

An additional window for early payment (with appropriate discount, say, for payment within two weeks after presentation of the bill) should be institutionalized to enable DISCOMs to take advantage of early payment through efficient financial planning.