

Setback to Reforms

Industry opinion on open access orders by Gujarat and Karnataka

The recent steps taken by the Karnataka and Gujarat governments to restrict power sale/purchase through open access are a major setback for the sector. The move adds to the woes of industrial consumers and generators which have been witnessing slow growth and facing fuel-related issues respectively, in turn, impacting overall investor sentiment in the sector. This issue has highlighted the need to strengthen the Electricity Act, 2003 in order to stop state governments from taking such steps in future. *Power Line* invited experts to share their views on the issue, its impact and the way forward...

Do the recent steps taken by state governments to restrict open access highlight the inadequacy of reforms in the power sector?

R.C. Agarwala

Even though the Electricity Act, 2003 introduced open access about 11 years ago, there have been several instances of state governments imposing restrictions on import/export of power. In addition, state transmission utilities (STUs) and/or state load despatch centres frequently impose restrictions on the import/export of power, which is a clear violation of the act. Such moves are not only retrograde but also a big setback for power sector reforms.

P.N. Bhandari

The state governments have historically focused on policy issues related to the power sector from the perspective of the state. For instance, if there is shortage of power in a state, the government would restrict its captive power producers

(CPPs) to sell power outside the state. Similarly, if a state (like Gujarat) has surplus generation, the government would want industrial consumers to purchase electricity from state-owned discoms, rather than from outside the state under open access, even if it is available at a lower rate.

In this backdrop, the provisions of open access, as visualised in the Electricity Act, 2003, have never been implemented in letter and spirit. In one way or the other, the state governments have resorted to arm-twisting to obstruct open access. The concept of open access can be successfully implemented only after breaking the state-imposed barriers.

Mahendra Kumar

The restrictions on open access highlight the inadequacy of reforms in the sector. This could also be a result of lack of understanding of the reform process as well as an unwillingness to implement it.

Steps have been taken by some state governments to restrict open access for sale of power by generators to any agency outside the state; and on the purchase of power by consumers from a source other than the local distribution licensee.

The statement of objects and reasons of the act highlights that over a period of time, the performance of state electricity boards (SEBs) has deteriorated significantly on account of various factors. For instance, although SEBs and the state electricity regulatory commission (SERC) have the power to fix tariffs, they have generally been unable to take decisions on tariffs in a professional and independent manner and tariff determination in practice has been undertaken by the state governments. Also, with the policy of encouraging private participation in generation, transmission and distribution and the objective of transferring regulatory responsibilities from the government to the SERCs, there is a need for a new self-contained comprehensive legislation. The act highlights the need to introduce newer concepts like power trading and open access. Section 65 of the Electricity Act makes a specific provision that if the state government grants a subsidy to a consumer or a class of consumers, it should pay the amount in advance to the utility.



R.C. Agarwala

Managing Director and
Chief Executive Officer,
Noida Power Company Limited



P.N. Bhandari

Partner,
PKA Advocates



Mahendra Kumar

Chief Executive Officer,
Reliance Energy
Trading Limited



Rajesh Mediratta

Director, Business
Development,
Indian Energy Exchange



Siddharth Mehta

Chief Executive Officer,
India Power
Corporation Limited

In the current scenario, where the peak demand met is of the order of 129,815 MW against the installed capacity of 237,743 MW, there is no reason for any restriction on open access. The imposition of such restrictions not only highlights the inadequacy of reforms in the sector but also the intention of not moving in the desired direction.

Rajesh Mediratta

Restricting open access is indeed against the spirit and provisions of the Electricity Act. In March 2014, two such open access-related restrictions have been imposed even as the country gears up for the Lok Sabha Elections.

Karnataka has invoked Section 11 of the act, restricting its generators from selling electricity outside the state. Gujarat has also restricted its open access consumers in two of its distribution companies from buying electricity under short-term open access (STOA) agreements citing technical constraints in upstream transmission. As a result of these restrictions, about 40 generators in Karnataka that were selling power under STOA will not be able to do so. This is not the first instance when Karnataka has used Section 11 of the act – it did so on two occasions in the past.

In Gujarat, at least 180 industrial consumers that were procuring almost 600 MW through the power exchanges under open access have been impacted. Despite the high open access charges, including the recently imposed additional surcharge of Re 0.42 per unit, sev-



M.G. Raoot

Managing Director and
Chief Executive Officer,
Power Exchange India Limited

“The biggest impact of creating artificial barriers is preventing the promotion of competition.”

R.C. Agarwala

eral industrial and commercial consumers (of 1 MW and above) are now deprived of their legislative right to select their supplier and are left with no other option but to buy expensive power from alternative sources. The state's power-surplus situation could be one of the reasons behind the move.

These developments are regressive and reflect serious drawbacks in the system in implementing the provisions of the act. The act envisioned full implementation of open access in distribution by 2009.

In terms of reforms, we believe that segregation of content and carriage would have obviated such situations. Neutral transmission and distribution wire companies would have acted impartially to supply at the price structure of competing suppliers/generators. Recent amendments to the Electricity Act initiated by the Ministry of Power should have been undertaken in 2003, which would have facilitated the implementation of open access in its true spirit. This would have also helped in overcoming several operational hurdles that arise due to potential conflict of interest on the part of state utilities in their bundled role as the owner of wires as well as the electricity supplier.

Open access charges vary widely across states – from Rs 3.50 per unit (West Bengal) to Re 0.50 per unit (Mizoram) – with most states having high charges. This impacts the viability of the frame-

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P.N. Bhandari

work even though the National Electricity Policy, 2005 (NEP) clearly states that open access charges should not be so onerous that they thwart the very competition that is intended to be achieved through the mechanism. Also, there are regulatory, infrastructural and operational issues that undermine this fundamental tenet of the act. Another key roadblock is “bringing cross-subsidies within 20 per cent of the average cost of supply” as specified in the NEP, which is yet to be achieved. All these inadequacies are a result of poor implementation of reforms. Moreover, the separation of content and carriage has been a missing piece in the reforms.

Siddharth Mehta

While the restriction of open access cannot be a single parameter of inadequacy of reforms in the power sector, the recent restriction imposed the state governments is more political in nature than anything else. These restrictions strengthen the belief that reforms need to be expedited and gradually moved towards open access to retail consumers in the near future, thereby making cheaper power available.

M.G. Raoot

The recent steps taken by various state governments to restrict open access do not really highlight the inadequacy of reforms, but the misconceptions on the part of the state governments about the intended reforms related to open access and creation of dynamic markets in the electricity sector. Reforms across the power value chain including development of competitive markets were aimed at bringing transparency and improving the operational performance of the states. In a nutshell, these were meant for the benefit of states in the long run and should be implemented in a transparent manner.

What would be the impact of the move on consumers, generators and the overall investor sentiment?

R.C. Agarwala

The biggest impact of creating artificial

barriers (that is, restriction on open access) is preventing the promotion of competition. Due to such restrictions, consumers are either forced to buy power at a much higher cost or face avoidable load shedding. For example, recently Gujarat imposed a ban on sourcing power from other states, which will force industrial consumers to buy power at an additional cost of Rs 1.50-Rs 2 per unit. Such restrictions do create an atmosphere of uncertainty and dampen the overall investor sentiments.

P.N. Bhandari

Restrictions on open access will adversely impact the functioning of power exchanges. If CPPs are denied open access, many of them with excess capacity may have to back down, which would be a national loss. Under Section 7 of the Electricity Act, generation has been de-licensed, while under Section 9, CPPs do not require any licence. The state authorities should, therefore, refrain from issuing directives to CPPs. Further, the case pertaining to issue of directives to CPPs is under consideration by the Supreme Court, which had earlier held (in the case of Tata Power Company versus Reliance Energy) that if the regulators go beyond their jurisdiction, it would lead to the revival of the permit licence regime.

Competition is one of the pillars of power sector reforms as enunciated in the preamble of the Electricity Act. The functioning of market forces through competition helps all – consumers, generators and investors. Any avoidable restraints on the free flow of electricity would lead to the revival of outdated and outmoded monopolies.

Mahendra Kumar

In the current market scenario, consumers (industrial) are working hard to control costs in the highly competitive market, including the international market. If relevant regulations and market conditions provide them an opportunity to reduce costs by purchasing power through open access, any restriction on the same would put extra pres-

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Mahendra Kumar

sure and affect not only consumers but also industrial growth in the country.

Several generators are not able to generate adequate revenue even to meet the costs and for repayment of loans. They do not have guaranteed buyers who would procure power at a reasonable rate on a long-term basis. In such a scenario, where generators are required to sell power at a rate lower than the production cost, or keep the plant idle for some time, there is no reason for the imposition of any restriction on them. Generators are already under pressure and such restrictions would impact them further and put pressure even on lenders. Such steps have started pushing investors out of the power market and shaken lenders' confidence in the sector.

Rajesh Mediratta

Restricting generators from selling or restricting consumers from procuring power under open access may help utilities meet their short-term goals but is certainly not sustainable in the long run. Such measures are counterproductive and against the legislative provisions as well as impact investor sentiment. The generators which have been restricted to sell power outside Karnataka were helping other supply-starved states in the southern region. Such restrictions may push supply-starved states into a greater crisis and lead to overall inefficiency in resource usage.

“The interpretation of Section 11 and the way in which state governments have used it are major concerns for the market.”

Rajesh Mediratta

With regard to the impact on consumers, the statutes of the Electricity Act allow consumers with usage of 1 MW and above to procure electricity under open access. Over the past five years, since the mechanism has been operational on the power exchanges, over 2,400 industries and commercial consumers across industries – steel, aluminium, textiles, glass, automobiles, pharmaceuticals, chemicals, commercial complexes, malls, educational institutions, group housing societies – have been procuring power from the power exchanges through open access.

In order to truly foster competition in the sector and safeguard the interest of stakeholders including investors and consumers, it is important to facilitate open access in the spirit of the Electricity Act.

Siddharth Mehta

Consumers do not have access to cheap power, especially industries, which impacts their competitiveness. Such barriers also close the option for generators to market their product across the country and restrict them to selling power to discoms, which are facing financial pressure.

M.G. Raoot

Such moves may hurt the sentiment of consumers, generators and investors. Open access and related provisions provide these entities a fair chance to optimise their cost and revenues in a transparent and efficient manner.

How can the loopholes in the current open access framework be plugged to prevent the misuse of Section 11 of the Electricity Act?

R.C. Agarwala

Large investments are required to strengthen and augment the state and central transmission networks. The financial position of the STUs is far from satisfactory. Therefore, private participation must be encouraged in the state/central transmission sectors. Further, heavy penalties including suspension/revocation of licences of transmission utilities that neither proactively invest in

strengthening their networks nor allow private players to do the same need to be introduced. If we want to ensure that reforms as envisaged under the Electricity Act are successful in “letter and spirit”, we need to bring strict discipline by imposing stiff penalties/punishment for violating the provisions of the act.

P.N. Bhandari

The courts and regulators should not overstretch the interpretation of the Electricity Act. Section 11 of the act is actually meant for “extraordinary circumstances” arising from the “threat to the security of the state” or “public order” or “natural calamity”. The sale of electricity by any generator/CPP outside the state or purchase of electricity by any stakeholder from outside the state cannot be treated in this category. Section 11 cannot be interpreted so as to nullify provisions of the act related to open access.

While invoking Section 11 (1), the state governments cannot ignore Section 11 (2), which requires the state regulators to compensate generators for losses resulting from any directive under Section 11 (1). If the regulators transparently compensate the stakeholders under Section 11 (2), the state governments may not need to resort to Section 11(1).

Another drawback is that the regulations notified by the state regulators cannot be challenged before the Appellate Tribunal for Electricity. The Electricity Act should be appropriately amended as currently, the regulations can be challenged only before the high courts. The power sector is a specialised subject, and hence it would be better if such matters are handled by specialised bodies instead of high courts. Also, in the case of Gujarat, it is estimated that the power-surplus state has to pay nearly Rs 80 billion annually towards fixed charges, as it is unable to buy contracted power from generators. In such a scenario, urgent steps should be taken for diversion of such surplus power to deficit states because making huge payments for idle capacity must be avoided.

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Siddharth Mehta

In the long run, the political leadership has to be sensitised about the wider impact of open access.

Mahendra Kumar

Considering the current market conditions, there is a need for out-of-box thinking and a vision beyond accusing someone for misuse of Section 11. The act will let the power market operate on commercial principles and provide freedom to all market participants with the universal obligation of the distribution licensee and protection of stakeholders’ interest. Steps are required to let the act operate in its right spirit. The continuing poor financial health of state utilities, especially distribution licensees, is the root cause of many evils. Some states have not imposed Section 11 but created a framework of rules that does not support open access. It is observed that issues in meeting the targets of loss reduction and recovery are the biggest reason for the shortfall in revenue realisation for distribution licensees.

Rajesh Mediratta

Open access is an important enabler of investments and drives efficiency, transparency and competitiveness in the sector. The interpretation of Section 11 and the way in which state governments have used it are major concerns for the market, alongside several other challenges.

“It is important to identify the specific circumstances under which Section 11 can be used by the states and limit its use to events triggered by these circumstances.”

M.G. Raoot

More recently, the Ministry of Power proposed amendments to the Electricity Act, including amendments to Section 11, to make the legislation more robust as well as to support the aspirations of the sector and the economy at large. The suggested amendments to Section 11 seem relevant and include a compensation (determined by the respective SERCs) for generating companies. The amendments propose that the capacity already committed under valid and binding contracts including open access should not be affected by state governments’ directives and any such directive will be valid for only 30 days. These provisions will certainly dissuade states from invoking Section 11.

In addition, we have suggested that routine power shortages should be explicitly disqualified as “extraordinary circumstances”. This will go a long way in preventing states from misusing Section 11 of the act as per the state government’s convenience.

Siddharth Mehta

The high level of cross-subsidisation in the tariff structure needs to be revisited by policymakers. It should be significantly reduced from the current level of +/- 20 per cent so that distortions in the tariff structures of various consumers are limited. This will also facilitate the migration of such consumers under open access as the perceived damage would be limited. Section 11 of the act should be amended to ensure that such restrictions of the state governments should be time barred with a maximum limit of one month.

M.G. Raoot

Today, the provisions under Section 11 are being used as a discretionary tool by some state governments which deters competition in the short-term power market. It is important to identify the specific circumstances under which Section 11 can be used by the states and limit its use to events triggered by identified circumstances. This is a simple way to prevent the misuse of the provision. ■