

Electricity Sector: What Difference the Regulators Can Make

P. Subramaniam

Chairman, Maharashtra Electricity Regulatory Commission

Utility regulation is important to the public interest. It is, generally speaking, a substitute for competition in industries characterized by high concentrations of market power. Today, Regulators in our society are identified with the Government and its functioning. Under this perspective, Regulators have all the more difficult issues to face and often-conflicting interests to serve. It is necessary, on one hand, to make sure that utility companies receive enough return on their investment to ensure that they are financially viable. At the same time, regulators must ensure that consumers receive reliable service at reasonable rates. It is often difficult to balance these objectives, as well as to take into account other important goals, such as encouraging competition and protecting the environment. However, some of the objectives may be more important to promote than others, depending on the evolutionary stage of the industry and economy at issue. As long as there is competition, the average consumer stands a reasonable chance of getting a fair deal.

There is no universally acceptable model of regulation. Regulatory traditions are rooted in the culture of a society, its political and governmental institutions, the need of the government for revenues, the rights of private citizens, the importance of inexpensive energy, and even the need for employment. There appear to be “first principles” of energy regulation that can apply everywhere. They include openness, predictability, expertise, and fairness.

Regulations and regulatory bodies work best when independent of undue political influence. Regulators ought to be experts in the law and economics of the industry they regulate. They should make their decisions, such as whether a rate is “just and reasonable”, based primarily on that expertise. Independent regulation appeals to investors. If investment bankers and other investors are confident that regulatory decisions will be based on the economic merits and that decisions by regulators can be roughly predicted, they will be encouraged to invest.

In fact MERC has set some trend in this matter addressing the following issues effectively:

- § The first issue, which MERC emphasized, is that of process. The MERC followed a completely transparent process.
- § Second important issue, which I must emphasise, is that the Commission worked with no external pressure.
- § Thirdly, while setting tariffs, we followed two principles. First, “No Tariff Shock” to any category of consumer and second, every tariff movement must be in the direction of the average cost of supply i.e. tariff rationalisation.

Now let us look at some of the practical issues in implementing the electricity market in India.

While we all welcome the advent of market economy in the best interest of the consumers, there are onerous tasks ahead in the hand of Indian Electricity Sector Regulators today to build up a better tomorrow.

First and the most important task is tariff rationalization. You must have noticed that in the new proposed structure (under the Electricity Bill 2000), bulk consumers, say above 5 MW contract demand, will go out of purview of the Distributors or Supply Companies as these players can have contracts based on the pool price or can have contract with the generators directly. Currently these consumers are paying consumers, who are subsidizing sales to the categories like domestic and agriculture. Clearly this is not the welcome situation. So if market is to be implemented, subsidy has to be given by the Government either to the Distributor or to the consumer directly. This means that the subsidies involved should be explicit. The problem here is not only the ability of the government to pay subsidy but also one of accurate estimation of subsidy required. The government will have to carry out structural changes to transfer the subsidies from ratepayers to tax payers by making provisions in the government budget. This structural change will take some time to implement.

Second task is adept handling of the pace of reforms and removing the uncertainty about the industry structure. During 1991, we opened generation sector to private investors by signing long term Power Purchase Agreements (PPA). Also, some of the States, while carrying out reforms, have implemented a single buyer model wherein the transmission company is purchasing all the power from the generators and selling it to the distribution companies. The Transmission and Distribution companies have signed long terms power supply contracts along with other contracts like Escrow Agreements. These long term PPAs will hinder the creation of the power market.

Third important focus is universal service obligation. Today, SEB has obligation to supply power within a period specified in the Electricity (Supply) Act to supply power to anyone who desires to have power connection. There will be no one to perform this universal service obligation in power market, as there will be no incentive to supply power in a remote and far-flung area.

Apart from the above mentioned areas, there are various issues like open access to transmission lines, loading of technical losses on generation costs, adequacy of transmission and distribution infrastructure, capacity building for supply business, demand side management, building up the cost for protection of the environment etc, which will have to be looked into detail. These issues are prominent in India. The government and the Regulators will have to work in unison to find an acceptable solution. The public opinion resulting from the public process will be critical for the success of the implementation of the future electricity market.

We must not forget that though the concept of electricity markets is theoretically a very good concept, however, a lot of restraint will have to be shown while implementing it as we definitely would not like to commit a mistake which we committed while opening generation sector without trying to solve the underlying problem of the viability of the distribution sector.

A major strength of a fairly regulated system is centralized decision-making. When a utility wants to change the rates that it charges its inter-state customers, it knows that it

can come to the Commission and only the Commission, to seek that change. If a customer feels that a utility group is not treating it fairly, it knows that it can file a complaint with the Commission.

The Commission must have the responsibility for such of our country's energy policy to encourage balanced action by the Commission. Since the Commission regulates electric utilities, it must understand the impact of its decisions regarding one type of utility upon other energy companies.

With the evolution of Commission's work in energy regulation, the Commission shall be able to develop expertise and what we call institutional memory, today, which we are acutely in shortage. The Commission has among its employees some of the leading experts in many areas of the energy field and can call upon those experts to assist in making decisions that are in the public interest.

The diversity in the makeup of the Commission means that the Commission has differing view points available to it at all times. This helps ensure that the Commission's decisions are well balanced.

The diversity of decision-making tools available to the Commission is also strength. The Commission can decide which matters require broad solutions like issuing new regulations and which matters should be decided narrowly. The Commission can issue orders, conduct rule-making proceedings, order hearings, and so on.

The complexity of the industries that Commission regulates presents a difficult problem. The decisions we make have implications that often are not obvious. The Commission must evaluate carefully how its actions affect the public. The complexity of regulation leads to other problems. For example, the language regulators traditionally use is simply not something that most people can understand. We tend to use complicated sounding terms and acronyms that make it difficult for anyone who is not an expert to figure out what we are saying. The Commission's orders sometimes have to be so long that no one would read them who doesn't have to.

The dictum is that regulation must adapt; if a mistake is made, regulators must correct it.