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March 9, 2001

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Part I : A note on the FOCA Methodology

1. Guiding principles of devising FOCA methodology:

Any automatic pass through, like FOCA charge, should be

i) Simple and transparent to calculate and verify.
ii) It should only cover costs which a) are outside MSEB's control and b) cannot be reasonably estimated (for the ensuing year) in the tariff revision process.
iii) By improving the estimation methodology, (of expenses for the ensuing year) attempt should be made to keep the quantum of automatic pass through at a minimum.
iv) Procedure used to apportion the FOCA on various consumer categories should not change the tariff structure w.r.t. cross-subsidy to a large extent.
v) MERC should reserve the right to give appropriate directions to MSEB, even post-facto, if it is found that either the FOCA methodology or calculations were deficient.

2. Suggestions:

In our opinion, in order to achieve the above purpose following aspects should be considered in the context of FOCA methodology:

1. Variable cost of generation: In case of variable cost of generation (from MSEB plants and power purchase) changes only in the fuel cost (in terms of Rs./ MKCal) should be considered. Other issues namely, (a) heat rate and (b) proper merit order dispatch should be kept out of FOCA methodology. (Refer Annexure I for more details)
2. Fixed cost of power purchase: The reasons for deviation (from MERC estimation) in fixed cost of power purchase should be clearly spelt out. For example, in the calculation submitted by MSEB on 12th Feb. 2001, the fixed cost of DPC in December 2000 is shown as Rs. 94.12 Cr., implying an increase of over 10% on the

actual for January 2000. MSEB should specify what % of this increase is on account of different factors such as change in $ / Rs. rate, inflation indices, fixed escalation as per PPA, duties and taxes, rebates and penalties. Further, MSEB should also certify, for each factor, that it was not possible to reasonably estimate these changes in costs. Also this should be based on actual amount paid and not billed amount.

3. <u>Other costs</u>: In FOCA the MSEB proposes to include incremental costs on account of items such as lease rent, interest rates, foreign exchange rate and taxes. In the FOCA calculation only the costs actually paid (and not estimated or billed) by MSEB on these accounts should be considered. Further, while calculating the incremental interest costs only those loans and costs, allowed by the MERC in the tariff order should be considered. For example, increase in interest costs due to increase in working capital need (on account of increased arrears and losses) should not be included in the FOCA calculation. As mentioned in the context of fixed cost of power purchase, MSEB should give breakup of contribution by different factors and reasons for not being able to estimate the same.
4. <u>FOCA cost period</u>: FOCA calculation should not consider costs relating to period ***prior to last tariff order*** without prior approval of MERC.
5. <u>Improved cost estimation</u>: In tariff revision proposals MSEB should estimate costs not just on the basis of actual costs in the past but also on the basis of likely increase in these costs. For example, it would be possible to estimate the ensuing year cost of fixed component of power purchase by considering the fixed escalation clauses in the PPA. Also interest payments on various loans should be worked out (giving more detail such as currency linkage, interest rate, tenure, repayment schedule etc.) Such an estimate would reflect more realistic revenue requirement for the ensuing year. This will help in keeping the incidence of FOCA charge to a minimum.
6. <u>Limit on FOCA charge due to other costs</u>: If the FOCA charge on account of factors **other than** i) change in fuel cost (Rs./MKCal), ii) rupee depreciation and iii) direct taxes, becomes more than 1 paise / unit (i.e. ~ Rs. 45 Cr. on annualised basis for FY 00-01), then prior approval of MERC should be sought.
7. <u>Detail calculations</u>: MSEB should submit detail calculations of FOCA charge. These calculations should clearly mention various assumptions made and data sources. Also these calculations, in the form of excel worksheets should be submitted to MERC and should also be made available through the web. (in the form of excel file and not picture format)

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Part II: Comments on the FOCA calculations submitted by MSEB

1. Based on the information submitted by MSEB, it appears that MSEB has worked out its cost of generation on the basis of actual generation i.e. including the auxiliary consumption. MSEB compares this cost of generation with generation cost specified in the MERC Order (Rs. 0.8843 / unit). But, the generation cost specified in the MERC order is based on the Bus-Bar generation (i.e. excluding auxiliary generation). As a result, MSEB claims that it's generation cost is less than cost estimated by MERC (i.e. – ve FOCA), when in reality its cost is higher than MERC estimate (i.e. + FOCA). This wrong comparison has resulted in MSEB claiming less FOCA to the tune of ~ Rs. 100 Cr.

2. MSEB has proposed to recover Rs. 241.64 Cr. on account of income tax payable to NTPC for FY 1998-99 and FY 1999-00. MSEB has not produced a proof that these costs are actually paid by MSEB. As these costs relate period prior to FY 2000-01 (relating to MERC order dated 5th May 00), MSEB should not be allowed to recover these costs through FOCA.

3. MSEB also proposes to recover Rs. 144 Cr. towards income tax payable to NTPC for FY 00-01. In its tariff proposal MSEB had mentioned that the issue of NTPC income tax was under scrutiny by CERC. MSEB should be allowed to recover this cost only if the issue has been settled and if there is no pending dispute. Further, MSEB should attach relevant documentary evidence.

4. DPC fixed cost: In the calculation submitted by MSEB on 12 Feb. 2001, fixed cost of DPC for December 2000 is shown as Rs. 94.12 Cr. implying an increase of over 10% in based on the actual for January 2000. MSEB should specify what % of this increase is on account of different factors such as change in $ / Rs. rate, inflation indices, fixed escalation as per PPA, duties and taxes, penalties and rebates. Also this should be based on actual amount paid and not billed amount.

5. The FOCA charge is the first automatic pass through to be approved by the MERC. Hence, the methodology to be specified for FOCA calculation is crucial, and it is essential that wider public inputs be invited through a public hearing. Considering the comments submitted in this note, MSEB would be required to modify the methodology and re-calculate the FOCA charge.

6. In light of MSEB's claimed rebate of Rs. 400 Cr. from DPC, the FOCA for next quarter will be –ve. As MSEB is likely to approach the commission shortly for tariff revision, we suggest that the proposal for FOCA methodology should be considered after due public process along with the tariff proposal.

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Annexure I: Methodology for FOCA relating to Variable Cost of Generation

In our opinion the variable generation cost component of the FOCA should be based only on variation in cost of fuel (in Rs./MKCal) and other aspects such as heat rate and proper merit order dispatch should be left out of FOCA calculations. The reasons for this are given below:

Components of varibale cost in FOCA:

Monthly variable cost of generation varies according to i) heat rate ii) merit order dispatch and iii) fuel cost (Rs./Mkcal). Heat rate and proper merit order dispatch are within MSEB's control and are also predictable on yearly basis. By stipulating Heat rate and Generation / Purchases from various sources, MERC has already dealt with these issues in its tariff order. If MSEB does not achieve targeted performance levels on these issues (i and ii) then it would result in a loss to MSEB, which is attributable to it's own inefficiency. It is not possible and neither desirable to work out a mechanical (and fixed) procedure or methodology to separate the impacts of improper merit order dispatch (this is due to factors such as changing monthly consumption patterns and plant outages).

Thus, in our opinion, issue of proper merit order dispatch should not be coupled with FOCA methodology. The commission should look into this issue independently.

If MSEB achieves better performance then directed by MERC in terms of heat rate, then MSEB should be allowed to keep this benefit as an incentive to perform better. Obviously, if MSEB fails to achieve the heat rate target then it should not be allowed to pass on this inefficiency to consumers. Further, MERC will be setting up revised heat rate target during subsequent tariff revision. So, this incentive / disincentive mechanism will be applicable only for period between two tariff revisions. **If this proposal of incentive for better performance is accepted then it would not be essential to include heat rate as a component of FOCA methodology.**

Thus, from the variable generation cost aspect only the **change** in fuel cost (i.e. Rs./MKCal) should be included in the FOCA methodology. In case of power purchase from DPC, change in fuel cost due to Rs. depreciation will automatically be covered in this component as the fuel cost is worked out in Rs./ MKCal.

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