ARR and Tariff Revision application of Reliance Infrastructure (D) for FY 09

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Comments / suggestions
before MERC, Mumbai
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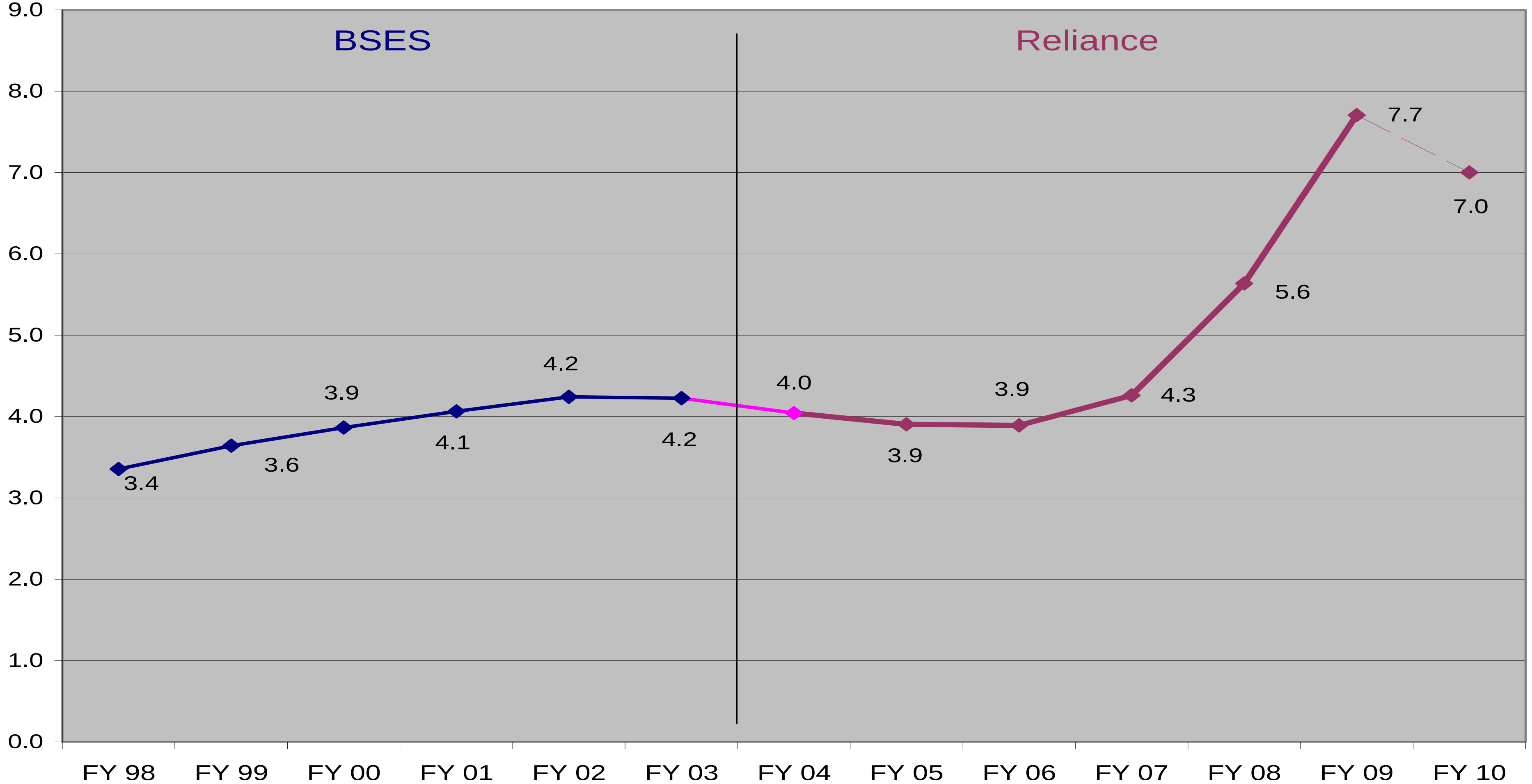
- Objective of this submission
- Historical overview of avg. cost of supply
- Major cost components of the ARR
  - Energy Cost
  - Distribution cost
- Appellate Tribunal of Electricity (ATE) judgments
- Salient Observations
- Prayers and suggestions/comments

Objective of the submission

- Sharp increase in cost of supply
  - Lack of planning and timely efforts to source economical/reasonable cost power
  - Very high capital expenditure in the recent years.
  - Large increase in O&M cost in spite of very high capital expenditure.
- Impact of past ATE judgments
- Need to experiment with and evolve new tariff policies.
- End of License term in 2011 and subsequent issues

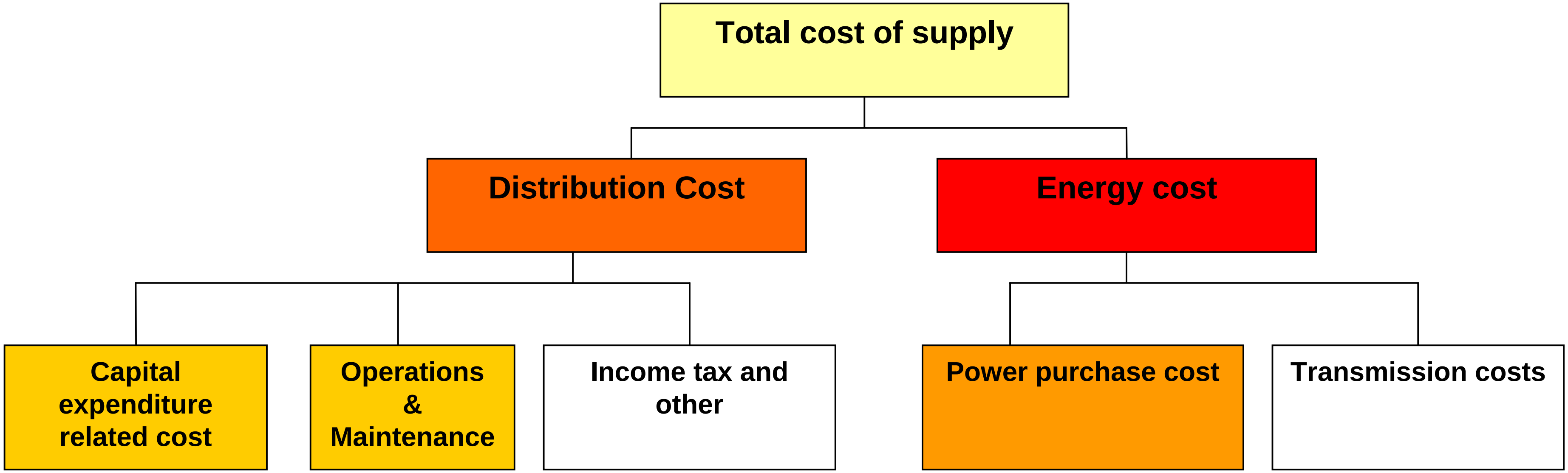
Trend in Avg Cost of supply since FY 98



Figures indicate avg cost of supply per unit sales

Major cost components of the ARR

- The two major components that constitute the cost of supply are:
  - Distribution cost and
  - Energy cost, which includes power purchase and transmission charges



Total cost of supply as on FY 07 and projected for FY 08 -10 as per current ARR

Particulars	FY 07		FY 08		FY 09		FY 10	
	Rs Cr	Rs/unit	Rs Cr	Rs/unit	Rs Cr	Rs/unit	Rs Cr	Rs/unit
Distribution cost	**868**	**1.16**	***981***	***1.26***	***1068***	***1.31***	***1186***	***1.40***
Energy cost	**2361**	**3.17**	***3419***	***4.38***	***5194***	***6.39***	***4736***	***5.60***
Total cost of supply	**3229**	**4.33**	***4400***	***5.64***	***6261***	***7.71***	***5922***	***7.00***

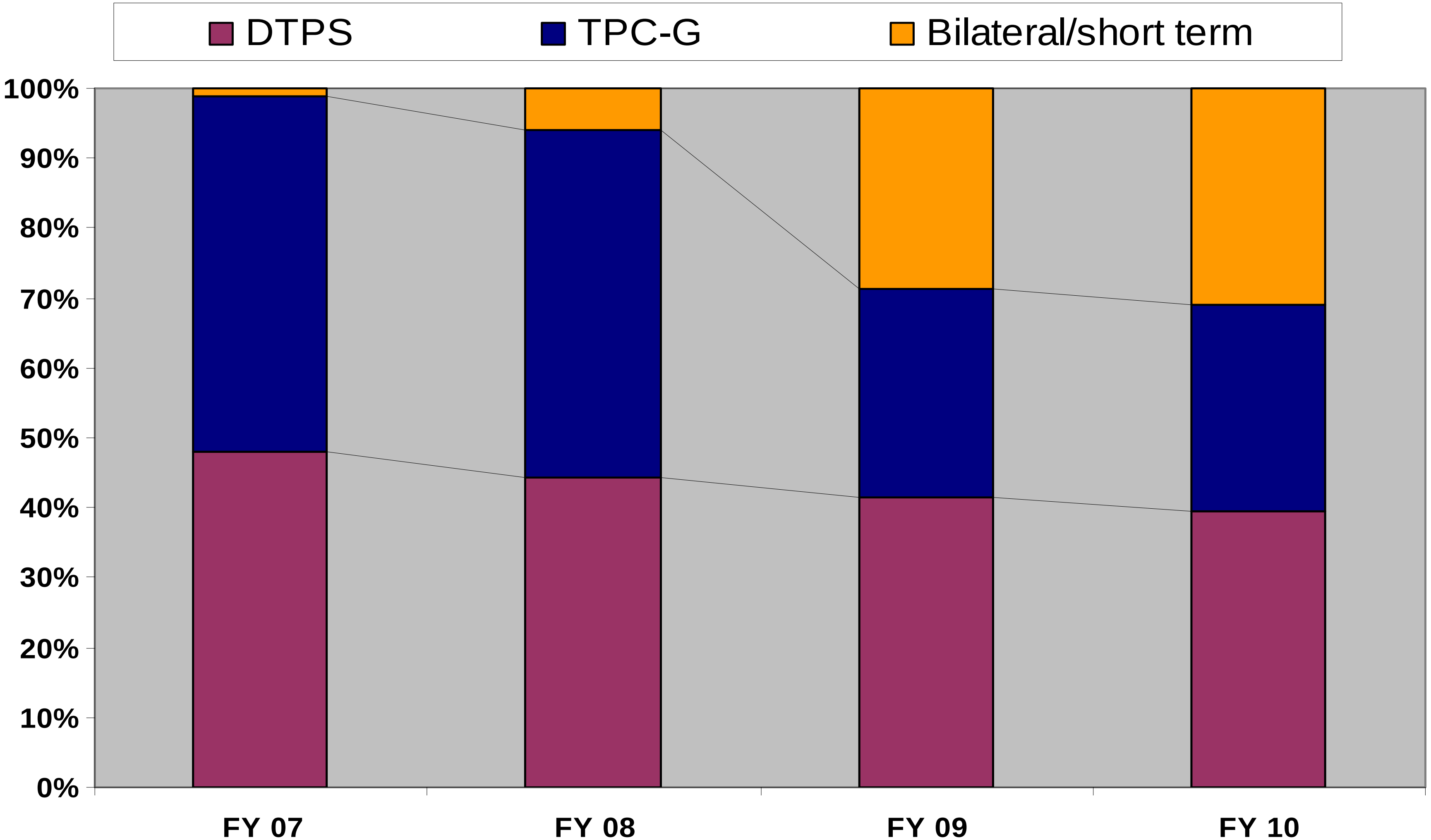
Rs/unit indicate cost per unit of sales

Energy Cost Analysis

Energy Cost Components

- The energy cost includes fixed and variable cost of power procured and the transmission costs
- Dramatic increase in energy cost in the recent times is mainly on account of:
  - Large quantum of bilateral / short term power purchase
  - Increase in fuel costs

Source wise Quantum of power procured



Source wise avg cost & share of power procured

Source	FY 07	FY 08	FY 09	FY 10
DTPS	2.01 (48%)	2.13 (44%)	2.45 (41%)	2.65 (39%)
TPC-G	3.02 (51%)	4.02 (50%)	4.83 (30%)	3.82 (30%)
RPO	0.00 (0%)	3.49 (0%)	3.50 (0%)	3.65 (2%)
Bilateral	4.39 (1%)	5.49 (5%)	8.77 (20%)	7.00 (29%)
Imbalance Pool	7.13 (0%)	5.69 (1%)	9.45 (8%)	0.00

% figures in brackets indicate share in total quantum of power

Lack of timely actions by licensee

- The utility has not defined any long term power purchase plan in the last 6 years

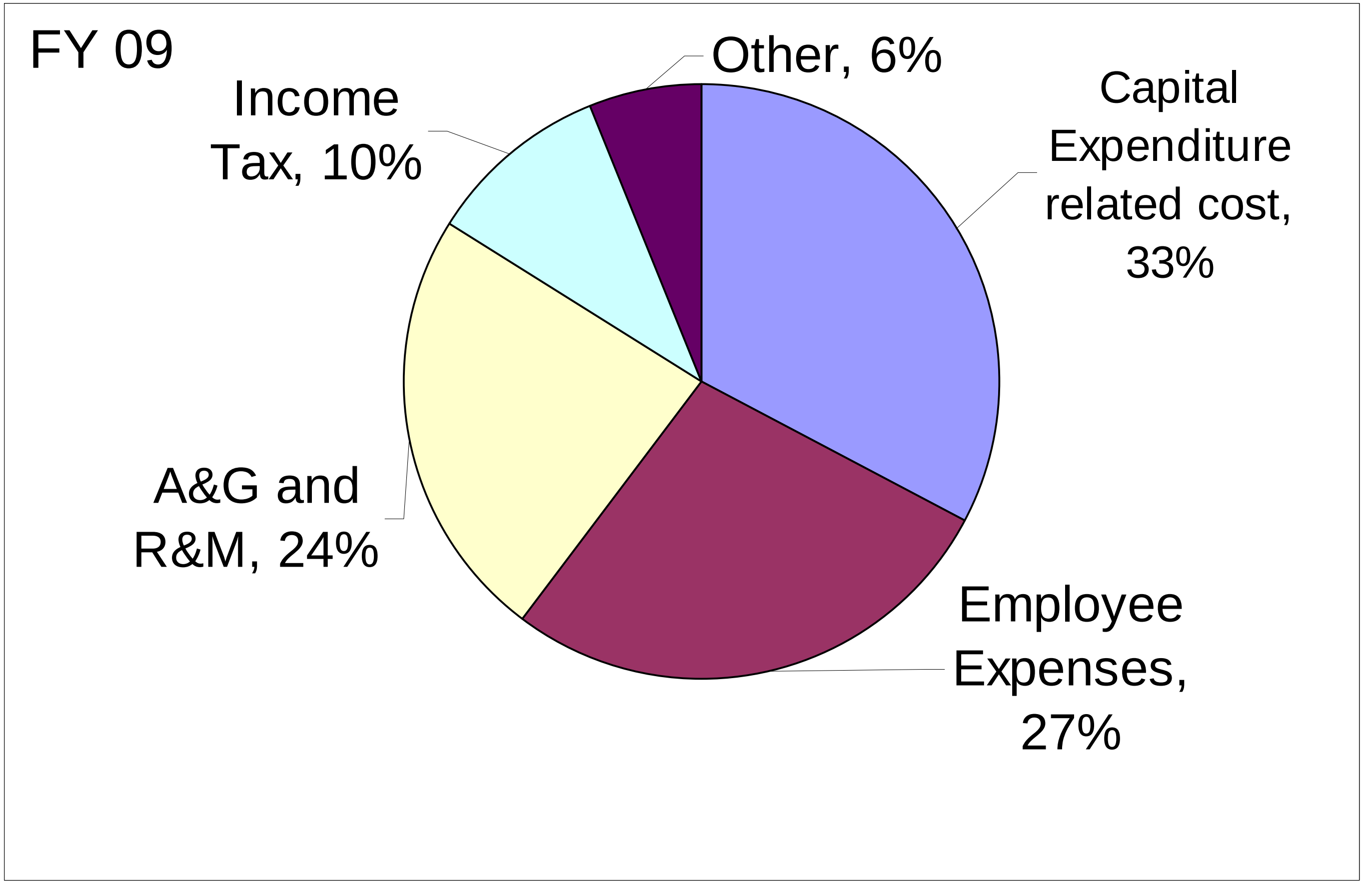
- The commission in its order dated 12th Feb 2009 directed the licensee to '*submit its long term power procurement plan in accordance with Regulation 23 of MERC (Terms and Conditions of Tariff) Regulations, 2005 within one month from the date of this Order*'

Sharp rise in energy cost

- Improper planning for last 5 years and failure to source adequate power in spite of being aware of the shortage
- Lack of prompt action on commission's directives ***since 2003*** for conducting demand forecast study and planning for additional power
- MERC order dated 4th Jan 2008 clearly states: '*licensees should not seek post facto approval for power procurement that has been undertaken on account of inadequate planning and demand assessment.*'
- Licensee should be penalized for failure to ensure cost effective power procurement by timely, advance actions

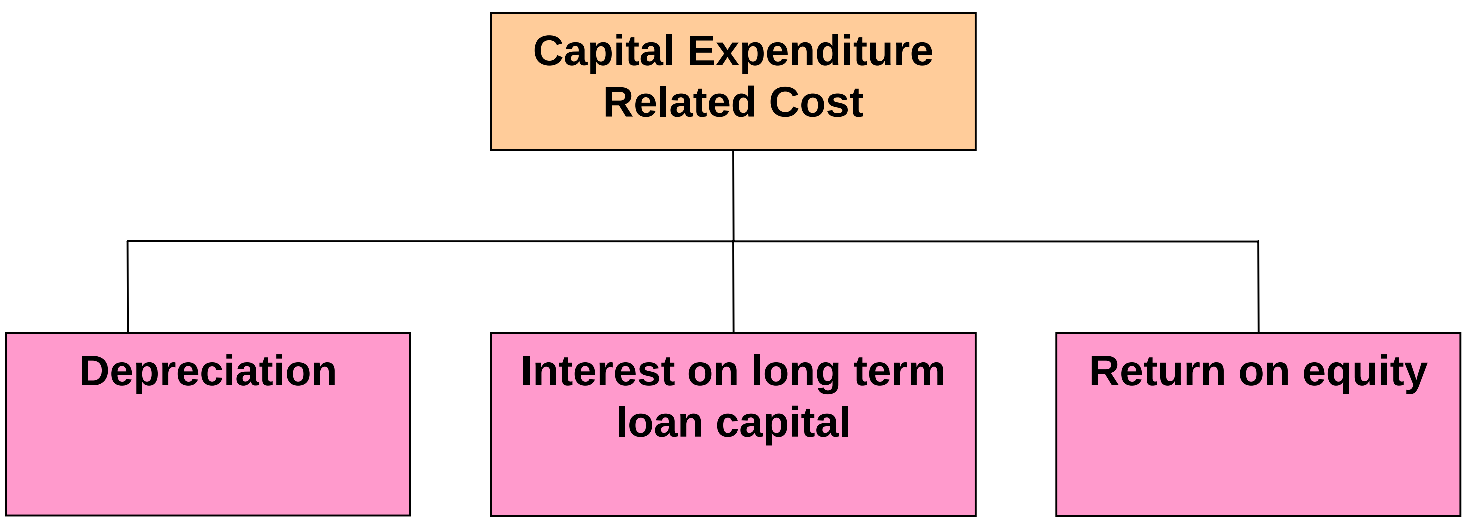
Distribution Cost Analysis

Break-up of Distribution cost for FY 2008-09

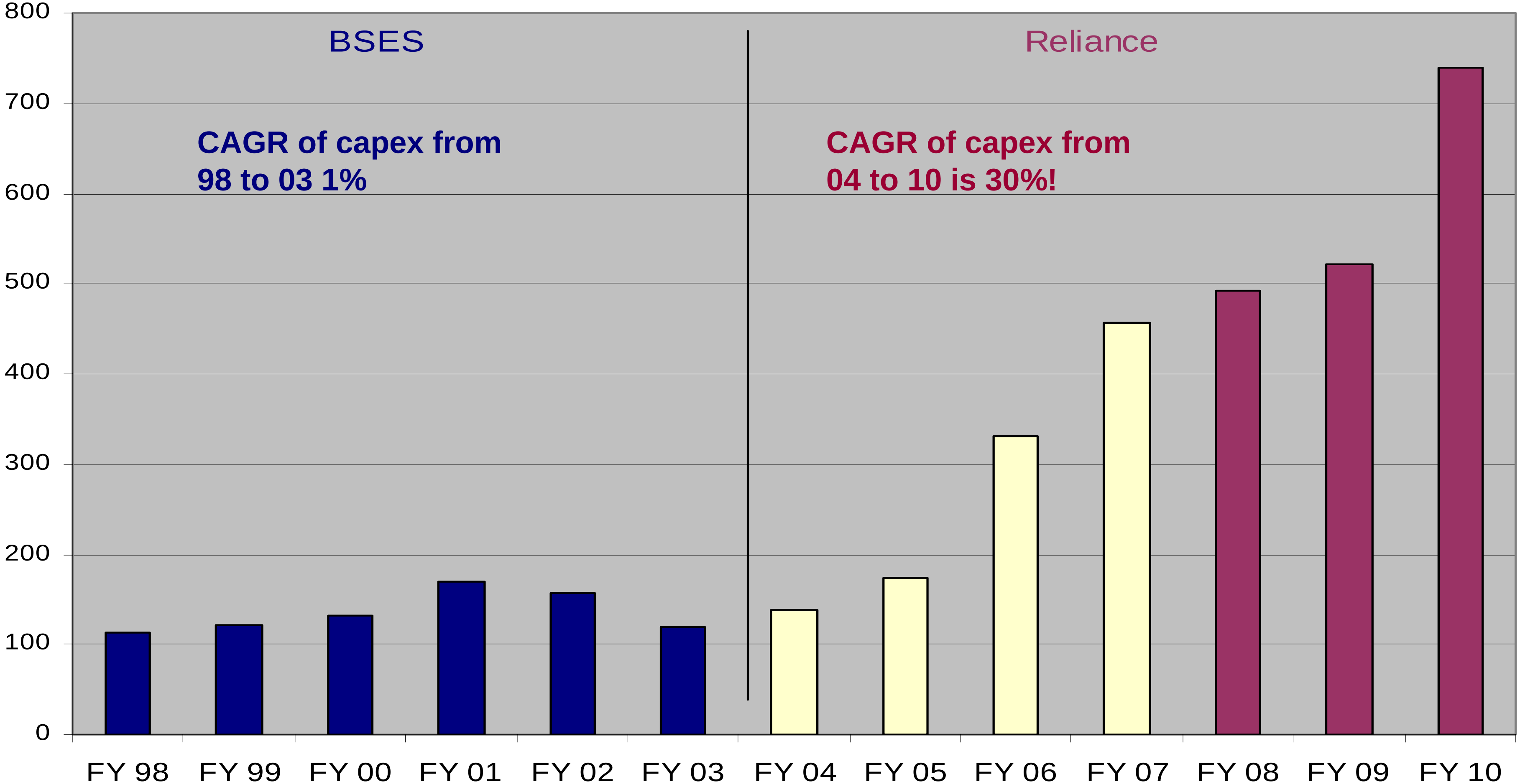


Capital expenditure

- Increases asset base and hence the capital expenditure related investment cost, thus affecting the tariff to the consumers.
- Following are the tariff components linked to capital expenditure



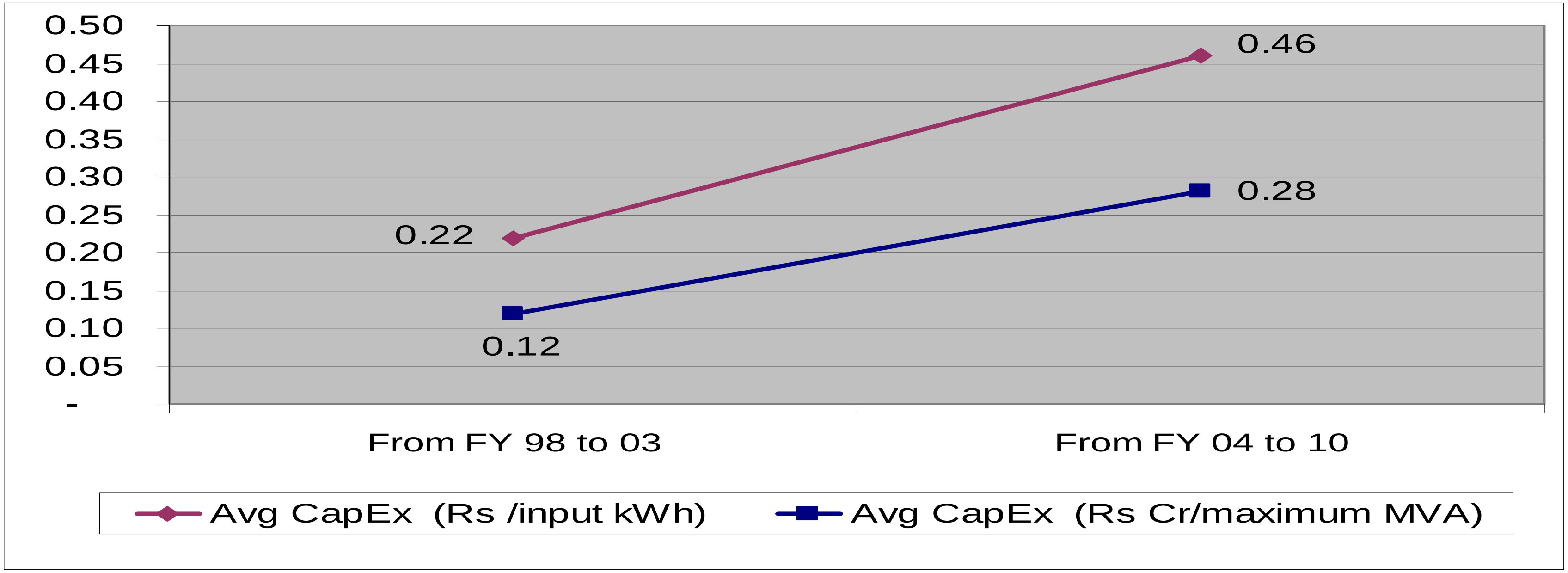
Growth in capital expenditure since FY 98



Bars indicate Capital expenditure in Rs. Cr

CAGR- Compounded Annual Growth Rate

Growth in Capex vs. I/p Energy and Max Demand



Particulars	From FY 98 to 03	From FY 04 to 10
Average Capital expenditure in Rs. Cr / yr.	**135**	**407**
Compounded Annual growth in Input energy in %	**1%**	**5%**
Compounded Annual growth in Maximum MVA demand in %	**3%**	**3%**
Increase in Capex in Rs.Cr per unit MVA increase	**4.62**	**8.22**

Need to verify ‘Prudence’ of Capex

- MERC’s in-principle clearance letter states: *‘in-principle clearance should not be construed as final approval for ARR purpose and the scheme will be open for scrutiny during tariff determination process/ARR review…’*
- Till date no scrutiny has been undertaken by MERC neither is there a clearly defined procedure for the same
- DERC undertook such a scrutiny and the results are revealing

DERC stands for Delhi Electricity Regulatory Commission

Relevant extracts from DERC order

- DERC's Order dt. 23rd Feb 2008 in the matter of ARR of BYPL and BRPL both of which are group companies of Reliance, observed the following:

- *'During the years 04-05 and 05-06, both BRPL & BYPL made **extensive purchases of capital goods from REL at rates considered exorbitant by the Commission**, resulting in transfer of substantial funds from these companies to REL by way of profit on sale of the capital goods.'*

- *'Restrictions are considered necessary on these companies for being instrumental in unjust enrichment of the group company REL..'*

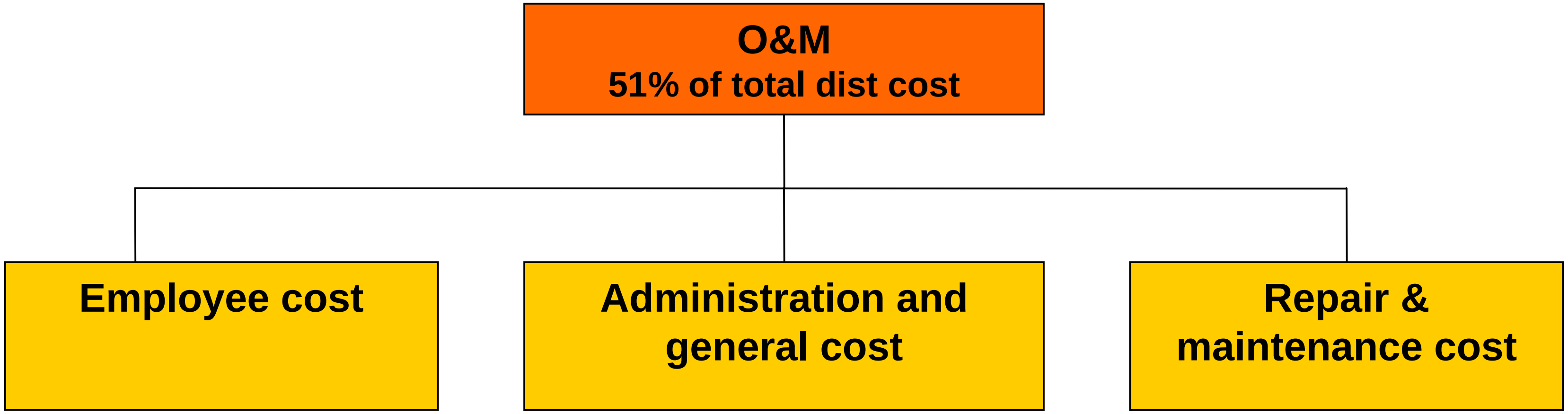
- '*Capital expenditure and asset capitalization in respect of these amounts totaling Rs.535 crore is accordingly disallowed…. '*

Prayers regarding capital expenditure

- Evidence underlines the need for through scrutiny of investment plans beyond in-principle clearance
- Capex during FY 04 to 10 is nearly double that of previous 6 years (FY 98 to 03)
- Tariff burden **(Rs. 251 Cr)** due to high capex related cost during control period should not be passed on until through scrutiny by MERC
- Constitute transparent and accountable procedure for cost-benefit and prudence analysis of all major capital expenditure

Operations & Maintenance costs

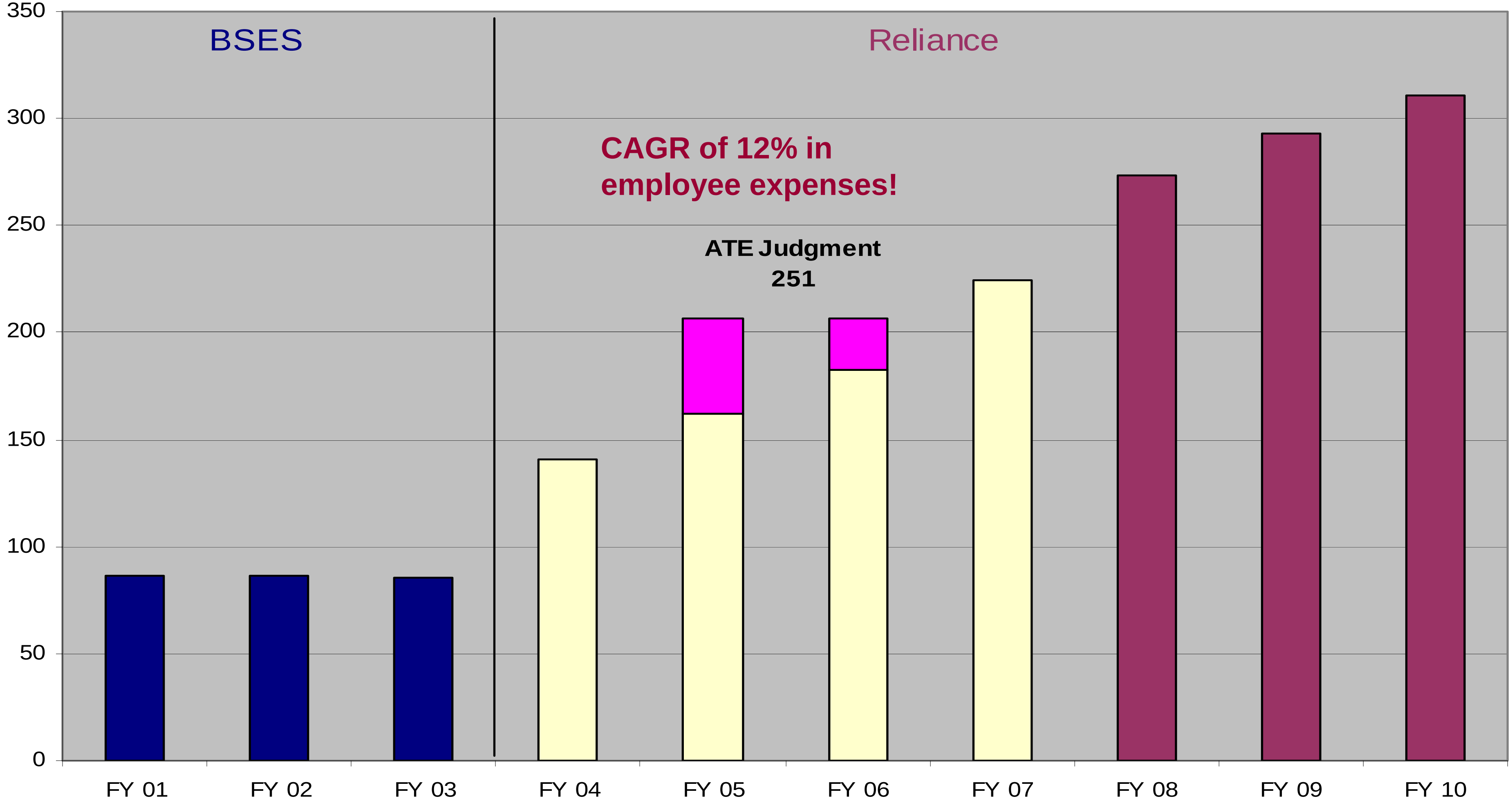
Operations & Maintenance cost analysis



- As per the MYT regulations, expense coming under O&M should be treated as controllable parameters

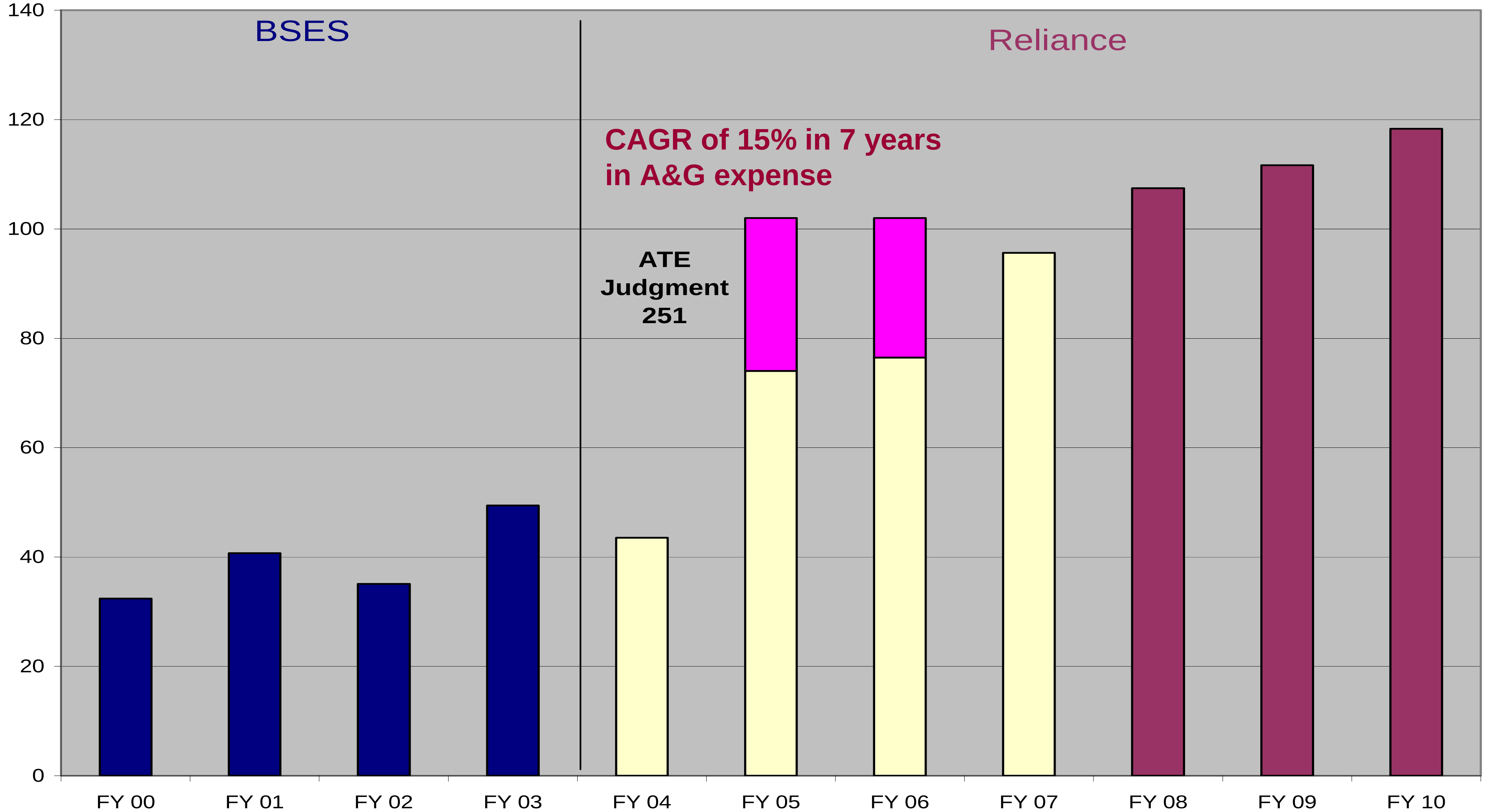
MYT stands for Multi Year Tariff regime

Trend of Employee expense since FY 01



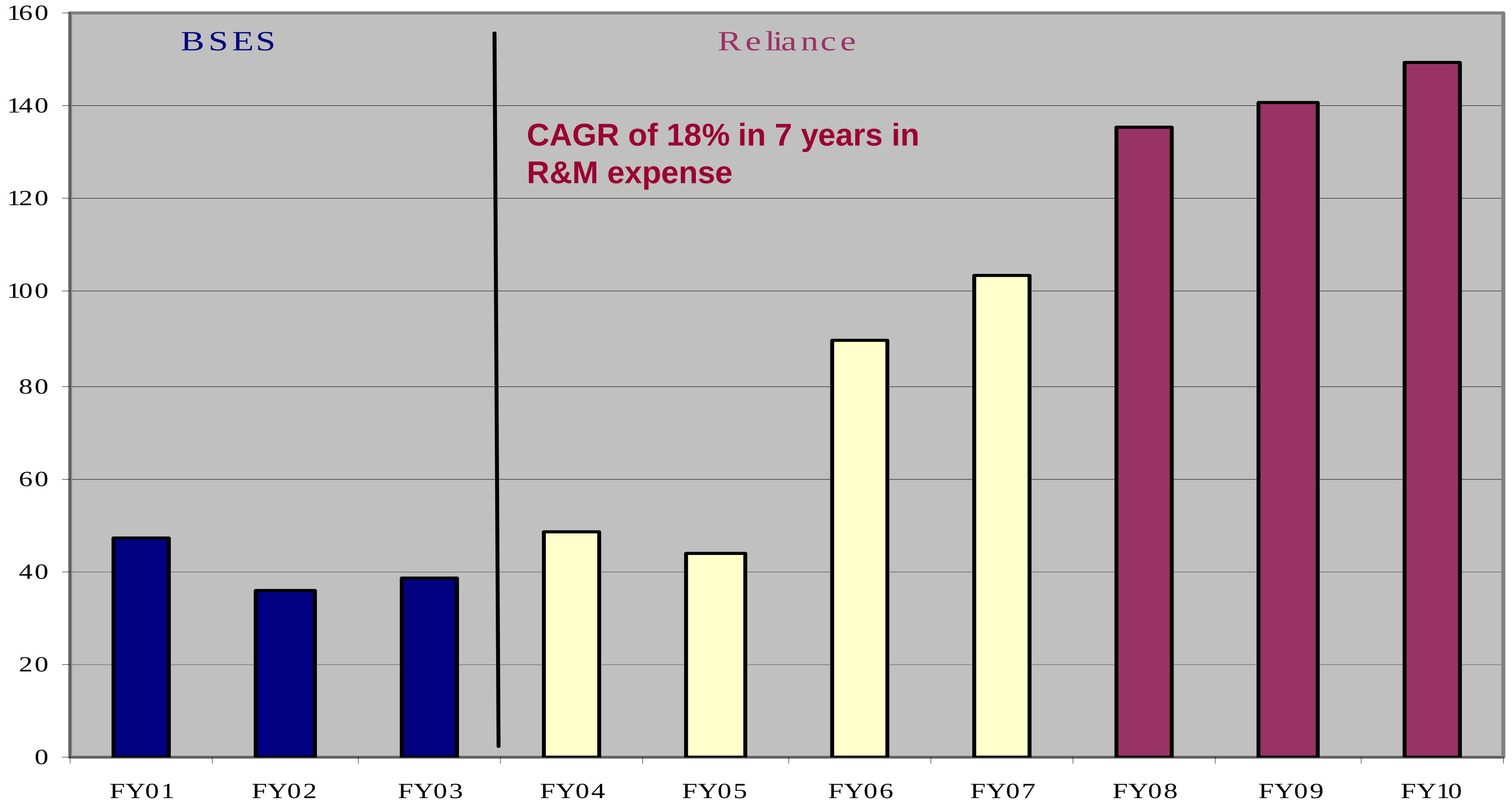
Employee expense Figures in Rs. Cr

A&G Expenditure since FY 2000



Bars indicate A&G expenditure in Rs. Cr

Trend in R&M expense since FY 01



Bars indicate R&M expenditure in Rs. Cr

O & M Expense prudence Check

- Growth in O & M expense ~ twice the inflation rate
- Essential to undertake prudence check before passing on these costs to consumers
  - ATE judgments 251 /2006 as well as 90 of 2007 allows passing of costs to consumers *only based on prudence check* by MERC
- Parameters for prudence check
  - Benchmark against inflation rate
  - Should be treated as controllable parameters under MYT
- Excess costs (Rs.198 Cr) based on above parameters should not be passed on to consumers

Appellate Tribunal of Electricity (ATE) judgments

ATE judgments related to past orders

Details of the Challenged Order	Appeal No	Bench	Judgment in Favor of	Financial Impact in Rs. Cr
MERC Order dated 20th February, 2004	Appeal No. 32 of 2005	Mr. H. L. Bajaj, Tech Mem Mr. Jst E Padmanabhan, Judicial Mem	REL	Rs. 350 Cr
MERC Order dated October 3,2006	Appeal No.251 of 2006	Mr. H. L. Bajaj, Tech Mem Mrs. Jst Manju Goel, Judicial Mem	REL	Rs. 400 Cr
MERC Order dated April 23, 2007 in case No. 2 of 2007 and tariff order dated April 24, 2007	Appeal No.90 of 2007	Mr. H. L. Bajaj, Tech Mem Mrs. Jst Manju Goel, Judicial Mem	REL	Rs. 225 Cr

PEG's past interventions / submissions

Regarding ATE in appeal no. 251 / 2006

- PEG submission dated 19 January 2007 Before ATE
  - Opposed REL appeal
  - Highlighted various legal and regulatory provisions and demanded that
    - Licensee merely incurring expenditure can not be a ground to pass on costs to consumers
    - SERC / ATE must pass on costs to consumers only based on tests of 'prudence' and 'justifiability'
- PEG submission dt. 10 April 2007 before MERC
  - Highlighted large financial impact and urged MERC to
    - Undertake prudence check of employee expenses and Capital expenditure
    - Conduct public hearing
    - Appeal before Supreme court

Impact of the ATE judgments

- Increased tariff burden on consumers (around Rs. 1000 Cr.)
- Negates regulatory / SERC authority and efforts to ensure efficient and economic operation
- Renders multi-year tariff regime futile
- Need for the Commission to defend its orders right up to the Supreme court

End of license term in 2011

End of License term and subsequent issues

- Term of license ends on 15th Aug, 2011
- Licensee has failed:
  - to build an efficient and economical distribution system
  - ensure reasonable cost of supply
- Commission should undertake public process for deciding terms of new license and licensee
- Criteria for appointing new licensee
  - Agreed distribution cost reduction trajectory
  - Firm commitment to procure adequate amount of economical/reasonable cost power

Regulatory Asset

- Creation of future regulatory asset by suppressing tariff increase
  - National Electricity Tariff Policy states the facility of a regulatory asset should be used *only as exception, and subject to certain guidelines*
- Excessive increase in revenue gap is on account of exceeding approved distribution and energy costs
- Commission should not allow creating of any financial burden for the future licensee
- In accordance with the National Electricity Tariff Policy, recovery of the regulatory asset should be planned within the control period

Conclusions and Prayers

Salient observations

- MYT regime has failed to put a check on controllable parameters such as capital costs and operations & maintenance costs
- In spite of very high capital expenditure, employee and A&G cost have increased to great extent indicating lack of real efficiency gains
- Licensee has failed to ensure
  - Efficient and economical distribution system
  - Economical / cost effective power procurement

Prayers

- Financial penalty for high energy cost on account of improper planning and failure to sign long/mid term power purchase agreement
- Capital expenditure
  - Thorough scrutiny of prudence and efficiency gains
  - Constitute transparent procedure for post-facto scrutiny of CapEx
  - Disallow burden of CapEx related tariff component (Rs.251 Cr) till through scrutiny by MERC
- O&M expenditure
  - Excess costs (Rs.198 Cr) should not be passed on to consumers

Prayers…..contd

- Need for the commission to defend its orders
- Need to experiment and evolve new tariff policies
  - E.g. 'distribution margin' based tariff mechanism, (which allows distribution margin to increase at a lower rate than inflation) to ensure efficiency improvements
- Undertake public process for deciding terms of new license and licensee
- Not to create any future regulatory asset by suppressing tariff increase
- Entire revenue gap should be recovered within the control period

Thank you!