

Supplementary Submission by Prayas to MERC
on BSES (REL) ARR 03-04 & 04-05

INDEX

1. Capital Structure
 2. Capital Expenditure by BSES
 3. Coal Blending
 4. Coal Cost
 5. Cost benefit of VRS
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1. Capital Structure

BSES has argued in its reply that there was no norm for Debt:Equity ratio and hence its near full dependence on equity cannot be considered as imprudent.

We wish to point out that there need not be legal limit to check prudence. Following are some examples of norms:

- (a) A 70:30 norm is generally considered prudent not just for power projects but for several categories of projects.
- (b) K P Rao Committee says in its conclusions that “*The debt equity ratio in private utilities may be higher than 4:1, particularly in view of limited returns*”.
- (c) A letter by S Rajagopal Sec Energy (GoI) 3/07/1990 letter to all CS, Energy Sec of all states, All SEB Chairmen etc. recommends a debt equity ratio of 80:20.

We also wish to point out that REL has recently acquired funds (convertible bonds) of nearly \$ 300 Mn. This is a debt till 2008 (with BSES having option to convert it to equity in 2008). This amount is nearly equal to the debt required as per normative ratio of 70:30 for Mumbai operations.

As pointed out in the oral submission, REL has also sought permission from GoM to create charges on the land allocated to it by GoM, as a security for foreign loan. This would be breaching the “ring-fencing” unless that money is used for Mumbai operations.

Loss to consumers due to imprudent financing has been in the range of 100 to 200 Cr / yr. We request MERC to stop this continuing loss and adopt a normative debt:equity ratio of 70:30 while calculating the capital base and reasonable returns of REL (and TPC). This would reduce REL tariff by about 7%!

2. Capital Expenditure

The REL has justified its capital expenditure with some explanations. In no case it shows a clear benefit-cost comparison.

- As mentioned in oral submission the SCADA costs of Rs 2.5 crore / receiving station and Rs 27 lakh / DT seem too high.
- In the oral submission, REL replied that they are planning comparable investments in Delhi. But it should be remembered that the energy handled by REL companies in Delhi (Yamuna and Rajadhani) is about 65% more than in REL Mumbai operations. Hence simple comparison of Rs Cr investment would be misleading.

We wish to point out that the utilities should not be allowed to carry out non-essential expenditure, aimed at preparing for the likely future of competitive environment. The assured returns under cost plus regulation require that present customers are not unduly charged for this.

At this time, MERC may not have time to check if the present rate of expenditure of Rs 135 Cr/yr is reasonable or too high. Considering the good health of REL network, we feel that it is an imperative that MERC allows only Rs 135 Cr / year as Capital Expenditure for REL.

3. Coal Blending:

BSES has argued that (1) washed coal reduced ash coming to DTPC. (2) cost of imported coal has increased in 2004 and higher use of imported coal could have led to higher FCA. We do not agree with both of these: It should be noted that with use of raw coal, the quantity of Indian coal reduces and ash coming to DTPS does not change appreciably. And FCA can increase only if the delivered cost of imported coal increases beyond 30% over and above the cost assumed in the ARR.

But considering that the decision about coal washery was taken years ago, its prudence need to be seen in the context of appropriateness at the time of taking the decision.

4. Coal Cost

The data by BSES related to coal cost, consumption etc. (from file "BSES – Coal – Data.XLS") was analysed. Total cost of coal burnt – multiplication of Ton of coal burnt and Rs / Kg of coal for FY 2002-03 is Rs 388 Cr. Where as the cost of coal mentioned in ARR for the same year is Rs 427 Cr. For earlier two years the cost calculated in above manner matches with cost mentioned in ARR. We request MERC to get explanation of this difference of 10% in the coal cost for FY 2002-03.

5. Cost Benefit of VRS

REL has argued that the VRS it is offering has a payback of only 3 to 3.5 years. We wish to raise three issues. First, the VRS is a corrective action for the improper decisions in the past. We wonder why the consumers should be burdened for this.

Second, with the kind of automation REL is planning (such as Distribution automation, automatic meter reading etc.), there is a possibility that it may find range of manpower being in excess. This could include meter readers, and other staff in operations. REL wants consumers to pay for the automation as well as the VRS schemes to retire workers. This is a classic case of replacing labour by capital – as mentioned by Averch, Johnson.

Third, we need to see payback period of VRS (3 to 4 years) mentioned by REL in the light of the likely scenario of competition – where commission will be setting only the ceiling on tariff. Once competition is allowed, the benefit of VRS will accrue to REL but REL wants to recover the cost of VRS now from consumers. This is not fair.

We urge MERC to consider disallowing the cost of VRS. If commission want to allow the cost of VRS only the cost equivalent to annual saving from VRS should be allowed in ARR, till the utility is under cost plus regulation (with a maximum of next five years). Assuming that annual saving is 28% of one time cost of VRS, the NPV of annual saving for five-year matches one time cost of VRS.

20th March 2004

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