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July 31, 2012

To,
The Secretary
MERC
Mumbai.

Subject: Prayas submission regarding draft Suo-motu order on stipulation of revised ceiling for levy of Fuel Adjustment Cost (FAC) by Distribution Licensees in the State of Maharashtra under Regulation 82 of the Maharashtra Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations, 2005

Ref: Public notice dated 6th July 2012, MERC case no 63 of 2012

Dear Sir,

In response to above matter, please find enclosed the comments/suggestions on behalf of Prayas (Energy Group). These comments and suggestions were presented during the public hearing held at Pune on 25th July 2012. We request the commission to kindly take the same on record.

1. The section 82.3 of Tariff regulations 2005 states: "*The FAC charge shall be computed and charged on the basis of actual variation in fuel costs relating to power generated from own generation stations and power procured during any month subsequent to such costs being incurred, in accordance with these Regulations, and shall not be computed on the basis of estimated or expected variations in fuel costs.*" Thus, FAC is calculated based on *actual* change in cost of own generation and power purchase due to variation in the fuel cost, change in interest on working capital and adjustment factor for over-recovery / under-recovery.

2. The provision of FAC was made to pass on non-controllable and non-estimable costs which cannot be accounted for in the tariff determination exercise. However, as it is a direct pass-through charge applicable for all tariff categories and all consumption slabs, care needs to be taken that it does not distort existing tariff and hence the underlying cross-subsidy structure. Also it is very important to ensure that FAC reflects only the costs on account of actual variation in fuel price of approved generation and not high cost power purchase arising out of inadequate or inefficient planning. Therefore, ceiling on FAC is essential to ensure that no costs arising out of inefficiency are being passed through this mechanism.

3. As per the section 82.6 of the same regulations, monthly FAC charge is capped at 10% of the variable component of tariff. The draft order proposes to increase the same to 25% of variable Tariff for all the Distribution Licensees. The proposed ceiling of 25% is the average ceiling for the Distribution Licensee as a whole, and the applicable ceiling will be different for different consumer categories and consumption slabs, equivalent to 25% of the variable tariff of that category/slab.

4. As this submission will demonstrate, there is neither a need nor justifiable reason for this increase in FAC limit proposed by the commission. Further, the draft order does not provide any analysis of actual increase in variable costs (i.e. fuel costs) in recent times, and it's comparison with prevalent FAC norm. Also there is no segregation of increase in FAC on account of variation in interest rates on working capital, if any. Curiously, one of the arguments in support of increase in FAC ceiling limit made in the draft order is based on delay in tariff revision process, a factor for which any licensee is solely responsible. One could understand the licensee making such a claim but at least the commission has no reason to modify its regulations on such grounds. In fact, it only makes case for the commission to make more concerted efforts towards ensuring that tariff revision process happens in a timely manner.

5. As per the draft order, prevailing FAC ceiling for MSEDCL computed at 10% of average variable tariff works out to 39.33 Paise/unit. If we look at the escalation rates notified by CERC for domestic coal (which is the predominant fuel in MSEDCL's power purchase), then it becomes clear that FAC as per present ceiling itself is mostly sufficient to cater for this variation.

Table: CERC notified escalation index for domestic coal

Month	CERC Escalation rate for domestic coal in %	Revised fuel cost on account of escalation in Rs/u	Normative fuel cost in Rs/unit	Monthly FAC requirement Paisa/unit
Oct-11	38%	2.063	2.00	6
Nov-11	38%	2.127	2.00	13
Dec-11	38%	2.190	2.00	19
Jan-12	38%	2.253	2.00	25
Feb-12	38%	2.317	2.00	32
Mar-12	38%	2.380	2.00	38
Apr-12	13%	2.402	2.00	40*
May-12	13%	2.423	2.00	42*
Jun-12	13%	2.445	2.00	45*

** Under normal circumstances, tariff is supposed to be revised at the beginning of financial year. Hence in timely tariff revision process, the base variable cost will increase to account for increase in fuel price till that date and hence FAC applicable for these months will be only 0.67, 2.67 and 5.67 Paisa/unit respectively. This example shows that problem is not with the ceiling but because of delay in tariff revision process.*

6. Further, the commission is already undertaking tariff revision process for all utilities through which increase in fuel price till date will be factored in and will become part of the revised base tariff itself. This will also address the issue regarding increase in power purchase cost of central sector generation on account of new CERC norms, as the revised tariff will be determined after considering the same.

7. It also needs to be noted that 2005 tariff regulations are valid till only FY 12-13. Starting from FY 13-14, tariff including FAC is going to be determined as per the MYT regulations 2011 which have a different mechanism for FAC pass-through. Hence, after increasing base tariff to account for variation in fuel price till date (which will be in August 2012 when commission's tariff order in MSEDCL's case no 19 of 2012 is expected), there seems no rational justification for modifying

the FAC ceiling for next 7-8 months, as that would make the effectiveness of the tariff revision process itself questionable.

8. Therefore, based on the points submitted above, it becomes clear that there is absolutely no merit in the proposal of increasing the FAC limit from 10% to 25%. In any case, if there is a genuine need to increase FAC beyond the 10% ceiling, the commission can always approve the same post-facto. Post facto approval of such charge which is of direct pass-through nature is more appropriate in ensuring accountability of licensee and gives commission scope for due analysis and scrutiny that needs to be undertaken, in case a sufficiently high ceiling is crossed. Hence the commission should maintain the ceiling at 10% level as stipulated in 2005 Tariff regulation and concentrate its efforts towards ensuring timely tariff revision as per its regulations.

We once again request the commission to take our submission.

Thanking you,

Yours sincerely

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