

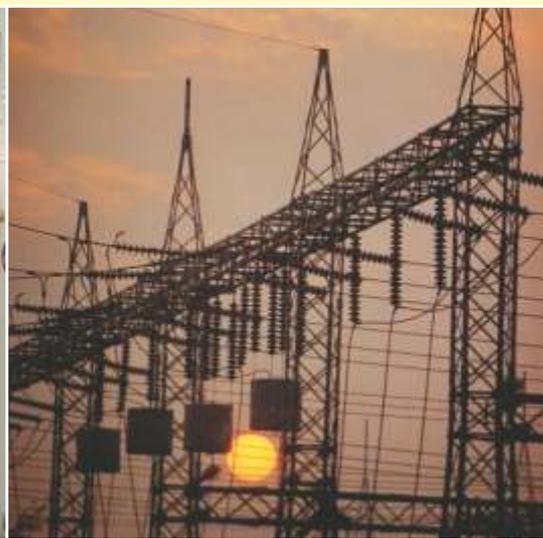


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Report of the Task Force Private Participation in Power Distribution





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Report of the Task Force on **Private Participation in Power Distribution**

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Foreword

Distribution continues to be the weakest link in the Indian power sector. Losses of distribution companies had risen to about Rs. 60,000 crore in 2010-11 and this figure is likely to be significantly higher in 2012-13. In the absence of timely revision in consumer tariffs coupled with inadequate reduction in AT&C losses, the financial losses of distribution companies have been financed largely by loans from commercial banks. This has serious implications on the sustainability of the electricity sector as a whole, including future investments in capacity addition. It is, therefore, imperative that urgent measures be taken to restore the health of the distribution segment of the power sector.

In the above context, a Task Force on Private Participation in the Power Distribution was constituted under the chairmanship of Member (Power), Planning Commission, for exploring the scope and nature of private participation in power distribution with the objective of harnessing private sector investment and associated efficiencies. The Task Force, in turn, constituted two Sub-Groups to examine and evolve the frameworks for Public-Private Partnership (PPP) and Franchisee models respectively.

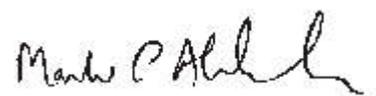
The proposed Public Private Partnership (PPP) Model in the distribution of electricity encompasses all functions and obligations relating to distribution of electricity in a license area. The concessionaire, selected through competitive bidding, would be responsible for maintenance, operation and upgradation of the distribution network and for the supply of electricity to the regulated consumers. Reduction of AT&C losses, improvement in the quality of power supply, strengthening of the distribution network, improved customer satisfaction and introduction of competition through open access are some of the salient features of the proposed model.

The objective of PPP in distribution would be to ensure zero power cuts, reduced transmission and distribution losses, and affordable distribution tariffs. The PPP Model would also be consistent with the Electricity Act which requires distribution to be a licensed business, and would enable full regulatory oversight for ensuring consumer protection and competition. The ownership of assets would continue to remain with the Government and the use of assets would revert to the Government after the concession period. The PPP Model would also enable limited recourse financing and Viability Gap Funding (VGF) support.

The proposed Franchisee Model addresses constraints such as political acceptability, resistance against private ownership of public assets, etc. It also provides other advantages like strong incentives to reduce transmission and distribution losses and significant improvement in consumer interface.

The Report of the Task Force on Private Participation in Power Distribution is being published to disseminate the salient features of the PPP Model and Franchisee Model with a view to encouraging their adoption by the States depending on their respective assessment. Given the characteristics of the two models, PPP is likely to offer better outcomes in terms of investment, economy and efficiency. However, it is for the State Governments to make their choice after a careful evaluation of the two approaches.

May 15, 2012
New Delhi



(Montek Singh Ahluwalia)
Deputy Chairman
Planning Commission

List of Abbreviations

ABT	Availability Based Tariff
APDRP	Accelerated Power Development and Reform Program
APERC	Andhra Pradesh Electricity Regulatory Commission
ARR	Aggregate Revenue Requirement
AT&C	Aggregate Technical and Commercial
CAG	Comptroller and Auditor General
CAPEX	Capital Expenditure
CCI	Competition Commission of India
CDM	Clean Development Mechanism
CERC	Central Electricity Regulatory Commission
CESU	Central Electricity Supply Utility of Orissa
CIS	Consumer Information System
DF	Distribution Franchisee
DBFOT	Design, Build, Finance, Operate and Transfer
DEA	Department of Economic Affairs
DISCOM	Distribution Company
DVVNL	Dakshinanchal Vidyut Vitran Nigam Limited
EA	Electricity Act, 2003
EMD	Earnest Money Deposit
FOR	Forum of Regulators
FY	Financial Year
GUVNL	Gujarat Urja Vikas Nigam Limited
HESCOM	Hubli Electricity Supply Company Limited
HLP	High Level Panel
HT	High Tension
IDFC	Infrastructure Development Finance Company
IFRS	International Financial Reporting Standards
IGRC	Internal Grievance Redressal Cell
KESCO	Kanpur Electric Supply Company Limited
kWh	Kilo Watt Hour

LC	Letter of Credit
LT	Low Tension
MCA	Model Concession Agreement
MERC	Maharashtra Electricity Regulatory Commission
MIS	Management Information System
MoP	Ministry of Power
MSEDCL	Maharashtra State Electricity Distribution Company Limited
MU	Million Units
MW	Mega Watt
NDPL	North Delhi Power Limited
NGO	Non-Governmental Organization
O&M	Operation and Maintenance
PBG	Performance Bank Guarantee
PF	Power Factor
PFC	Power Finance Corporation
PPA	Power Purchase Agreement
PPP	Public Private Partnership
PTC	Power Trading Corporation
R-APDRP	Restructured APDRP Program
REC	Rural Electrification Corporation Limited
RGVY	Rajiv Gandhi Grameen Vidyutikaran Yojana
SBD	Standard Bidding Document
SERC	State Electricity Regulatory Commission
SEZ	Special Economic Zone
SLDC	State Load Dispatch Centre
SPV	Special Purpose Vehicle
T&D	Transmission and Distribution
TNERC	Tamil Nadu Electricity Regulatory Commission
UERC	Uttarakhand Electricity Regulatory Commission
VGf	Viability Gap Funding
VRS	Voluntary Retirement Scheme
WPI	Wholesale Price Index

Report of the Task Force on Private Participation in Power Distribution

1. Introduction

1.1 A Task Force on Private Participation in Power Distribution was constituted on November 09, 2010 under the chairmanship of Shri B. K. Chaturvedi, Member, Planning Commission to develop a framework for enabling private participation in the distribution of electricity, especially by way of Public Private Partnership (PPP). The constitution of the Task Force and its Terms of Reference are at **Annex-I**.

1.2 Distribution continues to be the weakest link in the power sector. Losses of distribution companies have increased from Rs.27,101 crore in 2006-07 to about Rs.60,000 crore in 2010-11. The Thirteenth Finance Commission has projected the losses in the distribution sector to be over Rs.1,16,000 crore in 2014-15. Peak shortage of power has increased from 12.2% in 2002-03 to 13.3% in 2009-10. Due to shortage, state distribution utilities are forced to buy power at high rates. In 2009-10, 6,590 crore units were purchased by distribution utilities for a sum of Rs.33,000 crore which meant a bulk power rate of about Rs.5 per unit, which is abnormally high. These purchases have added to the financial distress of a large number of distribution utilities. In the absence of timely revision in consumer tariffs coupled with inadequate reduction in AT&C losses, the financial losses of distribution companies are being financed largely by loans from commercial banks. This has serious implications on the financial health of the electricity sector as a whole, including future investments in capacity addition.

1.3 One of the principal reasons for the financial unviability of the distribution segment is the high level of AT&C losses. The losses remain high at around 27%, compared to an average of around 10% in developed countries. This is because of inadequate metering and widespread theft of electricity, which is reflected in under billing.

1.4 Absence of timely tariff revisions has also gradually increased the gap between the cost of supply and tariff. This gap was estimated at about Rs.1.07 per kWh in 2010-11, implying a commercial loss of this order for every unit of power sold. The current tariffs levels are unsustainable and cannot elicit further investments. They also impose a severe burden on the finances of the respective State Governments who must provide large subsidies in order to keep the system afloat.

1.5 The Task Force was constituted in the above background for exploring the scope and nature of private participation in power distribution with the objective of harnessing private sector investment and associated efficiencies.

2. Deliberations of the Task Force

2.1 The first meeting of the Task Force was held on December 14, 2010 in which it was decided to co-opt Chief Secretaries of Gujarat and Karnataka, Power Secretaries of Rajasthan and West Bengal, Managing Directors of Maharashtra, Haryana and Delhi (NDPL) Discoms, Chairmen of the State Electricity Regulatory Commissions (SERC) of Tamil Nadu and Andhra Pradesh, and Shri Divakar Deb, former Chairman of Uttaranchal Electricity Regulatory Commission (UERC), as members of the Task Force. Proceedings of the first meeting of the Task Force are at **Annex-II**.

2.2 A round table on private participation in the distribution of electricity was held under the chairmanship of Deputy Chairman, Planning Commission on January 04, 2011 to elicit the views of experts and stakeholders on power distribution reforms. In this meeting, the Deputy Chairman, Planning Commission observed that the accumulated losses of the state-owned distribution utilities had become too large to be wiped at one go. He added that the distribution utilities are able to carry on with such huge losses only because banks continue to fund them and this would inadvertently affect the health of banks and financial institutions. In this scenario, efforts must be made to harness private sector efficiencies to restore the financial health of the power distribution sector. During the course of discussion, the participants also emphasized the need for segregation of wire or the network business from the supply of electricity (implying separation of natural

monopoly from the competitive elements of power supply) and open access in the distribution sector. The proceedings of the round table on private participation in the distribution of electricity are at **Annex-III**.

2.3 In its second meeting held on March 28, 2011, the Task Force constituted two Sub-Groups to examine and evolve the frameworks for the PPP and Franchisee models respectively. The Sub-Group on the PPP Model was constituted under the chairmanship of Adviser to Deputy Chairman, Planning Commission and the Sub-Group on the Franchisee Model was constituted under the chairmanship of Secretary, Ministry of Power. It was also observed that since the primary responsibility for power distribution is that of the states, the state governments should have the freedom to choose the model that suits them. The proceedings of the second meeting of the Task Force are at **Annex-IV**.

2.4 The third meeting of the Task Force was held on November 16, 2011 to consider the Report of the Sub-Group on PPP in the Distribution of Electricity. The Task Force endorsed the PPP Model for adoption by the state governments. It was also recommended that the PPP Model should be tried in a few cities. The proceedings of the third meeting of the Task Force are at **Annex-V**.

2.5 The fourth meeting of the Task Force was held on 14 February, 2012. In this meeting, the Report of the Sub-Group on the Franchisee Model was considered. The Task Force endorsed both the PPP Model and the

Franchisee Model, leaving it to the states to choose a model that they think is more useful to them. During the course of deliberations, the Infrastructure Division of the Planning Commission raised a number of issues on the Franchisee Model. While deciding that there was no need to question the legal validity of the Franchisee Model at this stage, the Task Force felt that it is up to the MoP and the State Governments to address the issues while adopting the Franchisee Model. The proceedings of the fourth meeting of the Task Force are at **Annex-VI**.

2.6 The PPP Model and the Franchisee Model are briefly described below.

3. The Public Private Partnership Model

3.1 The proposed Public Private Partnership (PPP) Model in the distribution of electricity encompasses all functions and obligations relating to distribution of electricity in the licence area. The concessionaire, selected through competitive bidding, would be responsible for maintenance, operation and upgradation of the distribution network and for the supply of electricity to the regulated consumers. Reduction of AT&C losses, improvement in the quality of power supply, strengthening of the distribution network, improved customer satisfaction and introduction of competition through open access are some of the salient features of the proposed model. However, the success of the PPP Model would largely depend on its structuring.

3.2 The PPP Model would also be consistent with the Electricity Act which requires distribution to be a licensed business, and would enable full regulatory oversight for ensuring consumer protection and competition. The ownership of assets would continue to remain with the Government and the use of assets would revert to the Government after the concession period. The PPP Model would also enable limited recourse financing and VGF support.

3.3 The PPP Model would provide the requisite flexibility to the concessionaire to procure bulk power from the market at competitive prices. It would be expected to reduce the network charges and minimise the T&D losses rapidly. To make the PPP model viable and attractive to the investors, a longer

concession period may be considered. The objective should be to ensure zero power cuts, reduced T&D losses, and affordable distribution tariffs. The PPP model would also ensure modernisation of the network by attracting the requisite investment and improved technology.

3.4 The salient features of the PPP Model are:

(a) *Compliance with the Electricity Act, 2003:* Distribution is a licensed business as per Section 12 of the Electricity Act.

Therefore, the Concessionaire would be required to procure a distribution licence under Section 14 of the Act. In order to facilitate the process, the State Government would provide reasonable support and assistance to the Concessionaire in procuring the aforesaid licence and any other permits required under the applicable laws.

(b) *Feasibility Report:* The State Government would need to engage an experienced and qualified firm as a technical consultant to prepare the feasibility report which would be provided to the bidders as part of the bidding documents. The Feasibility Report will describe the physical and financial attributes of the existing system, including an inventory of the assets, current status of the network and the investment to be made during the first three years. The feasibility report would also bring out the desired standards of the distribution system, including the time frame for reaching those standards.

(c) *Selection criteria:* Selection of the Concessionaire will be based on open competitive bidding. All project parameters such as the concession period, subsidies, wheeling/ distribution tariff, supply margin, T&D losses, technical parameters and performance standards would be clearly stated upfront. Based on these terms, the short-listed bidders will be required to submit their financial bids. The bidder who seeks the lowest grant or offers the highest premium, as the case may be, would win the concession. A Design, Build, Finance, Operate and Transfer (DBFOT) model would be adopted.

(d) *Inventory of assets:* An inventory of the assets to be transferred to the concessionaire would have to be prepared on a 'best effort' basis. Replacement/ repairs of defective assets like transformers, cables etc. would have to be carried out by the Concessionaire who may retain or dispose off the defective equipment which has been replaced.

(e) *Use of assets by the Concessionaire:* The Concessionaire would be given the exclusive use of the distribution assets, but the ownership of the assets would remain with the Government. The nature and extent of the use of distribution assets shall be regulated in accordance with the concession agreement and the applicable laws.

(f) *Concession period:* The concession will be granted for a period of 25 years in accordance with the provisions of the Electricity Act. Provision would be made for extension of the concession agreement for a

further 10 years on the terms specified in the concession agreement and subject to the approval of the SERC.

(g) *Equity participation by the Government:* The State Government need not have any share in the equity of the concessionaire's company. However, on certain issues of public policy, an affirmative vote could be provided to the Government through a Golden Share. The obligations of the Concessionaire with respect to the Golden Share would be specified in the concession agreement. A similar arrangement has been adopted in some of the concession agreements for power transmission and metro rail projects.

(h) *Concession agreement between government and private entity:* A concession agreement specifying the rights and obligations of both parties shall be signed between the government and the selected private entity. This will enable the private entity to raise funds from the financial institutions for meeting its capital expenditure. The concession agreement will specify the over-arching principles while providing sufficient flexibility to the private entity to manage the distribution system in conformity with the laid down requirements. Regular monitoring would be undertaken by the government for enforcing the provisions of the concession agreement. The key features of the concession agreement would include:

- Tariff structure
- Scheme of financial support
- Mandatory investments

- Key performance indicators
- Incentives and penalties
- Monitoring, inspection and enforcement
- Suspension/ Termination for breach of Agreement
- Maintenance standards
- Safety requirements

(i) *Procurement of bulk supplies:* The concession agreement would specify the existing Power Purchase Agreements (PPAs) which shall be transferred to the Concessionaire for supply of electricity to the regulated consumers. The Concessionaire would also be free to procure additional power by entering into new PPAs or making other arrangements with the approval of the SERC insofar as supplies to the regulated consumers are concerned.

(j) *Tariff for regulated consumers:* In accordance with the provisions of Section 45(3)(a) of the Electricity Act, the tariff to be charged by a distribution licensee from all regulated consumers (i.e. all consumers other than open access consumers) shall consist of the tariff for supply of electricity and a fixed charge reflecting the wheeling/ distribution charge. The supply tariff would comprise the cost of electricity and a pre-determined margin for meeting the costs of the Concessionaire. The wheeling/ distribution charge shall be shown separately and would be charged in accordance with the provisions of the concession agreement. The concession agreement should also provide for a

progressive reduction in wheeling/ distribution charge to reflect the agreed reduction in AT&C losses.

(k) *Tariff for open access consumers:* In the case of open access consumers, the supply tariff would have to be determined bilaterally between the suppliers and the consumers in accordance with Section 49 of the Act. However, the wheeling charge for open access consumers shall be at par with the wheeling/ distribution charge payable by regulated consumers in accordance with the provisions of the concession agreement. In addition, open access consumers would also have to pay the wheeling surcharge (cross subsidy) in accordance with the provisions of the Electricity Act. The bid documents would specify the wheeling surcharge, which should be reduced progressively over the concession period.

(l) *Wheeling/ Distribution charge:* The wheeling/ distribution charge would be pre-determined and would also include the element of T&D losses. Based on the projected investment, the likely costs of distribution and the trajectory of T&D losses, the bidding documents should specify the wheeling/ distribution charge to be recovered from different categories of consumers over the concession period. A part of the wheeling charge would be linked to WPI so as to offset the impact of inflation.

(m) *Continuation of financial support:* At present, the electricity tariff is subsidised in three ways. First, the State Governments

provide direct subsidies. Second, differential tariffs for various categories help subsidise some categories of consumers. Third, some losses of the distribution companies are left uncovered. It would be essential to quantify each of these categories and agree on their phased reduction. This would imply that the State Governments would have to provide substantial subsidies to the concessionaires in order to prevent a sharp rise in tariffs, especially during the initial years of the concession period. Such direct subsidies can be shown separately in the consumer bills as a support by the State Government. The level of these subsidies may not exceed the present burden being borne directly or indirectly by the Government. As a result, introduction of PPP would not result in any additional burden on the Government. However, in case these subsidies are to be restricted, then a corresponding rise in consumer tariffs would have to be considered.

(n) *Capital investment:* Based on the Feasibility Report, the bid document shall specify the level of investment to be made by the Concessionaire for augmenting and upgrading the existing distribution system to specified standards. Any utility shifting required during the upgradation would have to be carried out either by the Government or by the concerned utility at Government cost. In case of electrification of new colonies, townships etc., the capital cost would have to be recovered from the consumers as per norms approved by the SERC in accordance with the Electricity Act.

(o) *Performance Standards:* Operation and maintenance of the distribution system is proposed to be governed by strict performance standards with a view to ensuring a high level of service to the users. Any violation of these standards would attract stiff penalties. In effect, operational performance would be the most important test of service delivery. However, any future changes in the standards and specifications of the network, as mandated either by the Central Electricity Authority or the SERCs, shall be treated as change in specifications or change in scope, and the additional costs arising from such changes would either be borne by the Government or passed on to the consumers through revision of tariffs.

(p) *Loss reduction targets:* The concession agreement shall assume a reduction in AT&C losses based on year-wise projections. The projections of AT&C loss will be fixed on the basis of what can be achieved by an efficient operator. If the reduction in AT&C losses in a particular year is more than the projection set for that year, the additional revenue earned would be retained by the Concessionaire. Similarly, in case of a lower than expected reduction in AT&C losses, the resultant revenue loss would be borne by the Concessionaire.

(q) *Incentives and penalties:* The output parameters would be specified in accordance with the best practices. A pre-determined system of incentives and penalties will be specified based on the key performance indicators to ensure quality and reliability of

supply by the Concessionaire. The key performance indicators would include relevant benchmarks for operation and maintenance of the distribution system, quality of supply etc. in order to ensure world-class service to the consumers.

(r) *Enforcement and inspections:* The concession agreement would be enforced by regular inspections and monitoring for quality assurance. There would be stiff penalties for violation of the agreement or for shortfalls in key performance indicators.

(s) *Billing and payment mechanism:* Billing and collection would be the responsibility of the Concessionaire. The concession agreement would specify the cycle for billing and payment, including the incentives for early payment.

(t) *Existing agreements and liabilities:* The concession agreement will specify the agreements which would be transferred to the Concessionaire along with all rights and obligations thereunder. Similarly, all existing liabilities required to be transferred to the Concessionaire would also be stipulated in the concession agreement.

(u) *Treatment of existing employees:* Ideally, the existing employees should be absorbed by the State Governments against vacant posts outside the distribution system. However, the Concessionaire should be given the option to take selected employees on deputation. Alternatively, the Concessionaire could be required to employ/ absorb a specified number

of existing employees on pre-determined terms. The additional costs of such a stipulation would get included in the bids. At any rate, it would have to be ensured that the rights and entitlements of existing employees are not adversely affected. The obligations relating to employees will have to be determined upfront by the State Government and stated clearly in the bid documents.

(v) *Safety requirements:* The concession agreement would provide for a dynamic mechanism for evaluating and upgradation of the safety requirements on a continuing basis.

(w) *Transfer of assets on expiry of concession:* At the end of the concession period, the concessionaire would be required to transfer a fully functional distribution system to the Government. The principles for determination of the termination payment to be made by the Government to the Concessionaire on expiry of the concession period would be specified upfront.

(x) *Model Concession Agreement (MCA):* To provide a comprehensive framework for PPP in distribution, it may be necessary to prepare a Model Concession Agreement (MCA) after extensive consultations with stakeholders and experts.

3.5 The expected outcomes of the PPP Model are:

(a) *Improvement in the Distribution System:* The concessionaire would make significant improvements in the distribution system of the

Discoms by making capital investments in the physical infrastructure, expanding and modernising of the network, reducing AT&C losses, ensuring collection and billing efficiencies, and improving the quality of supply with no outages. The PPP Model would also provide for open access as per law, leading to a healthy competition that would help eliminate shortages and attract investment in generation of electricity for direct supply to such consumers.

(b) *Reliable and quality supply of electricity:* The Concessionaire would provide reliable and quality supply of electricity to the consumer based on the laid down performance parameters. The PPP Model would also enable full regulatory oversight for ensuring consumer protection.

(c) *Savings in resources and time:* Given the paucity of budgetary resources and the deteriorating financial health of the Discoms, it is important to restore order in the distribution segment of the power sector. Under this PPP Model, the Government will be able to secure significant volumes of private investment as well as efficiency improvements, thus reducing losses and eliminating shortages in the distribution of electricity.

(d) *Elimination of regulatory risk:* Prior to bidding, the concession agreement will have to be approved by the SERC in order to ensure its conformity with the Electricity Act and the rules or regulations thereunder. The principles for determining the wheeling/

distribution tariffs as well as the margins for supply of electricity would also need to be specified upfront so as to eliminate any regulatory risk and provide the much-needed predictability and certainty to the bidders. Implementation of the concession agreement and ensuring consumer protection would always remain under the regulatory oversight of the SERC.

(e) *Government's overarching role to continue:* The State Government would continue to retain and discharge its overarching obligations relating to the provision of universal supply of reliable and affordable quality of electricity.

3.6 Report of the Sub-Group on PPP in the Distribution of Electricity is at **Annex-VII**.

4. The Franchisee Model

4.1 The proposed Franchisee Model addresses constraints such as political acceptability, resistance against private ownership of public assets, etc. It also provides other advantages like selection of private operator through competitive bidding, strong incentives to reduce transmission and distribution losses and significant improvement in consumer interface.

4.2 Five major franchisees are operating, out of which 4 are in the state of Maharashtra (Bhiwandi, Nagpur, Aurangabad and Jalgaon) and one is in the state of UP (Agra). Bhiwandi was the first large scale 'input based franchisee' that became operational in January 2007 followed by Agra in April 2010. The other three franchisees in Maharashtra have commenced operations recently.

4.3 In Bhiwandi, AT&C loss has been brought down from 62% in FY 2005-06 to 18% in FY 2010-11 and collection efficiency has improved from 68% in FY 2005-06 to 99% in FY 2010-11. The High Level Panel headed by Shri V K Shunglu, former CAG has observed that the Bhiwandi franchisee has invested approximately Rs.500 crore in a period of five years and felt that capital expenditure has been the key factor in loss reduction besides better management and operational practices. In the case of Agra, the T&D losses have come down from 68% in April 2010 to 46% in October 2011 while collection efficiency has improved from 85% to 96% on the corresponding dates.

4.4 The Department of Legal Affairs,

Ministry of Law and Justice has opined that distribution franchisee (DF) is consistent with the Electricity Act 2003. Bombay High Court, Nagpur Bench, in its judgment dated 12 February 2008 in the case of Citizen Forum, Maharashtra and Others vs. State of Maharashtra & Others has also ruled that appointment of distribution franchisee in urban area is lawful.

4.5 Since the DF model has made significant contribution towards reduction in losses, improvement in billing and collection efficiency and also improvement in customer support, it can be considered for large scale replication in the country.

4.6 The Franchisee Model developed by the Forum of Regulators (FoR) can serve as the base document and the Ministry of Power and the respective State Governments would make suitable modifications while adopting this model.

4.7 The salient features of the proposed Franchisee Model are:

(a) *Franchisee area*: The area with distribution loss level higher than 20% should be first picked up for franchisee arrangement.

(b) *Contract period*: A period of 15 years is considered appropriate for the franchisee to effect necessary improvement in the distribution system and also get adequate return on investment.

(c) *Pre-qualification criteria*: Any

prospective bidder meeting the following criteria should be allowed to participate in the bidding process: (i) a Public Limited Company meeting the conditions of Code of Conduct for grant of Distribution Business License under Section 14 of the Electricity Act, 2003; (ii) Having experience of handling consumers of at least 20% of the total estimated number of consumers in the area to be franchised; (iii) Net Worth at least 50% of the annual revenue of the franchise area in base year; (iv) Internal Resource Generation, i.e., Cash Accruals of at least 25% of the annual revenue of the franchise area in base year. All bidders who meet the prescribed technical qualification would be treated at par while evaluating the financial bid.

(d) *Baseline parameters* of at least last one year such as input energy, energy sales, amount billed and collected, distribution losses and AT&C losses should be clearly indicated in the bid document.

(e) *Bid variable*: There will be only one bid variable, i.e. input rate in Rs. per unit of energy input in the area to be franchised, and bid will be decided on the basis of NPV. Minimum Benchmark Rates should be suitably specified in the bidding documents on year-to-year basis by the utility and the bidders should not be allowed to quote below the specified minimum benchmarks. This will safeguard the minimum expectations of the utility. Specific provision for loss reduction target is not required as this will be factored in the minimum benchmark rates.

(f) *Securities against performance*: There is provision for bid bond, performance guarantee, payment security and escrow account.

4.8 The DF model would not cause regulatory gap so far as distribution of electricity and consumer services are concerned. Though the franchisee is not directly regulated by the SERC and is accountable to the Discom, the regulatory mechanism is enforced through the licensee. Thus, DF is bound to perform in consonance with the performance standards as may be set out by the concerned SERC.

4.9 SERC can exert regulatory oversight on DF through licensee and DF will have to meet the performance standards as may be set out by SERC. In order to meet such performance obligations, DF needs to necessarily incur capital expenditure and the bidder is expected to factor such expenditure into their bids. The DF is required to make a minimum investment equivalent to 50% of annual revenue of the base year spread over a period of five years.

4.10 Under the Franchisee Model, the distribution company (the “utility”) shall not discriminate in the supply of power between the franchise area and its other distribution divisions. If the hours of supply depend on loss level of that area, that policy may continue so that in the event of reduction of losses in the franchise area, it may get comparatively higher quantum of energy to meet consumer demand. In case the utility is unable to provide sufficient energy to meet the

requirement of the franchise area, the franchisee may request the utility to source the energy that is in deficit from the open market. The cost of supply of additional electricity in franchise area will be recovered as reliability charges from the consumers of franchise area with prior approval of the SERC.

4.11 The Franchisee Model does not prohibit open access. In the event that any consumer in the franchise area wants to avail open access under the relevant regulations issued by the SERC, the franchisee shall retain the cross subsidy surcharge paid. The wheeling charge for using the distribution system shall be apportioned between utility and the franchisee on the basis of a mutually agreed formula.

4.12 Report of the Sub-Group on Franchisee Model is at **Annex-VIII**.

5. Relative Merits of the Two Models

PPP Model

5.1 The Task Force deliberated on the PPP Model at length. Some of the members expressed the following concerns relating to the PPP Model:

(a) *Tariff*: In the PPP Model, tariffs will be fixed separately in respect of the PPP project area. This may bring about differential tariffs for different areas of a state. Multiple tariffs in the same state may not be desirable and could pose difficulties.

(b) *Political acceptability*: The PPP Model may not be politically acceptable in the present environment where there is considerable resistance against privatisation of public services.

(c) *Complex model*: The PPP Model is complicated and impractical as compared to the Franchisee Model. It will be difficult for the State Governments to structure their PPP projects.

5.2 After deliberations, the Group felt that urban areas getting superior services under the PPP Model could be charged a slightly higher tariff and this should not pose problems. It was pointed out that Mumbai has multiple tariffs already. In case the State Government wishes to have uniform tariffs, it can provide subsidies, especially since it would be providing subsidies for other areas too. As far as political acceptability is concerned, there is no difference in the two models as both retain public ownership of assets while operations

are transferred to a private entity. Only the proposed length of the concession period is different (15 and 25 years), but that should not make any material difference. Moreover, better and reliable supplies should gradually attract political support for the PPP Model. Further if an MCA can be prepared, the complexities of the PPP Model can be handled by the States in a comprehensive manner as has already been done in other sectors. The Task Force noted that the PPP Model has succeeded in a number of sectors in improving services and performance. It was felt that the above concerns would be best tested when the model is actually implemented rather than raising questions on a model which is *prima facie* good. After detailed deliberations, the Task Force supported the PPP Model and recommended its adoption by the States.

Franchisee Model

5.3 During the course of deliberations, some members flagged the following concerns relating to the Franchisee Model:

(a) *Legal Status*: Section 12 of the Electricity Act, 2003 (the “Act”) prohibits any person from engaging in distribution of electricity without a license; Section 13 provides that a franchisee can be exempted from licensing in case it is distributing electricity in rural areas; 7th proviso of Section 14 cannot be extended to cover a franchisee in urban areas so as to provide exemption from licensing; and a franchisee cannot distribute electricity in substitution of a licensee in the entire city unless he obtains a distribution

license. Consequently, any franchisee undertaking electricity distribution in urban areas without a license may not be conforming with the provisions of Section 12 of the Act.

(b) *Regulatory Gap:* The Franchisee Model is essentially a sub-contract for discharging the O&M obligations of the Discoms. The franchisee is not regulated by the SERC pursuant to the provisions of Sections 12 and 13 of the Act, even though it is distributing electricity. Moreover, all the legal obligations continue to remain with the Discom while actual control over the distribution business is passed on to the franchisee. In the Franchisee Model, the SERC will regulate the government-owned Discom which in turn can only enforce its contractual terms with the franchisee. Firstly, the jurisdiction of SERC will not extend to the franchisee. Secondly, the Discom will be able to regulate the franchisee only to the extent of its contract and it would have to bear the remaining regulatory burdens and risks. The above issues can be resolved simply by requiring the franchisee to obtain a distribution licence under the Act.

(c) *Treatment of existing employees:* Under the Franchisee Model, employees have an option to join the franchisee on deputation purely on voluntary basis. They continue to be on rolls of the Discom and would join the Discom at the end of the deputation period. There is no loss in terms of seniority at the Discom. However, it is likely that the Discoms would be left with the burden of their

employees and it needs to be determined whether they can bear this burden in perpetuity. In practice, the Discom will pass on this burden to the State Government or the consumers and a view, therefore, needs to be taken.

(d) *Capital investment and performance standards:* The bid document should specify the level of investment to be made by the Concessionaire for augmenting and upgrading the existing distribution system to specified standards. In case of electrification of new colonies, townships etc., the capital cost would have to be recovered from the consumers as per norms approved by the SERC in accordance with the Electricity Act. The contract should also provide for enforcement of pre-determined performance standards in order to protect consumer interests.

(e) *Need for ensuring quantity and quality of supply:* It should be the responsibility of the licensee to provide reliable and quality supply of electricity to the consumer based on pre-determined performance parameters. For this purpose, the licensee may procure additional power by entering into new PPAs or making other arrangements with the approval of the SERC insofar as supplies to the regulated consumers are concerned.

(f) *Single buyer model:* The proposed Franchisee Model will only perpetuate the 'single buyer' model which has been the subject of much abuse and criticism. When a

significant proportion of generation will come from the private sector and the DF will also be a private entity, the mandatory intermediation of a state-owned Discom in the purchase of bulk power will be an anachronism that should be regarded as inconsistent with EA 2003. This could also perpetuate the present problems of shortages and losses. It is suggested that the franchisee should have the obligation to meet the shortages and ensure quality supply. For this purpose, it should be allowed to source bulk electricity under the oversight of the SERC.

(g) *Need for introduction of competition and Open Access:* Under the existing law, the licensee will have the obligation to provide non-discriminatory open access to the consumers. The supply tariff would have to be determined bilaterally between the suppliers and the consumers in accordance with Section 49 of the Act. However, the wheeling charge for open access consumers shall be at par with the wheeling/ distribution charge payable by regulated consumers in accordance with the provisions of the license agreement. In addition, open access consumers would also have to pay the wheeling surcharge (cross subsidy) in accordance with the provisions of the Electricity Act. The mechanism for enabling and enforcing the aforesaid provisions may be complex, especially for their impact on the input rate. In addition, the proposed Franchisee Model makes open access a matter of choice for bulk consumers, while the Electricity Act 2003 makes it obligatory for all consumers of 1 MW and

above to source power through open access and the tariffs for such consumers to be determined on the basis of bilateral negotiations.

5.4 The Task Force considered the above concerns, specifically the legal status of the franchisees. It was noted that issues relating to legal status have already been considered by the Maharashtra High Court and the legal validity of the Franchisee Model need not be questioned at this stage. The Task Force also observed that the problems of relocation/ absorption of existing employees would arise in the franchisee as well as the PPP models. This issue has been addressed by the Discoms in Maharashtra and Uttar Pradesh by giving option to the employees to be absorbed with the franchisee or get relocated with the State utility. After a sizeable number of Discoms adopt the Franchisee Model, the nature and extent of the problem may become clearer. At that stage, it may be more appropriate to resolve the problem. The Task Force also noted that in respect of the need for capital investment for ensuring adequate quantity and quality of supply, the appropriate strategy may be for the State Government to structure the bid documents/ conditions appropriately. The Task Force also observed that Open Access provisions are part of the Electricity Act (2003) and are, therefore, mandatory. The Task Force noted that the franchisee will have to comply with the mandatory provisions of the Electricity Act. The Task Force also observed that this was an evolving model and it may be useful to expand it and learn from experience.

It was felt that, in any case, the Ministry of Power and the respective State Governments would be structuring the franchisee bid documents and the above concerns could be addressed by them at that stage. The Task Force, therefore, accepted the Franchisee Model as a possible option and recommended the same for consideration of the respective State Governments.

6. Conclusion

6.1 Given the importance of the power sector to the economy, the paucity of budgetary resources and the deteriorating financial health of the distribution companies, it is important to restore order in the power distribution sector. Private participation in the power distribution sector should be pursued in order to attract investment and to harness the efficiencies of the private sector. In this regard, the Task Force endorsed both the models, i.e., the PPP Model and the Franchisee Model, leaving it to the states to choose a model that they think is more suited to their needs.

F. No. N-14026/5/2010-Infra
Government of India
Planning Commission
(Infrastructure Division)

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Yojana Bhavan, New Delhi
Dated, 09 November, 2010

OFFICE MEMORANDUM

Subject: Constitution of the Task Force on Private Participation in the Power Distribution Sector

To develop a framework for enabling private participation in distribution of electricity, especially by way of Public Private Participation (PPP), a Task Force is hereby constituted as below:

Chairman

- (i) Shri B. K. Chaturvedi, Member, Planning Commission

Members

- (ii) Shri Ashok Chawla, Finance Secretary, Ministry of Finance
(iii) Shri P. Uma Shankar, Secretary, Ministry of Power
(iv) Smt. Sushma Nath, Secretary, Department of Expenditure
(v) Shri Gurdial Singh, Chairman, Central Electricity Authority
(vi) Dr. J. M. Phatak, CMD, Rural Electrification Corporation
(vii) Shri Satnam Singh, CMD, Power Finance Corporation
(viii) Shri Rajiv Lall, MD, IDFC
(ix)-(x) Two State Chief Secretaries: to be co-opted by the Task Force
(xi)-(xii) Two State Power Secretaries: to be co-opted by the Task Force
(xiii)-(xv) Three Discom Chiefs: to be co-opted by the Task Force
(xvi)-(xvii) Two State Regulators/ former State Regulators to be co-opted by the Task Force

Member Convener

- (xviii) Shri Gajendra Haldea, Adviser to Deputy Chairman, Planning Commission

2. The Terms of Reference of the Task Force will be as under:

- (i) The Task Force will review the experience relating to privatisation, franchisees and other forms of private participation;
- (ii) The Task Force will make an assessment of the investment required during the 12th Plan period for augmentation and modernization of the distribution system;

- (iii) The Task Force will identify any regulatory impediments constraining private investment in the distribution system and make specific recommendations to facilitate their removal; and
- (iv) The Task Force will consider various models of privatisation and recommend a suitable model(s) for adoption by the states.
3. The Expert Group will be serviced by the Infrastructure Division and will submit its report within a period of three months.

-sd-

(Namita Mehrotra)

Director (Infra)

Tele: 2309 6618

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1. Shri Ashok Chawla, Finance Secretary, Ministry of Finance, North Block, New Delhi
2. Shri P. Uma Shankar, Secretary, Ministry of Power, Shram Shakti Bhawan, New Delhi
3. Smt. Sushma Nath, Secretary, Department of Expenditure, Ministry of Finance, North Block, New Delhi
4. Shri Gurdial Singh, Chairman, Central Electricity Authority, Sewa Bhawan, R. K. Puram, New Delhi
5. Dr. J. M. Phatak, CMD, Rural Electrification Corporation, Core-4, Scope Complex, Lodhi Road, New Delhi
6. Shri Satnam Singh, CMD, Power Finance Corporation Ltd. , 'Urjanidhi', 1, Barakhamba Lane, Connaught Place, New Delhi-110 001
7. Shri Rajiv Lall, MD, IDFC, Naman Chambers, C-32, G-Block, Bandra-Kurla Complex, Bandra (East), Mumbai - 400 051

Copy to:

1. PS to Deputy Chairman, Planning Commission
2. PS to Member (BKC), Planning Commission
3. PS to Adviser to Deputy Chairman, Planning Commission
4. PS to Adviser (Infra), Planning Commission

Minutes of the First Meeting of the Task Force on Private Participation in the Power Distribution Sector held on 14 December 2010 at the Planning Commission

1. The first meeting of the Task Force on Private Participation in the Power Distribution Sector under the chairmanship of Member (BKC), Planning Commission was held on December 14, 2010 at 15:30 hrs in Yojana Bhawan, Planning Commission, New Delhi. The list of participants in this meeting is annexed.
2. After discussion, it was decided to co-opt two Chief Secretaries of Karnataka, Gujarat and Haryana; Power Secretaries of West Bengal, Rajasthan, UP and Bihar; Chief of Discoms of Haryana, Maharashtra and Tata Discom in Delhi; Chairman of Electricity Regulatory Commissions of Tamil Nadu and Andhra Pradesh and Former Regulator Shri Divaker Deb as members of the Committee.
3. Adviser to Deputy Chairman, Planning Commission stated that distribution is a network related function which has to be subjected to open access. Currently, State owned Discoms are suffering from huge T&D losses, inadequate investment and inefficiencies. Large investment is required through private sector to bring in competition and operational efficiencies. The franchisee models adopted by States has merits and demerits and the franchisee only performs certain functions on behalf of the Discoms who are the licensees. Other alternative of bringing in private investment is through PPP in which the entity will run as a full-fledged licensee who will be accountable for providing all the services unlike in the franchisee model.
4. It was stated that the franchisee model has so far been moderately successful in bringing down the T&D losses but is in the nature of short term arrangements of 5-10 years, involving low to medium investment. They do not promote open access and could act as impediment in the long term. Therefore, private investment through PPP model should be encouraged. This would also help to modernise the network by bringing in more investment. The PPP model should provide the flexibility to the private party to procure bulk power from the market at competitive prices, they should be required to reduce the network charges and reduce T&D loss level of the area significantly. To make the PPP model attractive to the States, the system should be handed over to the private party for a longer concession period leading to near zero power cuts, reduced T&D losses, and reduced costs. He also stated that consensus should be built to reduce subsidies in urban areas which are capable of self sustenance.
5. Adviser (Infra), Planning Commission stated that issues like employees interest, coordination among various PPP arrangement under one Discom and VGF scheme to incentivise States would need to be looked into while developing the model framework for PPP in distribution of electricity.
6. Secretary, Ministry of Power stated that since rural areas have their own complexities which will be dealt at a later stage, the urban areas, where the potential for improvement is high, should be identified to implement the model. Areas which have huge AT&C losses should be identified to initiate the process. Both, a full-fledged PPP model and the franchisee models should be looked into for bringing in private investment in distribution. He also stated that the Ministry of Power had developed the standard bidding

document for urban franchisee model which could be looked as a starting point.

7. Joint Secretary, Ministry of Power stated that for a successful franchisee model in distribution it is important that the minimum load of the area should be 500 MW and should be a mix of rural-urban load. Also, depending upon the requirement of cities, both urban-franchisee model and licensee model should be looked into.

8. Chairman, Rural Electrification Corporation stated that in case of distribution, a market-based model will be successful if there is sufficient purchasing power as in larger cities. It is also important to ensure equitable distribution of suppliers in the area.

9. Chairman, Power Finance Corporation stated that for successful privatisation in distribution, it is important to have proper baseline data of loss levels, its projections, and audited accounts of the network areas which are missing. He also mentioned that it has been proven by the past experience that the quantum of investment expected from private sector is too large due to the rural-urban divide and lack of proper framework.

10. Representative of the Central Electricity Authority stated that the Discoms are suffering from huge losses. However, the credibility of the private sector should be ensured because it has no obligation to provide services and generally are interested in higher returns. Moreover for successful PPP, it is important that the States should be taken on Board.

11. Representative of the Department of Economic Affairs stated that so far franchisee model adopted by a few States have not been successful and have certain pitfalls. The Task Force should look into both the option of PPP and franchisee model suitable for different areas.

12. Representative of IDFC stated that private investment in distribution has been unsuccessful so far. The configuration of creation of revenue mix of Discoms is distorted if multiple models of franchisee are adopted in one State. The efficiency and losses of the Discoms have not improved due to the high power purchase cost and non-revision of tariffs by the SERCs.

13. Member, Planning Commission stated that it is important to ensure regular power supply, regular revision of tariffs in the states and flexibility to buy power from the market. He strongly felt that provisions available to regulators to adjust the tariff at least to the extent of increase in the price of fuel need to be implemented to ensure that the losses of Discoms are reduced. He stated that the flow of funds to the states through the Planning Commission should be subject to the outcome of monitoring of certain performance indicators. He stated that annual regulatory assessment should be undertaken to check irregularities. He requested Adviser to Deputy Chairman to initiate an exercise for bringing out an annual report on the performance of regulators for which the necessary performance parameters would be indicated by the Ministry of Power.

14. Concluding the discussions at this meeting, following course of action was decided:

- Constitution of the Task Force with States Representatives;
- Ministry of Power should share the standard bidding document for urban franchisee with other members;
- Possibility of providing VGF may be examined;
- List of cities and towns where high T&D losses are high and which would be amenable to private participation may be identified by the Ministry of Power;
- Evolving a mechanism for ensuring automatic annual tariff revision; and
- Planning Commission to initiate action to bring out an annual report on the performance of regulators.

15. The meeting concluded with a vote of thanks to the Chair.

List of Participants

1. Shri B.K. Chaturvedi ...in Chair
Member (Power), Planning Commission
2. Shri P. Uma Shankar
Secretary, Ministry of Power
3. Shri Gajendra Haldea
Adviser to Deputy Chairman, Planning Commission
4. Shri JM Phatak
CMD, Rural Electrification Corporation
5. Shri Satnam Singh
CMD, Power Finance Corporation
6. Shri Jaipal Singh
Member, Central Electricity Authority
7. Shri Ravi Mital
Adviser (Infra), Planning Commission
8. Shri Devender Singh
Joint Secretary, Ministry of Power
9. Smt. Namita Mehrotra
Director (Infrastructure), Planning Commission
10. Dr. Sambit Basu
Director (Policy Group), IDFC
11. Shri PK Mishra
Director (I&I), Department of Economic Affairs
12. Ms. Reenu Aneja
Consultant (Infra), Planning Commission

**Minutes of the Round Table on Private Participation in Distribution of Electricity
held on 4 January 2011 at the Planning Commission**

1. A Round Table on Private Participation in Distribution of Electricity was held under the chairmanship of Deputy Chairman, Planning Commission on January 04, 2011 at 10:30 hrs in Yojana Bhawan, Planning Commission, New Delhi. The list of participants is annexed.
2. Initiating the discussion, Deputy Chairman, Planning Commission stated that the accumulated losses of the state-owned distribution utilities had become too huge to be wiped out at one go. The distribution utilities are able to carry on with such huge losses only because banks continue to fund them and would inadvertently affect the health of banks and financial institutions. He added that due to shortage of power, State Electricity Boards are forced to buy power at high rates whereas the generating cost of such power is not more than Rs. 2.50 per unit on an average. The Central Electricity Regulatory Commission had imposed a reasonable limit on the bidding margin but in practice it has not been transferred on to the beneficiaries. Although there was a belief that private involvement in distribution would help in reducing AT&C losses and would bring in efficiency yet none of the State Governments had taken any initiative in this regard. He clarified that the Planning Commission is not of the opinion that private involvement is the only solution to bring reforms in the sector but for the sake of harnessing efficiencies, private participation must be experimented with. Initiatives have been undertaken by a few States by adopting the Urban Distribution Franchisee Model in Biwandi and other places like Nagpur, Agra and some parts of Noida.
3. Adviser to Deputy Chairman, Planning Commission made a presentation on the subject. He highlighted the impending crisis in the power distribution sector by stating that the losses of the distribution companies have increased from Rs. 27,101 crore in 2006-07 to about Rs. 60,000 crore in 2010-11 and the Finance Commission has projected that the losses would be around Rs. 1,16,000 crore in 2014-15. The peak shortage of power has increased from 12.2% in 2002-03 to 13.3 % in 2009-10. The Discoms have bought 6,590 crore units of power by paying Rs. 33,000 crore in 2009-10. He also stated that the Electricity Act, 2003 is not being implemented in letter and spirit so far as competition is concerned.
4. Analysing the Franchisee Model adopted by a few States, Adviser to Deputy Chairman stated that this model is essentially a sub-contract for discharging the O&M obligations of the Discoms and is sought to be covered under the 7th proviso of Section 14 of the Electricity Act, 2003 which is not meant for such cases. This would cause a regulatory gap because even though the franchisee is distributing electricity, it is not regulated by the SERC and is accountable to the Discom alone. This is also inconsistent with Section 12 and 13 of the Act. Moreover, there is little incentive for the franchisee to make significant capital investments in the long run. Since the Discoms have no obligation to supply additional power to meet the demand gaps, it will only perpetuate the shortages. All obligations will remain with the Discoms while the actual control will be shifted to the franchisee. The model has no

provisions relating to time of day tariffs and the impact of change in consumer mix. Further, the model does not address the issues regarding competition, open access, investment, quantity and quality of supply and financial sustainability in the long run. He mentioned that the franchisee model is a home-grown remedy and is not practiced in developed countries. He suggested that neither privatisation (like Delhi and Orissa) nor the franchisee model would deliver the desired outcomes but a well-formulated PPP model could be the solution. He clarified that in the PPP model, the ownership of assets would continue with the Government and the assets would revert to the Government after the concession period. A PPP model would also enable limited recourse financing and VGF support. The PPP model would also be consistent with the Electricity Act which requires distribution to be a licensed business unlike a franchisee and would enable full regulatory oversight for ensuring consumer protection. It would also provide for open access as per law.

5. Chairperson, Forum of Regulators stated that for bringing in reforms in the distribution segment it is important to segregate the business of wires and the supply of power. The wires or network function must be looked at separately and should be regulated. He pointed out that non-revision of tariffs was one of the factors responsible for the financial crunch being faced by the Discoms.

6. Chairman, Competition Commission of India stated that from the cases filed in the CCI and from the legal position that has emerged, it is clear that there is an urgent need and desirability to operationalise open access. The Supreme Court directive in case of Mumbai to allow Tata Discoms to supply power to Reliance customers has been successful and some of the consumers have shifted from Reliance to Tata network. He mentioned that CCI was of the opinion that consumers should be given the choice to choose the service providers. In his opinion, the PPP model suggested in the presentation made by Adviser to Deputy Chairman, Planning Commission was a better model than the franchisee model adopted by a few States. This should be supported by regulations for metering and billing. He also suggested augmentation of manpower requirements, training of manpower on competition issues and occasional social audits.

7. Chairman and MD, NDPL, Delhi supported the views expressed in the presentation and stated that reduction of AT&C losses is an inclusive and sustainable process. Franchisee model does not pass on the benefit of loss reduction to the ultimate consumer. Further, the franchisee model doesn't provide any incentive for higher investment and chooses the short-term repair method over investments in a sustainable network.

8. Chairman, BSES Rajdhani Power, Delhi stated that in the case of BSES, which involves private participation, AT&C losses in most areas have reduced to less than 20%. However, a significant amount of investment is needed to supply power 24*7. This is possible only if tariff adjustment takes place regularly. He suggested that a PPP model with appropriate regulatory provisions and specific network growth will have several advantages over the franchisee model which is static in nature.

9. Member, Appellate Tribunal for Electricity stated that the investment coming up in the power sector will not be sustainable if reforms in distribution are not undertaken. He was of the view that a think-tank should be created at the Discoms level for planning, design, engineering and implementation of good practices, better technology and standardisation.

10. Chairman, Gujarat Urja Vikas Nigam Ltd. suggested that a dual licensing model may be adopted as has been done by Gujarat in the SEZ area in which one is the existing distribution utility as the licensee and the other licence is given to the SEZ developer who has the physical control.

11. Principal Secretary, Government of Haryana stated that the Government of Haryana has examined the various urban franchisee models adopted by the States. The issues related to capital expenditure, upgradation of the system, high investment, reliable 24*7 power supply, existing manpower of the Discoms, SOP obligation of the Act are being examined in detail.

12. During the second session of the Round Table, Member BKC, Planning Commission invited comments from the participants on the nature of reforms required for the distribution segment. He also invited suggestions on the issue of segregation of wire or the network business from the supply of electricity.

13. Chairman, Forum of Regulators made a presentation regarding distribution sector reforms in which he stated that the franchisee model has been adopted in distribution because it addresses the constraints such as political acceptability, resistance against private ownership of public assets etc. He opined that the franchisee model was a good example of public ownership of assets and private management of distribution for efficiency improvement which has been already proved in the case of Bhiwandi, Pune, Agra, and Nagpur etc. He mentioned that the Forum of Regulators had evolved a standard model as a template for the States to adopt for urban franchisee in Distribution which aims at ensuring commitment of all stakeholders viz. Distribution licensee, franchisee and regulators.

14. Representative of the Tata Power Company Ltd., Mumbai stated that the option of two licensees in the same distribution area in which one could control the network function and other supply of power could be looked at. Further, private participation in distribution would bring in the much needed investment in the sector.

15. Chairman & Managing Director, Andhra Pradesh Central Power Distribution Co. Ltd. stated that the regulatory mechanism in the States has not been working on an independent and regular basis. The ARR requirements, forecasting, fuel surcharge adjustment are irregular. Strict guidelines should be put in place for delay in decision which should be monitored by an independent agency because of the huge financial implications. He stated that the cross subsidy surcharge is wrongly contemplated and is beyond the provisions of the National Tariff Policy and Electricity Act, 2003. According to him, long-term measures are needed with political consensus for sustainable distribution reforms and APDRP should be used as a mechanism to incentivise and disincentivise the States to perform and broad guidelines should

be framed to control deviations from National Tariff Policy and Electricity Act, 2003.

16. Representative from the World Bank and some of the other participants opined that to follow any model it is primarily important to segregate urban and rural consumers in the distribution area. However, representatives of Government of Gujarat and Power Exchange of India Ltd. felt that separation of urban and rural area will lead to an issue of sustainability as high paying consumers cross subsidise the rural consumers. It was also felt that depending upon the requirement of different segments, a set of models in the form of franchisee, PPP or any other alternative model should be looked into.

17. Additional Secretary, Ministry of Power stated that unbundling has resulted in financial sickness in the distribution segment. Regulators have not been working as intended in the Act. He also stated that a study was conducted to examine the applicability of the Pune Reliability Model to Gurgaon and in the public hearing it was strongly suggested that providing regular supply of electricity is the responsibility of the Discoms and consumers should not be made to pay the reliability charge.

18. Adviser to Deputy Chairman, Planning Commission stated that in the developed countries like UK, Australia etc. the generation, transmission and distribution segment were separated long back in the 1990s. The sole purpose was to bring in competition in the power sector to improve efficiencies. He also mentioned that separation of wires and supply business could be gradually done without any amendment in the Act. Further, a franchisee is not a licensee and the entire model is based on only a proviso to Section 14 of the Electricity Act and does not assume open access. He suggested that the PPP model would ensure regulated tariffs, VGF and higher investments. He also suggested that the States should take the initiative and a pilot project could be undertaken on PPP basis in one or two cities.

19. Concluding the discussions at the meeting, Member (BKC), Planning Commission stated that one common model would not be suitable for the entire country. Various possibilities suggested by the participants would be examined in detail by the Task Force on Private Participation in Power Distribution Sector and would also invite some of the participants from the Round Table to the Task force for a detailed discussion.

20. The meeting concluded with a vote of thanks to the Chair.

List of Participants

Planning Commission

1. Shri Montek Singh Ahluwalia ...in Chair
Deputy Chairman, Planning Commission
2. Ms. Sudha Pillai
Member Secretary, Planning Commission
3. Shri B.K. Chaturvedi
Member (Power), Planning Commission
4. Shri Gajendra Haldea
Adviser to Deputy Chairman, Planning Commission
5. Shri Arbind Prasad
Senior Adviser, Planning Commission
6. Shri Ravi Mital
Adviser (Infra), Planning Commission
7. Smt. Namita Mehrotra
Director (Infrastructure), Planning Commission
8. Ms. Reenu Aneja
Young Professional (Infra), Planning Commission

Ministries

9. Dr. Kaushik Basu
Chief Economic Adviser, Ministry of Finance
10. Shri Ashok Lavasa
Additional Secretary, Ministry of Power
11. Shri Ashok Kumar
Director (Distribution), Ministry of Power
12. Shri R N Lal
Additional Member (Electrical), Railway Board
13. Shri Sudhir Kumar Saxena
Railway Board

14. Shri PK Mishra
Director, Department of Economic Affairs, Ministry of Finance
15. Ms. Poonam Suri
Assistant Legal Adviser, Department of Legal Affairs

Regulatory Commissions

16. Shri Pramod Deo
Chairperson, Forum of Regulators
17. Shri Dhanendra Kumar
Chairman, Competition Commission of India
18. Shri Gurdial Singh
Chairman, Central Electricity Authority
19. Shri S M Sahay
Chairman, Bihar Electricity Regulatory Commission
20. Dr. Jaipal Singh
Member, Central Electricity Authority
21. Shri S K Chatterjee
Deputy Chief Regulatory Affairs, Central Electricity Regulatory Commission
22. Shri Aditya Pyasi
Central Electricity Regulatory Commission

PSUs

23. Shri Satnam Singh
CMD, Power Finance Corporation
24. Shri AK Juneja
NTPC
25. Shri Ajay Dua
DGM, NTPC

State Utilities

26. Shri Madhusudan Prasad
Principal Secretary (Power), Government of Haryana and Uttar Haryana Bijli Vitran Nigam Ltd.
27. Shri MT Krishna Babu
Chairman & Managing Director, Andhra Pradesh Central Power Distribution Co. Ltd.
28. Shri S S Sarna
Chief Engineer, Punjab State Power Corporation
29. Shri Mukar Vashisht
DHVBN, Haryana
30. Shri L Chuanungo
Managing Director, Gujarat Urja Vikas Nigam Limited
31. Shri PS Jat
Ajmer Discom, Ajmer
32. Shri AK Kalke
Jaipur Discom
33. Shri Pankaj Kumar Pandey
MD, HESCOM, Karnataka
34. Shri Gopal Saxena
Chief Executive, BSES Rajdhani Power Limited
35. Shri Sunil Wadhwa
Managing Director, NDPL
36. Shri Vivek Singla
Senior General Manager, NDPL
37. Dr. G. Ganesh Das
Head of Group (Strategy), NDPL

MDBs

38. Shri H Nove Josserand
World Bank
39. Shri Ashish Khanna
World Bank

Power Exchanges

- 40. Shri Jayant Deo
MD & CEO, Indian Energy Exchange Limited
- 41. Ms Rupa Devi Singh
MD & CEO, Power Exchange India Limited

Power Producers

- 42. Shri Rahul Shah
Vice President- Business Development, Tata Power
- 43. Shri V H Wagle
DGM-Regulators, Tata Power

Bulk Consumers

- 44. Shri D M Chowdhary
Chief of Electrical, Tata Steel Jamshedpur
- 45. Shri R B Lal
Essar Group

Industry Associations and others

- 46. Ms. Tavleen Kaur
FICCI
- 47. Shri S Shasmohapatra
Director, CII
- 48. Shri Mahendra Kumar
CEO, Reliance Energy Trading Limited, for Assocham
- 49. Shri Naveen Kapoor
General Manager Distribution Practice, Feedback Ventures Private Limited

Minutes of the Second Meeting of the Task Force on Private Participation in the Power Distribution Sector held on 28 March 2011 at the Planning Commission

1. Second Meeting of the Task Force on Private Participation in Distribution of Electricity was held under the chairmanship of Shri B K Chaturvedi, Member, Planning Commission on March 28, 2011 at 11:30 hrs in Yojana Bhawan, Planning Commission, New Delhi. The list of participants is annexed.
2. Initiating the discussion in the meeting, Member (BKC), Planning Commission suggested that two Sub-groups should be formed to prepare a framework for franchisee and PPP models. The group preparing franchisee documents would be headed by Secretary/ Additional Secretary, Ministry of Power and the group for PPP would be constituted under Adviser to Deputy Chairman, Planning Commission. A note would also be prepared on the Delhi model by Tata Power. Member (BKC) was of the view that power was a state subject and imposing any single model on the State Governments would not be appropriate.
3. Adviser to Deputy Chairman, Planning Commission stated that it would be a good idea to explore the three models namely, franchisee model, Delhi model (privatisation) and PPP model for private participation in distribution of electricity. The major distinction between the Delhi model and PPP was that the former transferred the ownership of the distribution system in perpetuity to the private party as in the case of Delhi whereas in the PPP model ownership would remain with the government while the use of the distribution system would be assigned to the private entity only for the concession period. He also stated that there are certain weaknesses in the Delhi model as the responsibility for supply of bulk electricity still rests with the government and not with the private party. However, the privatisation model could also be looked into with necessary modifications. Further, he opined that the franchisee model in urban areas is not consistent with the Electricity Act, 2003. However, he stated that these issues could be discussed in detail by the Sub-groups.
4. Representative of the Rajasthan Discom stated that the Discom has already awarded contracts through competitive bidding to private parties for collection & billing in Jaipur. They have also awarded sub-contracts for operation and maintenance of transformers etc. However, so far the consumers are not satisfied. Further, the Discom has taken a decision to adopt the franchisee model on a pilot basis. The Discom has been buying power at Rs.6 per unit since last 3 years. High cost of power purchase has contributed to the increasing losses of the Discoms. He was requested to give a note on the modalities through which the private sector was involved in power distribution in the State.
5. Representative of IDFC stated that the franchisee model has been very successful in bringing the reduction in the AT&C losses and the capital investment required is also less. So far, the Torrent Power Company has been successful in the distribution of electricity as a franchisee in cities like Nagpur and Aurangabad. IDFC would be interested in financing the franchisees in the distribution of electricity although it has not financed any franchisee so far.

6. Representative of the Tata Power Company stated that the Sub-groups should also take into account the International Financial Reporting Standards (IFRS) which do not allow benefits related to depreciation and capitalisation in cases of contracts with reversionary rights. This is because the assets cannot be recognised by the concessionaire in his books in such cases. This also makes the raising of finances very difficult. He was also of the view that a concentric circle approach which allows the private party to increase the radius of its operation by retaining the same staff should be followed while adopting the franchisee or any other model for private participation in the distribution of electricity.

7. Chairman, Tamil Nadu Electricity Regulatory Commission stated that the commercial losses of Tamil Nadu are to the tune of around Rs. 9,000 crore because the electricity tariffs have not been revised since last 6 years. The Discoms have not filed any petition to the SERC to raise the electricity tariffs and the regulatory commission does not have the powers to revise the tariffs, *suo motu*. Member (BKC) observed that the SERCs were empowered to raise tariffs even if a distribution company does not file any petition. In fact, it was the duty of the SERC to do so.

8. Shri Divakar Dev, Ex-Chairman, UERC and Member, Shunglu Committee stated that the report of the Shunglu Committee will be finalised next month. He stated that due to various reasons, the State Governments are under pressure not to revise the electricity tariffs. It is important that the SERCs remain insulated from these issues and exercise their powers related to revision of tariff. The Appellate Tribunal of Electricity has already issued notices to the state regulatory commissions in this regard. He also expressed concern regarding the dismal state of the power sector, especially the distribution companies.

9. Managing Director, Maharashtra State Electricity Distribution Company Limited stated that the policy of filing multi-year tariff orders is not a sound practise. Open access in the distribution of electricity should be allowed at the current level of cross subsidy which should be reduced gradually. Regulatory commissions are cutting the expenditures of the Discoms every year resulting in further losses and inefficiencies. Also, consumption of electricity in the agriculture sector is not being metered. He informed that after Bhiwandi, the Maharashtra government had taken up Nagpur and Aurangabad on a franchisee basis. In both these cases, the franchisees were successfully bid out. For the first five years, the State Government would inject Rs. 50 crore and thereafter, capital investment will be the responsibility of the franchisee.

10. Chairman, Andhra Pradesh Electricity Regulatory Commission stated that to reduce AT&C losses, it is important to encourage metering for agriculture consumption. Andhra Pradesh has undertaken the task of segregating agriculture feeder in each of the Mandals. Further, he stated that there are four Discoms in the entire State. The loss level in certain pockets is around 16 to 17% whereas in certain areas the losses are very high but APERC has directed the Discoms for progressive reduction of losses over the next four years. In regions where the AT&C losses are high, any of the three models could be adopted based on its merits.

11. Managing Director, HESCOM, Government of Karnataka stated that they have also sub-contracted certain functions of the Discom to private parties for collection and billing similar to Rajasthan. He stated that it was difficult to reduce AT&C losses especially in rural areas. He suggested that Central Governments should provide certain incentives to the private parties especially in rural areas.

12. Joint Secretary, Department of Economic Affairs stated that there are greater inefficiencies in the irrigation system and exploitation of the ground water which is depleting rapidly. Operation, management and mechanisation in irrigation has been entrusted to the private sector in Haryana on a pilot basis which has resulted in lower consumption of water and electricity. The same method could be applied to the distribution of electricity in the power sector and the power company should be provided VGF for this purpose.

13. Additional Secretary, Ministry of Power stated that the Electricity Act and the National Electricity Policy does provide for private participation in the distribution of electricity. Since distribution is a state subject, the State Government should be the prime mover in private participation in the distribution of electricity. State Government should also be given the choice and freedom under the law to adopt the model they wish to adopt. Further, if any forms of financial incentives are to be provided by the government to the private sector, it should apply to all models.

14. Concluding the discussion, the following course of action was decided:

- Two Sub-groups were formed, namely one for Franchisee and the other for PPP in distribution. The Franchisee Group would include MD, Maharashtra Discom; Chairman, APERC; MD, Rajasthan Discom; MD, IDFC and CMD, REC. The PPP Group will include Chairman, TNERC; Shri Divakar Dev, CMD, UPRVNL; MD, Tata Power Company Ltd.; CMD, PFC and MD, Karnataka Discom. The Department of Economic Affairs requested to be part of both the Groups.
- The presentation of each of the Sub-groups would be made by 15 May, 2011 and subsequent to the discussion, their reports would be finalised by mid June.
- Member (BKC) requested the representative of Tata Power Company Ltd. to prepare a paper on the Delhi privatisation model and present it to the Task Force.
- The Sub-groups would also look into the issues of non-revision of tariffs, IFRS standards and regulatory changes required.

15. The meeting concluded with a vote of thanks to the Chair.

List of Participants

Planning Commission

1. Shri B.K. Chaturvedi ...in Chair
Member (Power), Planning Commission
2. Shri Gajendra Haldea
Adviser to Deputy Chairman, Planning Commission
3. Shri Arbind Prasad
Senior Adviser, Planning Commission
4. Shri Ravi Mital
Adviser (Infra), Planning Commission
5. Smt. Namita Mehrotra
Director (Infrastructure), Planning Commission
6. Ms. Reenu Aneja
Young Professional (Infra), Planning Commission

Central Ministries

7. Shri Ashok Lavasa
Additional Secretary, Ministry of Power
8. Shri Rajesh Khullar
Joint Secretary, Department of Economic Affairs, Ministry of Finance
9. Shri Prabhat Mishra
Director, Department of Economic Affairs, Ministry of Finance
10. Dr. J. M. Phatak
CMD, Rural Electrification Corporation
11. Shri Ajoy Mehta
Managing Director, Maharashtra State Electricity Distribution Company Limited
12. Shri Divakar Dev
Ex Chairman, UERC
13. Shri A. Raghotham Rao
Andhra Pradesh Electricity Regulatory Commission

14. Shri S. Kabilan
Chairman, Tamil Nadu Electricity Regulatory Commission
15. Shri MK Goel
Power Finance Corporation
16. Shri Sunil Wadhwa,
MD, NDPL
17. Shri Pankaj Pandey
Managing Director, HESCOM, Government of Karnataka
18. Shri Srinivas Kavra
IDFC
19. Shri Kuldeep Ranka
DISCOM, Government of Rajasthan
20. Shri Alok Gupta
CE, Central Electricity Authority
21. Shri Prafulla Pathak
Regional Manager, MSEB holding Co., New Delhi

Minutes of the Third Meeting of the Task Force on Private Participation in the Power Distribution Sector held on 16 November 2011 at the Planning Commission

1. A meeting of the Task Force on Private Participation in the Power Distribution Sector was held on 16th November, 2011 at 3:30 PM at the Planning Commission under the chairmanship of Shri B.K. Chaturvedi, Member, Planning Commission. The list of participants is annexed.
2. Initiating the discussions, Member (BKC) stated that the Task Force on Private Participation in the Power Distribution Sector had set up two Sub-Groups – one on PPP and the other on the Franchisee Model. Since the report of the first Sub-Group had been presented, the same was taken up for consideration of the Task Force.
3. Adviser (Infrastructure) made a presentation on the Report of the Sub Group on PPP in the Distribution of Electricity. It was stated that the Sub Group felt that both the franchisee and the privatization (Delhi) models will not be able to deliver desired outcomes and, therefore, the PPP model would be the way forward. The presentation covered the salient features of the PPP Model including compliance with the Electricity Act (2003); preparation of the Feasibility Report; selection of the concessionaire on the basis of open competitive bidding with viability gap funding (VGF) as the bidding parameter; pre-determined performance standards and other project parameters; the main elements of the Concession Agreement between the Government and the private entity; continuation of financial support; penalties and incentives; treatment of existing employees; and transfer of assets to the Government on expiry of the concession period.
4. CMD, Power Finance Corporation supported the recommendations made in the report. Member, Central Electricity Authority also expressed support for the report.
5. The representative of the Department of Economic Affairs supported the recommendations in the Report. He, however, pointed out that there must be adequate safeguards to ensure that the penalties levied on the PPP concessionaire for poor performance are not passed on to the consumers. It was clarified that penalties imposed on the concessionaire will not be passed on to the consumers.
6. The representative of IDFC stated that the power purchase cost should be a pass through in retail tariffs. He also stated that there should be provision for reviewing the concession agreement in extraordinary circumstances. Adviser to the Deputy Chairman clarified that the tariff to be charged by a distribution licensee from all regulated consumers shall consist of the tariff for supply of electricity and a fixed charge reflecting the wheeling/ distribution charge. The supply tariff would comprise the cost of electricity and a pre-determined margin for meeting the costs of the concessionaire. This would ensure that the cost of electricity is passed on to the consumers. Further, he clarified that since it would not be feasible to subject all the consumers to market forces, the existing PPAs should be earmarked for supply to the regulated consumers while in the case of open access consumers, prices should be determined by the market forces.

7. The representative of NDPL stated that the network operation and the supply business should be separated preferably by having two entities. It was clarified that though separation of the network from the supply business was desirable, its implementation in the initial stage would be difficult in view of the international experience and the present status of the power sector in India. It was suggested that the same can be done progressively in 6 to 10 years.
8. Secretary, Department of Energy, Government of Rajasthan stated that the private sector will only take up lucrative areas (like Jaipur) while the Government will be left with the loss making areas (like Jaisalmer). He also raised a concern about the likely emergence of huge tariff differentials across regions in a state following induction of private partners. It was clarified that the State Governments can allocate cheaper power to loss making areas in order to maintain a balance among the regions. The feasibility report should bring out these issues and suggest a rational allocation of cheaper power among different regions.
9. Representative of Hubli Electricity Supply Company (HESCOM) raised concerns about procurement of supplies by the Discoms over and above that provided by the transferred PPAs. It was clarified that the concessionaire would be free to procure additional power by entering into new PPAs or making other arrangements with the approval of the SERC insofar as supplies to the regulated consumers are concerned.
10. An issue about continuance of state financial support was raised. It was clarified that the State Government would have to continue with the existing subsidies in order to prevent a sharp rise in tariffs, especially during the initial years of the concession period. However, introduction of PPP would not result in any additional burden on the Government and is, in fact, meant to reduce the burden on the Government over the medium-term.
11. Representative of Gujarat Urja Vikas Nigam Limited (GUVNL) stated that if there are extraordinary profits to the concessionaire, they should be shared with the consumers. It was clarified that the concession agreement could provide for sharing of profits and losses beyond an agreed band.
12. Representative of Maharashtra State Electricity Distribution Co. Ltd. (MSEDCL) stated that the urban franchisee model is running well in 4 cities of Maharashtra. Its legal validity has also been confirmed by the Nagpur bench of the Bombay High Court in its judgment dated 12/02/2008. He stated that certain consumers in Aurangabad distribution franchise area are already using open access. Existing employees of the discom have been given an option to go on deputation to the franchisee, which has been availed of by about 20% of the employees. He felt that the PPP model is very complicated and difficult to implement.
13. Additional Secretary, Ministry of Power stated that the proposed PPP model is an alternative which the Power Ministry supports. However, the State Governments should be given as many options as possible and the choice of the model should be left to them.

14. An issue was raised about the legality of the franchisee model. Some of the members observed that it would be incorrect to describe the Franchisee model as illegal. Adviser to Deputy Chairman clarified that the Sub-Group on PPP model did not describe the Franchisee model as illegal. It had only observed that this model was not contemplated in the Electricity Act.

15. Summing up the discussion, Member (BKC), Planning Commission stated that after discussing the Report of the Sub-Group on Franchisee model, the Task Force would endorse both the models (i.e. Franchisee Model and PPP Model), leaving it to the States Governments to choose whichever model they think is more useful to them. Both reports would be annexed to the Report of the Task Force in order to ensure full transparency in the proceedings of the Task Force. He also stated that the PPP model should be tried in a few areas to firm up its practical validity. He observed that the Model Concession Agreement for PPP in distribution of electricity would require a lot of work.

16. The meeting ended with a vote of thanks to the chair.

List of Participants

1. Sh. B.K. Chaturvedi
Member, Planning Commission ...in Chair
2. Sh. Gajendra Haldea
Adviser to Deputy Chairman, Planning Commission
3. Sh. Ashok Lavasa
Additional Secretary, Ministry of Power
4. Sh. Satnam Singh
CMD, Power Finance Corporation
5. Sh. Jaipal Singh
Member, Central Electricity Authority
6. Sh. Ravi Mital
Adviser (Infrastructure), Planning Commission
7. Sh. Naresh Pal Gangwar
Secretary (Energy), Government of Rajasthan
8. Sh. Manoranjan Kumar
Director, Department of Economic Affairs
9. Dr. Kumar V Pratap
Director (Infrastructure), Planning Commission
10. Sh. Sunil Wadhwa, NDPL
11. Sh. Puneet Munjal, NDPL
12. Sh. Pankaj Pandey
Managing Director, Hubli Electricity Supply Company
13. Kamlesh P Jangid
General Manager, GUVNL
14. DD Wavhal
Director (F), MSEDCL
15. Vinayak Mavinkurve, IDFC
16. Reenu Aneja, Young Professional

Minutes of the Fourth Meeting of the Task Force on Private Participation in the Power Distribution Sector held on 14 February 2012 at the Planning Commission

1. A meeting of the Task Force on Private Participation in the Power Distribution Sector was held under the chairmanship of Shri B.K. Chaturvedi, Member, Planning Commission on February 14, 2012 at the Planning Commission. The list of participants is annexed.
2. Initiating the discussion, Member (BKC) requested Ministry of Power to make a presentation on the Franchisee model. Joint Secretary, Ministry of Power made a presentation on the Report of the Sub-Group on Franchisee in the Distribution of Electricity. The following points were made during the presentation:
 - (a) Five major franchisees are operating, out of which 4 are in the state of Maharashtra (Bhiwandi, Nagpur, Aurangabad and Jalgaon) and one is in the state of UP (Agra);
 - (b) In Bhiwandi, AT&C loss has been brought down from 62% in FY 2005-06 to 19% in FY 2010-11 and collection efficiency has increased from 68% in FY 2005-06 to 99% in FY 2010-11;
 - (c) Ministry of Law and Justice has opined that distribution franchisee (DF) is consistent with the Electricity Act 2003. Bombay High Court has also ruled that appointment of distribution franchisee in urban area is lawful;
 - (d) Since the DF model has made significant contribution towards reduction in losses, improvement in billing and collection efficiency and also improvement in customer support, it can be considered for large scale replication in the country;
 - (e) The DF as envisaged in the model would not cause regulatory gap. Though franchisee is not directly regulated by the SERC, the regulatory mechanism is enforced through the licensee;
 - (f) The DF is required to make a minimum investment equivalent to 50% of annual revenue of the base year spread over a period of five years;
 - (g) In case the utility is unable to provide sufficient energy to meet the requirement of the franchise area, the franchisee may request the utility to source the energy that is in deficit from the open market. The cost of supply of additional electricity in franchise area will be recovered as reliability charges from the consumers of franchise area with prior approval of the SERC;
 - (h) DF model does not prohibit open access. In the event that any consumer in the franchise area wants to avail open access under the relevant regulations issued by SERC, the DF shall retain the cross subsidy surcharge paid. The wheeling charge for using the distribution system shall be apportioned between utility and the DF on the basis of a mutually agreed formula.
3. The salient features of the proposed DF model were stated as:

- (a) *Franchisee area:* The areas with distribution loss level higher than 20% should be first picked up for franchisee arrangement.
- (b) *Contract period:* A period of 15 years is considered appropriate to effect necessary improvement in the distribution system and also get adequate return on investment.
- (c) *Pre-qualification criteria:* All bidders who meet the prescribed technical qualification should be treated at par while evaluating the financial bid.
- (d) Baseline parameters of at least last one year such as input energy, energy sales, amount billed and collected, distribution losses and AT&C losses should be clearly indicated in the bid document.
- (e) *Bid variable:* There will be only one bid variable, i.e. input rate in Rs. per unit of energy input in the area to be franchised, and bid will be decided on the basis of NPV.

4. Adviser (Infrastructure), Planning Commission subsequently made a presentation on the concerns of the Infrastructure Division of the Planning Commission on the Report of the Sub-Group. He made the following points in the presentation:

- (a) On the legal status of the franchisees, it was pointed out that the Additional Solicitor General has opined that a franchisee can only utilize or use the distribution system for the purpose of distribution of electricity in the area specified. In other words, the franchisee cannot by himself develop, install or maintain a distribution system falling under the purview of section 2(19) of the Act. It was suggested that the franchisee should be given an independent license to avoid any legal infirmities. It was also suggested that opinion of the Attorney General may be obtained on these issues.
- (b) On the issue of regulatory gap, it was pointed out that there could be conflict between directions issued by the regulator and the contract between the franchisee and the DISCOM.
- (c) It was also pointed out that in case the DF model is adopted in a large number of cities, there would be problems related to existing employees of DISCOM since they may not opt for the DF. In such a situation, the entire cost of such employees would have to be borne by the DISCOM and it will not be possible for the DISCOMs to recover these costs from any other source of revenue.
- (d) It was suggested that the bid document should specify the level of investment to be made by the concessionaire for augmenting and upgrading the existing distribution system to specified standards. In case of electrification of new colonies, townships etc., the capital cost would have to be separately recovered from the consumers as per norms approved by the SERC in accordance with the Electricity Act. It was further suggested that the contract should also provide for enforcement of pre-determined performance standards in order to protect consumer interests. The Sub Group has only recommended that the DF shall make a minimum investment equivalent to 50% of annual revenue of the base year spread over the first five years of the contract period. This may not be sufficient in many cases and would also leave a gap after expiry of 5 years.

- (e) It was stated that it should be the responsibility of the franchisee to provide reliable and quality supply of electricity to the consumer based on pre-determined performance parameters. For this purpose, the franchisee should procure additional power by entering into new PPAs or making other arrangements with the approval of the SERC insofar as supplies to the regulated consumers are concerned. The Sub-Group on DF has only observed that the utility shall not discriminate in the supply of power between the franchise area and other distribution divisions. This implies that the franchisee area will have the same power cuts as other parts of the state. As a result, the quality of supply may not improve. The Sub-Group has further stated that the hours of supply would depend on the loss level of that area; that policy may continue so that in the event of reduction of losses in the franchise area, it may get comparatively higher quantum of energy to meet consumer demand. The Sub-Group has also stated that in case the DISCOM is unable to provide sufficient energy to meet the requirement of the franchise area, the franchisee may request the DISCOM to source additional energy from the open market. According to the Sub-Group, the cost of supply of additional electricity in the franchise area will be recovered as reliability charges from the consumers of franchise area with prior approval of the SERC. Reservations were expressed on this arrangement.
- (f) It was suggested that the DF model should clearly provide for competition and open access as per law.
5. Elaborating on the presentation, Adviser to Deputy Chairman stated that an urban franchisee was never contemplated in the Electricity Act 2003, which only refers to rural franchisees. In addition, there is no international experience on the Franchisee model. Therefore, he suggested that at the very least, the urban franchisee may be required to obtain a distribution license to enable him to come under direct regulatory oversight of the SERC. He further expressed concern about the available capacity and expertise of the state governments to structure and implement the Franchisee model. He suggested that the standard bidding documents should be carefully drafted by the MoP and subjected to the scrutiny of an inter-ministerial group which may be set up under the chairmanship of Secretary, MoP. This is the standard process which has been followed for evolving and approving model concession agreements in other infrastructure sectors.
6. Joint Secretary, Department of Expenditure stated that they would go by the legal opinion of the Ministry of Law and Justice regarding the legality of the Franchisee model.
7. Director, Department of Economic Affairs (DEA) stated that the DEA supports both the models, i.e., PPP model and the Franchisee model, in different situations. Where investment is required, DEA supports that PPP model but where only services are to be provided, the Franchisee model could be adopted. She further suggested that investment requirement should be specified upfront in the contract documents, otherwise there is every possibility that the private sector would not make the required level of investment.

8. MD, Maharashtra State Electricity Distribution Company Limited (MSEDCL) stated that the four franchisees in the state of Maharashtra are functioning well. He further stated that there is no regulatory gap as the investment requirements of the franchisee form a part of the ARR that the DISCOM submits to the regulator and the performance standards are a part of the Standard Operating Procedures (SOPs). In addition, there is third-party audit of the accounts of the franchisees. On the issue of capital investment, he stated that all proposed investment by the franchisee has to be put up to the regulator for approval. On the issue of treatment of existing employees, he stated that attrition, both normal and through VRS, should take care of any surplus employees at the DISCOM level. On the issue of open access, he said that it is impractical to expect that open access would be operationalized as the cost of supply of electricity in Maharashtra is Rs.5.34 per unit of electricity while the average billing rate is only Rs.2 per unit. On the issue of licensing the franchisee, he stated that this could lead to a situation in which there would be no uniformity in the tariffs across the state and it will be politically problematic.

9. Adviser to Deputy Chairman stated that in the Franchisee model, all the legal obligations would continue to remain with the DISCOM while actual control over the distribution business will be passed on to the franchisee. While the DISCOM will be able to regulate the franchisee only to the extent of its contract, the licensee would bear the remaining regulatory burdens and risks. In addition, the proposed Franchisee model will only perpetuate the single-buyer model, which has been the subject of much abuse and criticism across the world. He reminded the participants that there has been very little investment in Bhiwandi, where the franchisee functions as a glorified recovery agent. He further cautioned that when the franchisees make capital investment and seek approval of the SERC, it could cause two problems. Firstly, (a) the DF would pass on the cost of its investment to the consumers through higher tariffs and (b) while the investment will be made by the DF, the responsibility for certifying the costs before the SERC would remain with the DISCOM who will have to bear the regulatory burden, and issues relating to potential gold plating. Secondly, the loss reduction that this investment would bring about will be a source of gain for the franchisee and thus franchisee would gain both ways, i.e., through higher tariffs and lower losses even though such loss reduction will be enabled by investments which consumers will be bearing through higher tariffs. This could attract adverse comment from agencies such as the CAG.

10. Principal Secretary (Energy), Government of Karnataka, while supporting the DF model, stated that the prescription of minimum investment of 50 per cent of annual revenue of the base year spread over the first 5 years of the contract period may not be sufficient and that the level of investment should depend on the existing status of the distribution network. Another issue is to how to avoid gold-plating of investments by the franchisee.

11. MD (HESCOM) stated that the reliability charge proposed to be levied on the consumers of the Franchisee may be too high. He further cautioned that the minimum benchmark rate below which bidders should not be allowed to bid would be difficult to arrive at given changing parameters over the 15-year proposed contract period.

12. Representative of CERC stated that all these issues have been considered by the Forum of Regulators (FoR) and they have prepared the standard bidding documents for urban franchisees, which is being considered as the base document by the MoP. He further quoted section 17 (3) of the Electricity Act 2003, which states that no licensee shall at any time assign his license or transfer his utility or any part thereof, by sale, lease, exchange or otherwise without the prior approval of the Appropriate Commission. It was clarified by the Adviser to Deputy Chairman that a franchisee arrangement does not entail either assignment or transfer of the license and, therefore, this section was not relevant to the present exercise.

13. Member, CEA stated that both PPP and franchisee model could be adopted. However, the Franchisee model is the only reform that was being implemented in the power distribution sector.

14. Representative of IDFC raised concerns about the sustainability of the operational improvements in the distribution network after the franchise area has been handed over to the licensee at the end of the contract period.

15. Summing up the discussion, Member (BKC) stated the following:

- (a) The Task Force endorses both the models, i.e., the PPP model and the Franchisee model, leaving it to the states to choose a model that they think is more useful to them;
- (b) There is no need to question the legal validity of the DF model at this stage in view of the legal advice and the judgment of the Bombay High Court;
- (c) The Franchisee model developed by the Forum of Regulators (FoR) can serve as the base document and the MoP may make modifications to finalise the SBD for appointment of urban franchisees;
- (d) A number of issues have been raised by the Infrastructure Division of the Planning Commission. It is up to MoP and the states to judge the validity of these and whether they can address these issues while moving forward in appointing franchisees.

16. The meeting concluded with a Vote of Thanks to the Chair.

List of Participants

1. Shri B.K. Chaturvedi ...in Chair
Member, Planning Commission
2. Shri Gajendra Haldea
Adviser to Deputy Chairman, Planning Commission
3. Shri P. Uma Shankar
Secretary, Ministry of Power
4. Shri Ashok Lavasa
Additional Secretary, Ministry of Power
5. Dr. J. P. Singh
Member, Central Electricity Authority
6. Shri Ravi Mital
Adviser (Infrastructure), Planning Commission
7. Ms Meena Agarwal
Joint Secretary, Department of Expenditure
8. Shri Devender Singh
Joint Secretary, Ministry of Power
9. Shri D. N. Narasimha Raju
Principal Secretary (Energy), Govt. of Karnataka
10. Shri Ajoy Mehta
CMD, MSEDCL
11. Shri Pankaj K. Pandey
MD, HESCON
12. Dr. Kumar V Pratap
Director, Planning Commission
13. Ms Anna Roy
Director, Department of Economic Affairs
14. Shri Sanjeev Kumar
Director (RE&D), Ministry of Power
15. Shri Sandesh Sharma
Director (Legal), CEA

16. Dr. Sambit Basu
Director (Policy), IDFC Ltd.
17. Shri D. Nagpal
Chief Manager (RGGVY Cell), Ministry of Power
18. Shri S. K. Chatterjee
CERC
19. Shri Arun Kumar Singh
US (RE), Ministry of Power
20. Shri S. K. Gupta
REC
21. Shri G. S. Ghai
PFC

Report of the Sub-Group on Public Private Partnership in the Distribution of Electricity

1. Introduction

1.1 A Task Force on Private Participation in the Power Distribution Sector was constituted on November 09, 2010 under the chairmanship of Shri B. K. Chaturvedi, Member, Planning Commission to develop a framework for enabling private participation in the distribution of electricity, especially by way of Public Private Partnership (PPP). The constitution of the Task Force and its Terms of Reference are at **Annex-1**.

1.2 The first meeting of the Task Force was held on December 14, 2010 in which it was decided to co-opt Chief Secretaries of Gujarat and Karnataka, Power Secretaries of Rajasthan and West Bengal, Managing Directors of Maharashtra, Haryana and Delhi (NDPL) Discoms, Chairmen of the State Electricity Regulatory Commissions (SERC) of Tamil Nadu and Andhra Pradesh, and Shri Divakar Deb, former Chairman of Uttaranchal Electricity Regulatory Commission (UERC), as members of the Committee. It was decided that the Task Force would also examine issues like the provision of VGF and identification of cities and towns where AT&C losses are high and which would be amenable to private participation.

1.3 In its second meeting held on March 28, 2011, the Task Force constituted two Sub-Groups to examine and evolve the frameworks for the Franchisee and PPP models respectively. The Sub-Group on the Franchisee model was constituted under the chairmanship of Secretary, Ministry of Power and the Sub-Group on the PPP model was constituted under the chairmanship of Adviser to Deputy Chairman, Planning Commission.

1.4 The constitution of the Sub-Group on PPP model is as follows:

(i) Adviser to Deputy Chairman, Planning Commission	Chairman
(ii) Secretary, Department of Expenditure	Member
(iii) Secretary, Department of Economic Affairs	Member
(iv) CMD, Power Finance Corporation Ltd.	Member
(v) Chief Secretary, Government of Gujarat	Member
(vi) Chairman, Tamil Nadu Electricity Regulatory Commission	Member
(vii) MD, Tata Power Company	Member
(viii) MD, Hubli Electricity Supply Company	Member
(ix) Shri Divakar Dev, former Chairman, UERC	Member

1.5 Shri Ashok Khurana, Director General, Association of Power Producers was co-opted as a member of the Sub-Group.

2. Deliberations of the Sub-Group

2.1 The first meeting of the SubGroup was held on May 23, 2011 in which the main elements of the Franchisee model and the PPP model were discussed and their comparative strengths and drawbacks were identified. In particular, the Franchisee model adopted by a few states was examined with respect to its inconsistency with the Indian Electricity Act, 2003. A presentation was made by Adviser to Deputy Chairman, Planning Commission to the Sub-Group in which the losses of the Discoms were highlighted and it was stated that according to the Finance Commission, the losses are projected to increase to Rs. 1.16 lakh crore by the year 2014-15.

2.2 Analysing the Franchisee model as adopted by a few States, it was stated in the presentation that this model is essentially a sub-contract for discharging the O&M obligations of the Discoms and the 7th proviso of Section 14 of the Electricity Act, 2003 was being relied upon to provide legal cover to the Franchise contracts. Evidently, there is a regulatory gap insofar as the franchisee is not regulated by the State Electricity Regulatory Commission (SERC), pursuant to the provisions of Sections 12 and 13 of the Act, even though it is distributing electricity. Moreover, all the legal obligations continue to remain with the Discom while actual control over the distribution business is passed on to the franchisee. The model does not address significant issues such as the need for capital investments, ensuring quantity and quality of supply, financial sustainability in the long run, and introduction of competition and open access.

2.3 In view of the above, it was suggested that neither privatisation (Delhi model) nor the Franchisee model would deliver the desired outcomes, but a well-formulated PPP model could be the way forward. The proposed PPP model would also enable limited recourse financing and VGF support, which do not seem possible in the Delhi model. Moreover, the PPP model would be consistent with the Electricity Act which requires distribution to be a licensed business under the regulatory oversight of the SERC for ensuring consumer protection.

2.4 In the second meeting of the Sub-Group held on June 14, 2011, the relevant provisions of the Electricity Act, 2003 with respect to the franchise arrangement, especially in the urban areas, were discussed. A note explaining the legal provisions relating to the Franchisee model was considered and endorsed by the Sub-Group (**Annex-II**). Further, the broad framework of the proposed PPP model for distribution of electricity was also discussed. Consensus emerged on issues such as a concession period of 25 years, requirement of a distribution licence for the concessionaire, use of the existing distribution assets by the concessionaire, and determination of wheeling/ distribution charges that would include the T&D losses.

2.5 In the third meeting of the Sub-Group held on June 29, 2011, there was consensus that a feasibility report would need to be prepared by qualified and experienced technical consultants for identifying the

physical and financial attributes of the existing system, the current status of the network, the desired level of investment and the projected quantity and quality of supply. In addition, the feasibility report would make an assessment of the existing AT&C losses and suggest a reasonable trajectory for year-wise targets of loss reduction based on upgradation of the network as well as reduction of pilferage. An assessment would also be made in respect of the reasonable costs of distribution that would have to be provided to the concessionaire. It was felt that determination of an appropriate distribution charge would be crucial for the viability of the project.

2.6 In the fourth meeting of the Sub-Group held on July 14, 2011, issues and options relating to the transfer of existing assets to the concessionaire, upgradation of the network, electrification of new areas, state of the distribution system at the expiry of the concession period, VGF support, effect of changes in the standards and specifications, and linkage with WPI were discussed. A report on electricity markets in India was also circulated by the Director General, Association of Power Producers. The analysis showed that power exchanges helped in price discovery for the industrial consumers, thus enabling them to access electricity at competitive prices. The need to operationalise open access with a roadmap for progressive reduction of cross subsidy was noted. Instances of state utilities resorting to load shedding due to their inability to purchase power from the market were also discussed.

2.7 In the fifth meeting of the Sub-Group held on August 5, 2011, the draft Report of the Sub-Group was discussed in detail and certain modifications were agreed upon. In particular, the bidding parameter and the legal provisions relating to the Franchisee model were discussed. It was agreed that viability gap funding (VGF) should be the only bidding parameter for selection of a concessionaire.

2.8 The Sub-Group observed that despite ten years of reforms in Delhi, the mandatory provisions relating to open access are yet to be operationalised. Also, the average power purchase cost in Delhi has witnessed an increase of 49 percent in the last two years. However, the representative of NDPL was of the view that the Delhi model had been a success as it had met the reform objectives of reducing AT&C losses, and improving availability and reliability of power. He further stated that the framework for open access is in place, but it has not been used by any consumer.

2.9 The Sub-Group felt that the PPP framework would be in consonance with the Electricity Act and would also obviate the shortcomings of the Franchisee model. In the case of a PPP concession, the concessionaire would be required to obtain a license under Section 12 of the Electricity Act and would, therefore, be regulated as per law. The concessionaire will also have the obligation to provide non-discriminatory open access to the consumers.

2.10 The Sub-Group felt that the Government need not have any share in the equity of the concessionaire's company. However, on certain issues of public policy, an affirmative vote could be provided to the Government through a Golden Share. A similar arrangement has been adopted in the concession agreements of some power transmission and metro rail projects.

2.11 The Sub-Group observed that the network operation and the supply business have been separated in the developed countries in a phased manner spread over 6 to 10 years. Germany is reportedly the only country which has separated the network (given to a concessionaire) and the supply function (continues with a State-owned company) in one go. It was noted that though separation of the network from the supply business was desirable, its implementation in the initial stage would be difficult in view of the international experience and the present status of the power sector in India. It was agreed that the same can be done progressively in 6 to 10 years.

2.12 The final draft of the Report of the Sub-Group was circulated for comments and following detailed discussion, the present Report incorporating the suggested clarifications was adopted in the sixth meeting of the Sub-Group held on September 30, 2011.

3. The PPP Model

3.1 After detailed deliberations, the Sub-Group felt that Public Private Partnership (PPP) in the distribution of electricity was clearly the way forward. However, the success of the PPP model would largely depend on its structuring. It was felt that the PPP model should encompass all activities and obligations relating to distribution of electricity in the licence area. The concessionaire selected through competitive bidding should be responsible for maintenance, operation and upgradation of the distribution network and for the supply of electricity to the regulated consumers. Reduction of AT&C losses, improvement in the quality of power supply, strengthening and modernisation of the distribution network, improved customer satisfaction and introduction of competition through open access would be some of the salient features of the proposed model.

3.2 The proposed PPP model would be consistent with the Electricity Act which requires distribution to be a licensed business that would enable full regulatory oversight for ensuring consumer protection and competition. The ownership of assets would continue with the Government and the assets would revert to the Government after the concession period. The PPP model would also enable limited recourse financing by financial institutions and VGF support from the Central Government in order to mobilise the requisite volumes of investment.

3.3 The PPP model would provide the requisite flexibility to the concessionaire to procure bulk power from the market at competitive prices. It would be expected to reduce the network charges and minimise the AT&C losses rapidly. To make the PPP model viable and attractive to the investors, a longer concession period may be considered. The objective should be to ensure zero power cuts, reduced AT&C losses, and affordable distribution tariffs.

4. Salient Features of the PPP Model

The PPP model envisaged by the Sub-Group would have the following salient features.

4.1 Compliance with the Electricity Act, 2003

Distribution is a licensed business as per Section 12 of the Electricity Act. Therefore, the concessionaire would be required to procure a distribution licence under Section 14 of the Act. In order to facilitate the process, the Authority would provide reasonable support and assistance to the Concessionaire in procuring the aforesaid licence and any other permits required under the applicable laws.

4.2 Feasibility Report

The State Government would need to engage an experienced and qualified firm as technical consultant to prepare the feasibility report which would be provided to the bidders as part of the bidding documents. The Feasibility Report will describe the physical and financial attributes of the existing system, including an inventory of the assets, state the current status of the network and the investment to be made during the first three years. The feasibility report would also bring out the desired standard of the distribution system, including the time frame for reaching that standard.

4.3 Selection criteria

Selection of the Concessionaire will be based on open competitive bidding. All project parameters such as the concession period, subsidies, wheeling/ distribution charge, supply margin, T&D losses, technical parameters and performance standards would be clearly stated upfront. Based on these terms, the short-listed bidders will be required to submit their financial bids. The bidder who seeks the lowest grant or offers the highest premium, as the case may be, would win the contract. A Design, Build, Finance, Operate and Transfer (DBFOT) model would be adopted.

4.4 Inventory of assets

An inventory of the assets to be transferred to the concessionaire would have to be prepared on a 'best effort' basis. Replacement/ repairs of defective assets like transformers, cables etc. during the concession period would have to be carried out by the concessionaire who may retain or dispose off the defective equipment which has been replaced.

4.5 Use of assets by the concessionaire

The concessionaire would be given the exclusive use of the distribution assets, but the ownership of the assets would remain with the Government. The nature and extent of the use of distribution assets shall be regulated in accordance with the concession agreement and the applicable laws.

4.6 Concession period

The concession will be granted for a period of 25 years in accordance with the provisions of the Electricity Act. The concession agreement may also provide for extension of the concession agreement for a further 10 years on the terms specified in the concession agreement and subject to the approval of the SERC.

4.7 Equity participation by the Government

The State Government need not have any share in the equity of the concessionaire's company. However, on certain issues of public policy, an affirmative vote could be provided to the Government through a Golden Share. The obligations of the concessionaire with respect to the Golden Share would be specified in the concession agreement. A similar arrangement has been adopted in some of the concession agreements for power transmission and metro rail projects.

4.8 Concession agreement between government and private entity

A concession agreement specifying the rights and obligations of both parties shall be signed between the government and the selected private entity. This will enable the private entity to raise funds from the financial institutions for meeting its capital expenditure. The concession agreement will specify the over-arching principles while providing sufficient flexibility to the private entity to manage the distribution system in conformity with the laid down requirements. Regular monitoring would be undertaken by the government for enforcing the provisions of the concession agreement. The key features of the concession agreement would include:

- Tariff structure
- Scheme of financial support
- Mandatory investments
- Key performance indicators
- Incentives and penalties
- Monitoring, inspection and enforcement
- Suspension/ Termination for breach of Agreement
- Maintenance standards
- Safety requirements

4.9 Procurement of bulk supplies

The concession agreement would specify the existing Power Purchase Agreements (PPAs) which shall be transferred to the concessionaire for supply of electricity to the regulated consumers. The concessionaire would also be free to procure additional power by entering into new PPAs or making other arrangements with the approval of the SERC insofar as supplies to the regulated consumers are concerned.

4.10 Tariff for regulated consumers

In accordance with the provisions of section 45(3)(a) of the Electricity Act, the tariff to be charged by a distribution licensee from all regulated consumers (i.e., all consumers other than open access consumers) shall consist of the tariff for supply of electricity and a fixed charge reflecting the wheeling/distribution charge. The supply tariff would comprise the cost of electricity and a pre-determined

margin for meeting the costs of the concessionaire. The wheeling/ distribution charge shall be shown separately and would be charged in accordance with the provisions of the concession agreement. The concession agreement should also provide for a progressive reduction in wheeling/ distribution charge to reflect the agreed reduction in AT&C losses.

4.11 Tariff for open access consumers

In the case of open access consumers, the supply tariff would have to be determined bilaterally between the suppliers and the consumers in accordance with section 49 of the Act. However, the wheeling charge for open access consumers shall be at par with the wheeling/ distribution charge payable by regulated consumers in accordance with the provisions of the concession agreement. In addition, open access consumers would also have to pay the wheeling surcharge (cross subsidy) in accordance with the provisions of the Electricity Act. The bid documents would specify the wheeling surcharge, which should be reduced progressively over the concession period.

4.12 Wheeling/ Distribution charge

The wheeling/ distribution charge would be pre-determined and would also include the element of T&D losses. Based on the projected investment, the likely costs of distribution and the trajectory of T&D losses, the bidding documents should specify the wheeling/ distribution charge to be recovered from different categories of consumers over the concession period. A part of the wheeling charge would be linked to WPI so as to offset the impact of inflation.

4.13 Continuation of financial support

At present, the electricity tariff is subsidised in three ways. First, the State Governments provide direct subsidies. Second, differential tariffs for various categories help subsidise some categories of consumers. Third, some losses of the distribution companies are left uncovered. It would be essential to quantify each of these categories and agree on their phased reduction. This would imply that the State Governments would have to provide substantial subsidies to the concessionaire in order to prevent a sharp rise in tariffs, especially during the initial years of the concession period. Such direct subsidies can be shown separately in the consumer bills as a support by the State Government. The level of these subsidies may not exceed the present burden being borne directly or indirectly by the Government. As a result, introduction of PPP would not result in any additional burden on the Government. However, in case these subsidies are to be restricted, then a corresponding rise in consumer tariffs would have to be considered.

4.14 Capital investment

Based on the Feasibility Report, the bid document shall specify the level of investment to be made by the concessionaire for augmenting and upgrading the existing distribution system to specified standards. Any utility shifting required during the upgradation would have to be carried out either by the Government or by the concerned utility at Government cost. In case of electrification of new colonies,

townships etc., the capital cost would have to be recovered from the consumers as per norms approved by the SERC in accordance with the Electricity Act.

4.15 Performance Standards

Operation and maintenance of the distribution system is proposed to be governed by strict performance standards with a view to ensuring a high level of service to the users. Any violation of these standards would attract stiff penalties. In effect, operational performance would be the most important test of service delivery. However, any future changes in the standards and specifications of the network as mandated either by the Central Electricity Authority or the SERCs, shall be treated as change in specifications or change in scope, and the additional costs arising from such changes would either be borne by the Government or passed on to the consumers through revision of tariffs.

4.16 Loss reduction targets

The concession agreement shall assume a reduction in AT&C losses based on year-wise projections. The projections of AT&C loss will be based on what an efficient operator can achieve. If the reduction in AT&C losses in a particular year is more than the projected level for that year, the additional revenue earned would be retained by the concessionaire. Similarly, in case of a lower than projected reduction in AT&C losses, the resultant revenue loss would be borne by the concessionaire.

4.17 Incentives and penalties

The output parameters would be specified in accordance with the best practices. A pre-determined system of incentives and penalties will be specified based on the key performance indicators to ensure quality and reliability of supply by the concessionaire. The key performance indicators would include relevant benchmarks for operation and maintenance of the distribution system, quality of supply etc. in order to ensure world-class service to the consumers.

4.18 Enforcement and inspections

The concession agreement would be enforced by regular inspections and monitoring for quality assurance. There would be stiff penalties for violation of the agreement or for shortfalls in key performance indicators.

4.19 Billing and payment mechanism

Billing and collection would be the responsibility of the concessionaire. The concession agreement would specify the cycle for billing and payment, including the incentives for early payment.

4.20 Existing agreements and liabilities

The concession agreement will specify the agreements which would be transferred to the concessionaire along with all rights and obligations thereunder. Similarly, all existing liabilities that need to be transferred to the concessionaire would also be stipulated in the concession agreement.

4.21 Treatment of existing employees

Ideally, the existing employees should be absorbed by the State Governments against vacant posts outside the distribution system. However, the concessionaire should be given the option to take selected employees on deputation. Alternatively, the concessionaire could be required to employ/ absorb a specified number of existing employees on pre-determined terms. The additional costs of such a stipulation would get included in the bids. At any rate, it would have to be ensured that the rights and entitlements of existing employees are not adversely affected. The obligations relating to employees will have to be determined upfront by the State Government and stated clearly in the bid documents.

4.22 Safety requirements

The concession agreement would provide for a dynamic mechanism for evaluating and upgradation of the safety requirements on a continuing basis.

4.23 Transfer of assets on expiry of concession

At the end of the concession period, the concessionaire would be required to transfer a fully functional distribution system to the Government. The principles for determination of the termination payment to be made by the Government to the concessionaire on expiry of the concession period would be specified upfront.

4.24 Model Concession Agreement (MCA)

To provide a comprehensive framework for PPP in distribution, it may be necessary to prepare a Model Concession Agreement (MCA) after extensive consultations with stakeholders and experts.

5. Expected Outcomes

5.1 Improvement in the Distribution System

The concessionaire would make significant improvements in the distribution system of the Discoms by making capital investments in the physical infrastructure, expanding and modernising the network, reducing AT&C losses, ensuring collection and billing efficiencies, and improving the quality of supply with no outages. The PPP model would also provide for open access as per law, leading to healthy competition that would help eliminate shortages and attract investment in generation of electricity for direct supply to such consumers.

5.2 Reliable and quality supply of electricity

The concessionaire would provide reliable and quality supply of electricity to the consumer based on the laid down performance parameters. The PPP model would also enable full regulatory oversight for ensuring consumer protection.

5.3 Savings in resources

Given the paucity of budgetary resources and the deteriorating financial health of the Discoms, it is important to restore order in the distribution segment of the power sector. Under this PPP model, the Government will be able to secure significant private investment as well as efficiency improvements, thus reducing losses and eliminating electricity outages.

5.4 Elimination of regulatory risk

Prior to bidding, the concession agreement will have to be approved by the SERC in order to ensure its conformity with the Electricity Act and the rules or regulations thereunder. The principles for determining the wheeling/ distribution charge as well as the margins for supply of electricity would also need to be specified upfront so as to eliminate any regulatory risk and provide the much-needed predictability and certainty to the bidders. Implementation of the concession agreement and ensuring consumer protection would always remain under the regulatory oversight of the SERC.

5.5 Government's overarching role to continue

The State Government would continue to retain and discharge its overarching obligations relating to the provision of universal supply of reliable and affordable electricity to all consumers.

Annex-1 of Annex-7

(Same as page 18-19 of the Report)

Sub: Legal framework for franchisee in distribution

1. For justifying the franchisee arrangement, reliance is often placed on the definition of franchisee as contained in section 2 (27) of the Electricity Act, 2003, which is reproduced below:

(27) franchisee means a person authorised by a distribution licensee to distribute electricity on its behalf in a particular area within his area of supply;

2. It is evident from the above definition that a franchisee can be authorised by the distribution licensee only to distribute electricity on behalf of the latter. As such, he cannot distribute electricity on his own behalf nor can he undertake the operation and maintenance of the distribution system or make investments in the distribution system and recover the same through tariff.

3. Further, in order to give effect to the aforesaid definition, it must be read with the substantive provisions of the Act. In fact, the entire Act contains only two references to the term 'franchisee'. The first reference is contained in section 5 which is reproduced below:

5. The Central Government shall also formulate a national policy, in consultation with the State Governments and the State Commissions, for rural electrification and for bulk purchase of power and management of local distribution in rural areas through Panchayat Institutions, users' associations, co-operative societies, non-Governmental organisations or franchisees.

4. It would be seen that Section 5 empowers the Central Government to formulate a national policy that would include local distribution in rural areas through franchisees. The relevant extracts of national policy notified by the Ministry of Power read as follows:

Rural Electrification

* * *

5.1.6 Necessary institutional framework would need to be put in place not only to ensure creation of rural electrification infrastructure but also to operate and maintain supply system for securing reliable power supply to consumers. Responsibility of operation & maintenance and cost recovery could be discharged by utilities through appropriate arrangements with Panchayats, local authorities, NGOs and other franchisees etc.

5. It would be evident from the above that the Act as well as the National Electricity Policy notified thereunder confine the role of franchisees to rural areas and do not recognise any franchisee arrangement for urban areas.

6. The second reference to the term "franchisee" is contained in Section 13 which is reproduced below:

13. The Appropriate Commission may, on the recommendations, of the Appropriate Government, in accordance with the national policy formulated under section 5 and in public

*interest, direct, by notification that **subject to such conditions and restrictions, if any, and for such period or periods, as may be specified in the notification, the provisions of section 12 shall not apply to any local authority, Panchayat Institution, users' association, co-operative societies, non-governmental organizations, or franchisees:***

7. The above section stipulates that the SERC may, in accordance with the national policy formulated under section 5, direct that subject to such conditions, restrictions and period as may be specified by the SERC, a franchisee may be exempted from the mandatory requirement of obtaining a licence. Since the exemption must conform to the national policy referred to in section 5, which applies only to rural areas, the provisions of section 13 cannot be applied to franchisees in urban areas. Consequently, a franchisee in urban areas cannot be exempted from obtaining a distribution licence as required under section 12.

8. Since the Electricity Act refers to franchisees only in the aforesaid two sections that apply to rural areas, franchisees for urban areas do not have any recognition in law. Moreover, in all the discussions, including the debate in the Standing Committee of the Parliament, any franchisee arrangement for cities was never contemplated. This is clearly an after-thought and that too of a recent origin. Pursuing such an arrangement is, therefore, fraught with several adverse consequences including challenge in courts.

Proviso to Section 14

9. The provision on which some of the States seem to be relying is the seventh Proviso of section 14 which is reproduced below:

14. Grant of Licence

The Appropriate Commission may, on an application made to it under section 15, grant a licence to any person

- (a) to transmit electricity as a transmission licensee; or*
- (b) to distribute electricity as a distribution licensee; or*
- (c) to undertake trading in electricity as an electricity trader, in an area as may be specified in the licence:*

* * *

*Provided also that in a case where a distribution licensee proposes to undertake distribution of electricity for a specified area within his area of supply **through** another person, that person shall not be required to obtain any separate licence from the concerned State Commission and such **distribution licensee shall be responsible for distribution** of electricity in his area of supply:*

10. It may be noted that the above proviso does not refer to a franchisee. If the legislature had intended this proviso as an enabling arrangement for a franchisee, it would have used this term as it is already defined in section 2(27). The fact that this term is used in section 5 and section 13, but excluded from

section 14 clearly suggests that the franchisee model is not covered under the aforesaid Proviso to section 14.

11. It could be argued that the term 'person' could include a franchisee. However, such an interpretation would render section 13 redundant because all the restraints imposed by section 13 such as conditions of exemption from licencing, period, conformity with the national policy etc. can be avoided by simply taking recourse to the above Proviso. It could not have been the intention of the legislature to impose several conditions and restrictions on a franchisee in rural areas while imposing none for urban areas.

12. Further, the Proviso clearly mandates that the distribution licensee shall remain responsible for distribution of electricity even when distribution is undertaken **through** another person in a specified area. While this Proviso enables a distribution licensee to engage another person in a specified area, it must demonstrate that the licensee continues to be responsible for such distribution. As such, all the duties and responsibilities of a licensee under law, rules and regulations would continue to belong to the licensee who must remain in control and must also be liable for any breach or default of licence conditions by his agent. While this proviso may enable a distribution licensee to undertake distribution **through** another person in a specified area such as a residential or commercial complex even while retaining its role and responsibility as a licensee, it cannot be extended to handing over of all its responsibilities for the entire city to a franchisee. If that were permissible, a licensee would even be able to transfer its entire area and functions to another person. That could not be the intent of this Proviso.

13. The use of the word “through” is important here. It implies that the principal obligations remain with the licensee even when he is acting through another person as his agent. In the case of a city franchisee, however, the licensee would hand over almost all his functions to the franchisee who will virtually act as a distribution licensee. The distribution licensee cannot, therefore, be regarded as acting 'through' the franchisee. In fact, the franchisee would virtually substitute the distribution licensee, but would not have the responsibilities and obligations of a licensee, as they would continue to rest with the distribution licensee as per law. In effect, the licensee would remain responsible in law but would cease to have any wherewithal to discharge his functions whereas the franchisee who takes on the distribution functions will not be accountable to the Regulator or the consumers, as its only accountability will be to the licensee under a bilateral contract. The entire scheme of the Act would thus be jeopardised.

14. A plain reading of the aforesaid proviso would suggest that the distribution licensee can only engage another person to act as its agent for the sole purpose of distributing electricity in a specified area. Functions such as O&M, upgradation of the distribution system etc. must continue to remain with the distribution licensee.

15. From a perusal of the above, it is evident that:

- (a) Section 12 prohibits any person from engaging in distribution of electricity without a licence;**

- (b) section 13 provides that franchisees can be exempted from licensing in case they are distributing electricity in rural areas;**
- (c) the seventh proviso to section 14 cannot be extended to cover a franchisee in urban areas so as to provide exemption from licencing. Doing so would be far-fetched and incompatible with the scheme of the Act. Moreover, such a franchisee can only act as an agent for the sole purpose of distributing electricity in a specified area. This cannot include other functions such as maintaining and developing the distribution system or exercising other powers of the licensee.**

16. It follows from the above that a franchisee cannot distribute electricity in urban areas unless he obtains a distribution licence. Consequently, any franchisee undertaking distribution of electricity in urban areas without a licence would be violating the mandatory provisions of section 12.

Report of the Sub-Group on Franchisee in the Distribution of Electricity

1. Introduction

A Task Force on Private Participation in the Power Distribution Sector was constituted on November 09, 2010 under the chairmanship of Shri B. K. Chaturvedi, Member (Energy), Planning Commission to develop a framework for enabling private participation in the distribution of electricity. The constitution of the Task Force and its Terms of Reference are:

- (i) The Task Force will review the experience relating to privatisation, franchisees and other forms of private participation;
- (ii) The Task Force will make an assessment of the investment required during the 12th Plan period for augmentation and modernization of the distribution system;
- (iii) The Task Force will identify any regulatory impediments constraining private investment in the distribution system and make specific recommendations to facilitate their removal; and
- (iv) The Task Force will consider various models of privatisation and recommend a suitable model(s) for adoption by the states.

1.1 The first meeting of the Task Force was held on December 14, 2010 in which it was decided to co-opt Chief Secretaries of Gujarat and Karnataka, Power Secretaries of Rajasthan and West Bengal, Managing Directors of Maharashtra, Haryana and Delhi (NDPL) Discoms, Chairmen of the State Electricity Regulatory Commissions (SERC) of Tamil Nadu and Andhra Pradesh, and Shri Divakar Deb, former Chairman of Uttaranchal Electricity Regulatory Commission (UERC), as members of the Committee. Task Force also requested Ministry of Power to share the standard bidding document developed by Ministry of Power for urban franchisee with members of the Task Force. It was also decided that the Task Force would examine the possibilities of providing Viability Gap Funding (VGF) scheme to incentivise States to facilitate PPP model in distribution of electricity. It also directed Ministry of Power to identify cities and towns where AT&C losses are high and which would be amenable to private participation. Minutes of meeting are enclosed at **Annexure-I**.

1.2 A round table on Private Participation in Distribution of Electricity was held under the chairmanship of Deputy Chairman, Planning Commission on 4th January 2011.

1.2.1 In this round table, Deputy Chairman, Planning Commission observed that the accumulated losses of the state-owned distribution utilities had become too huge to be wiped out at one go. He added that the distribution utilities are able to carry on with such huge losses only because banks continue to fund them and would inadvertently affect health of banks and financial institutions. He clarified that the Planning Commission is not of the opinion that private involvement is the only solution to bring reform in the sector but for the sake of harnessing efficiencies private participation must be experimented with. He further mentioned that initiatives have been taken by a few States adopting the Urban Distribution

Franchisee Model in Bhiwandi and other places like Nagpur, Agra and some parts of Noida.

1.2.2 Advisor to Deputy Chairman, Planning Commission made a presentation on the subject highlighting the impending crisis in the power distribution sector in view of increasing losses, shortage of power, absence of desired level of competition etc. Regarding Franchisee Model adopted by few states, Advisor to Deputy Chairman opined that this is essentially a sub contract for discharging the O&M obligations of the Discoms and he stated that the 7th proviso of section 14 of the Electricity Act, 2003 does not cover appointment of franchisee by Discoms in urban areas. According to him, franchisees also cause regulatory gap because even though the franchisee is distributing electricity, it is not regulated by SERC and is accountable to Discom alone as all the legal obligations continue to remain with the Discom while actual control over the distribution business is passed on to the franchisee. He further observed that distribution franchisee is also inconsistent to Section 12 & 13 of the Act. He also cited certain shortcomings in Distribution Franchisee model and its resultant inability to tackle the crisis in the distribution sector. According to him, the model does not address significant issues such as the need for capital investments, ensuring quantity and quality of supply, financial sustainability in the long run, and introduction of competition and open access.

1.2.3 Chairman, Forum of Regulators also made a presentation regarding distribution sector reforms in which he stated that the franchisee model has been adopted in distribution because it addresses important constraints such as political acceptability, resistance against private ownership of public assets etc. He opined that the franchisee model is a good example of public ownership of assets and private management of distribution for efficiency improvement which has already been proved in the case of Bhiwandi, Pune, Agra and Nagpur etc.. He mentioned that the Forum of Regulators has evolved a standard model as a template for the States to adopt for urban franchisee in distribution which aims at ensuring commitment of all stakeholders viz. Distribution licensee, franchisee and regulators.

The detailed proceedings of round table are enclosed at **Annexure-II**.

1.3 In its second meeting held on March 28, 2011, the Task Force constituted two Sub-Groups to examine and evolve the frameworks for the Franchisee and PPP models respectively. The Sub-Group on the Franchisee model was constituted under the chairmanship of Secretary, Ministry of Power and the Sub-Group on the PPP model was constituted under the chairmanship of Adviser to Deputy Chairman, Planning Commission.

1.4 The constitution of the Sub-Group on Franchisee in Distribution of Electricity model is as follows:

- | | |
|---|----------|
| (i) Sh P.Uma Shankar Secretary , MoP | Chairman |
| (ii) Secretary, Department of Expenditure | Member |
| (iii) Secretary, Department of Economic Affairs | Member |
| (iv) CMD, Rural Electrification Co Ltd | Member |
| (v) MD, IDFC | Member |

(vi) Principal Secretary (Energy) West Bengal	Member
(vii) Chairman , APERC	Member
(viii) CMD, UPRVUNL	Member
(ix) MD, MSEDCL	Member
(x) Chairman, Jaipur VVNL	Member

2 Stakeholder Consultation and Deliberations of the Sub-Group

2.1 After the preliminary meeting of stakeholders held on 06.04.2011, the first meeting of the Sub-Group was held on May 5, 2011 under the chairmanship of Special Secretary (Power) in which the main elements of the Franchisee in the distribution of Electricity model were discussed. A presentation was made on various aspects of Distribution Franchise Model of Forum of Regulators ('FOR') and concerns raised by Advisor to Dy Chairman (Planning Commission) were also discussed in detail. During discussion, it emerged that the Standard Bidding Document (SBD) significantly addresses concerns raised about operational suitability of Distribution Franchisee model.

2.2 For wider consultation amongst various stakeholders, it was decided to forward a copy of SBD on DF model of FOR to all the states, state power utilities, private utilities etc. for their comments. It was also decided that legal opinion of Ministry of Law and Justice should be obtained on legality of Distribution Franchisee in urban areas in view of the issues raised by Advisor to Dy Chairman (Planning Commission) in round table on the subject held on 4th January 2011 and also through a communication received by Ministry of Power vide his letter dated 7th April 2011. Copy of the concerned letter is enclosed at **Annexure-III**. Vide a note dated 18.05.2011, Ministry of Power sought the views of the Ministry of Law and Justice, Department of Legal Affairs on specific queries to clear the issue of legal validity of Distribution Franchisee as per the Electricity Act 2003. The specific queries of MoP are enclosed at **Annexure-IV**.

2.3 Further, meetings of stakeholders were held on 29th June 2011 and 25th August 2011 wherein salient features of the proposed DF model were reviewed in detail and suggested modification along with new provisions were discussed.

2.4 In the meantime, comments were received from the states of UP, Maharashtra, Kerala, Orissa, Bihar, Gujarat, Rajasthan, Himachal Pradesh, Sikkim etc. Comments have also been received from BSES, NDPL, Tata Power, PTC etc. Received comments are mainly on the issues of sharing of revenue on change in consumer mix and tariff, desirability of having minimum benchmark rates, provision of capital expenditure by Distribution Franchisee, penalties on non-compliance of performance standards, bidder qualification, securities, supply of adequate power, etc. Gist of the comments is enclosed at **Annexure-V**.

2.5 The opinion of Ministry of Law and Justice was received on 08.11.2011, which is enclosed at **Annexure-VI**.

2.6 Sub-Group held its 2nd meeting on 02.12.2011 and discussed the legal opinion of Ministry of Law and Justice on legal validity of DF model and comments on the Standard Bidding Document by States. Joint Secretary (DS), Ministry of Power, made a detailed presentation on the subject covering details of constitution of task force and sub-group on distribution franchisee ('DF'), legal framework, experience so far, perceived gaps in DF model, stakeholder consultation, development of Standard Bidding Document in view of comments received from various stakeholders and important features of Standard Bidding Document (SBD). Copy of presentation is enclosed at **Annexure VII**. Sub-Group discussed the legal opinion given by Ministry of Law and Justice and judgement of Bombay Hon'ble High Court (Nagpur Branch) at length. It also discussed the concept of SBD prepared by Ministry and suggestions given by various States / Stakeholders. Sub-group unanimously decided that Distribution Franchisee concept is legally compliant with the Electricity Act 2003 and proposed concept of SBD addresses the concerns raised regarding operational suitability of Distribution Franchisee model in tackling the concerns in distribution sector. It was also decided to recommend adoption of DF model by States. Minutes of the meeting are enclosed at **Annexure-VIII**.

3 Distribution Franchisee - Experience so far

The Sub-Group took stock of the distribution franchisees operating in the country in urban areas to understand their operation and draw learning from them. It noted that 5 major franchisees are operating, out of which 4 are in the State of Maharashtra (Bhiwandi, Nagpur, Aurangabad and Jalgaon) and one is in the State of Uttar Pradesh (Agra City). Bhiwandi was the first large scale "Input Based Franchisee" that became operational in January 2007 followed by Agra in April 2010; other three Franchisees have commenced operations very recently.

3.1 Experience of Bhiwandi

3.1.1 Maharashtra State Electricity Distribution Co. Ltd. (MSEDCL) informed that it has developed and implemented Distribution Franchise model and the first Distribution Franchisee was appointed in Bhiwandi. M/s Torrent Power Limited is operating as DF in Bhiwandi from January, 2007. In the opinion of MSEDCL, results of operationalization of DF in Bhiwandi have been above expectations and the following remarkable improvements have been made by the Franchisee to improve the Power Distribution in Bhiwandi.

- (i) AT&C loss has been brought down from 62% in FY 2005-06 to 19% in FY 2010-11 and collection efficiency has also increased from 68% in FY 2005-06 to 99% in FY 2010-11.
- (ii) With the prior approval of MSEDCL, DF has implemented Network Upgradation Plan by incurring capital expenditure to improve reliability of supply and curb commercial losses including :

- (a) Addition of 35 new HT feeders to relieve the existing overloaded feeders;
 - (b) Revamping of distribution transformers to reduce failure rate and enhance distribution transformation capacity;
 - (c) Provided appropriate protection system and built a systematic LT network with mapping;
 - (d) Addition of Shunt Capacitors.
- (iii) DF also took steps to improve customer services by investing in:
- (a) 24X7 control room and fault attendance centre, call center facility for power related complaints, Mobile Customer Service Van, User friendly electricity bill;
 - (b) Replacement of approximately 1,24,000 Energy Meters at consumers' premises.

This resulted in increased billing on the basis of meter reading which can be gauged from the fact that now 97% consumers are billed as per actual meter reading as against only 40% consumers being billed on the basis of meter reading before handing over to DF.

Consequently, the power distribution system in Bhiwani has improved and taken up the entire operation to a better level compared to what it was prior to appointment of DF.

3.1.2 Performance of DF in Bhiwandi in terms of certain vital parameters is summarised below :

Particulars	Prior to Franchisee (2005-06)	After Franchisee (2010-11)
No. of Consumers	1.60 Lakh	2.03 Lakh
Energy Input in MUs	2427	3060
Energy Billed in MUs	1346	2510
Collection Efficiency (%)	68.20%	99.38%
Billing Efficiency (%)	55.5%	82.03%
AT & C Loss (%)	62.15%	18.48%

3.2 Experience in Nagpur and Aurangabad

Recently M/s MSEDCL has also appointed DF in two major cities of Maharashtra i.e. Nagpur & Aurangabad. The designated area of Nagpur and Aurangabad, has been taken over by M/s Spanco Limited & M/s GTL Ltd respectively since May 2011 as Distribution Franchisees. MSEDCL reported that both DFs have improved the quality of power distribution by taking up some initiatives. Brief of such initiatives is enclosed at **Annexure-IX**.

MSEDCL also intimated that both DFs have improved the customer satisfaction by launching initiatives like Door Step Services, 24x7 Helpline, Consumer Awareness Campaign, Call centre and using SMS platform to improve delivery of information to customers.

3.3 In addition to the enhanced efficiency in the Power Distribution, the employees of the MSEDCL are also absorbed and deployed by DF. The salient features are:

- (i) MSEDCL employees all across the State have option to join DF on deputation purely on voluntary basis;
- (ii) They continue to be on rolls of MSEDCL and would join MSEDCL at the end of deputation period;
- (iii) No loss in terms of seniority at MSEDCL;
- (iv) Experience of working in new system;
- (v) Financially more rewarding to employees.

3.4 In addition to these DFs, M/s MSEDCL has appointed M/s. CGL as Distribution Franchisee for Jalgaon (consisting of Urban and Rural Divisions). The designated Distribution Franchise area has been handed over to M/s CGL on 1st November 2011.

Thus, in Maharashtra total four urban areas have been handed over to Distribution Franchisees for power distribution and results are satisfactory. It is pertinent to mention that monthly power input to DF area is approximately 600 MUs which is 7.5 % of the overall MSEDCL input and the revenue from the DF area is about Rs 240 crore per month which is approx 9% of the total monthly collection from consumers of MSEDCL. The total consumers in the DF area are approx 9.6 lakh which is 5% of the total consumers of MSEDCL.

3.5 Experience in Agra

Uttar Pradesh state utilities after studying the Bhiwandi Model and taking into account the lessons learnt there and also its own experience in the distribution sector, decided to implement Input based Franchisee in 9 major cities of UP including Agra and Kanpur.

A competitive bidding process was undertaken in February 2009 for handing over distribution operations of Urban Areas of Agra, a part of Dakshinanchal Vidyut Vitran Nigam Limited (DVVNL) and the Urban Areas of Kanpur being served by Kanpur Electric Supply Company Limited (KESCO) with the objective of minimizing Distribution Losses, improving Collection Efficiency, Consumer Service and Quality of Supply through upgradation of utility system.

It was a single stage bidding process wherein the bidders were required to submit both technical bid and financial bid in two separate envelopes. Consequently, based on its highest bid, M/s Torrent Power was declared the successful bidder. Upon satisfaction of conditions precedent specified in the Distribution Franchisee Agreement, M/s Torrent Power was handed over the operations of Agra on 1st April, 2010.

3.5.1 The following impact of franchisee operation in Agra has been reported by M/s Torrent :

Particulars	Unit	Apr'10	Oct'10	Oct'11
Input Energy	MU	171.9	182.4	177.2
Sales	MU	55.4	88.2	95.3
T&D Loss	%	67.70%	51.70%	46.30%
% Collection	%	85.4%	90.8%	96.3%
Power Complaint of consumers	Nos	33363	16413	20085
% Attended within 4 hr	%	31%	97%	94%

3.6 On review of experience of Distribution Franchisee operating in the country, the Sub-Group observed that the Distribution Franchisee has made significant contribution towards reduction in losses, improvement in billing & collection efficiency and also improvement in customer support services. Thus Distribution Franchisee can be one of the effective steps to tackle the present crisis in distribution sector and may be considered for large scale replication in country with suitable modifications in the model. MD, MSEDCL, who is also one of the members in the Sub-Group also expressed his satisfaction with distribution franchisees operating in Maharashtra and suggested that such Distribution Franchisee model may be implemented in other areas of the country to induce efficiencies of the private sector in distribution of electricity.

4 Distribution Franchise - Legal Framework

Keeping in view the success of Distribution Franchisee model in select areas of Maharashtra and Uttar Pradesh as discussed in the previous section, it is felt that Distribution Franchisee can certainly be considered as one of the option to seek private sector participation in distribution of electricity. However, before prescribing the Distribution Franchisee model, the Sub-Group considered it appropriate to first examine the legal framework with respect to engagement of distribution franchisee keeping in view the concerns raised by Advisor to Dy. Chairman, Planning Commission.

The Electricity Act 2003, enacted by Parliament in the Fifty Fourth year of the Republic of India consolidates the laws relating to generation, transmission, distribution, trading and use of electricity and generally for taking measures conducive to development of electricity industry, promoting competition therein, protecting interest of consumers and supply of electricity in all areas, rationalisation of electricity tariff, ensuring transparent policies regarding subsidies etc. Therefore Sub-Group decided to examine the legality of appointment of DF in distribution of electricity under the provisions of the Electricity Act 2003.

In particular reference to distribution of electricity, it is important to first understand following legal terms as per provisions under the Electricity Act 2003 :

- (a) What is distribution system ?

(b) Who is eligible to distribute electricity ?

(c) What is Franchisee ?

Section 2(19) defines 'distribution system' as system of wires and associated facilities between source of electricity i.e. input point up to consumers point. Section 12 says that a person authorized by a licence can only distribute electricity and such licence can be granted by the Appropriate Commission as stated under Section 14 which also provides for that in case a licensee engages another person to undertake distribution of electricity for a specified area within its area of supply, that person need not obtain separate licence. Section 2(27) defines this another person as 'franchisee'. Further, Section 13 empowers appropriate commission to exempt franchisees from such license for distribution of electricity for a specified period on recommendation of appropriate government. The relevant provisions under the Electricity Act 2003 referred above are reproduced below for ready reference and clarity.

4.1 Relevant provisions under the Electricity Act 2003

Section 12 (Authorised persons to transmit, supply etc. electricity):

No person shall

- (a) Transmit electricity; or
- (b) Distribute electricity; or
- (c) Undertake trading in electricity, unless he is authorised to do so by a licence issued under Section 14, or exempt under Section 13.

Section 14 (Grant of licence):

The Appropriate Commission may, on an application made to it under section 15, grant a licence to any person -

- to transmit electricity as a transmission licensee; or
- to distribute electricity as a distribution licensee; or
- to undertake trading in electricity as an electricity trader, in any area as may be specified in the licence:

Provided also that in a case where a distribution licensee proposes to undertake distribution of electricity for a specified area within his area of supply through another person, that person shall not be required to obtain any separate licence from the concerned State Commission and such distribution licensee shall be responsible for distribution of electricity in his area of supply:

Section 13 (Power to exempt):

The Appropriate Commission may, on the recommendations, of the Appropriate Government, in

accordance with the national policy formulated under section 5 and in the public interest, direct, by notification that subject to such conditions and restrictions, if any, and for such period or periods, as may be specified in the notification, the provisions of section 12 shall not apply to any local authority, Panchayat Institution, users' association, co-operative societies, non-governmental organizations, or franchisees:

Section 2(19) - Definition of Distribution System

'distribution system' means the system of wires and associated facilities between the delivery points on the transmission lines or the generating station connection and the point of connection to installation of the consumers.

Section 42(1) - Duties of distribution licensee

It shall be the duty of a distribution licensee to develop and maintain an efficient, coordinated and economical distribution system in his area of supply and to supply electricity in accordance with the provisions contained in this Act.

Section 2 (27) - Definition of Franchisee

'Franchisee' means a person authorised by a distribution licensee to distribute electricity on its behalf in a particular area within his area of supply;

4.2 Sub-Group also studied the judgement dated Feb. 12, 2008 of Hon'ble Bombay High Court, Nagpur Bench in the case of Citizen Forum, Maharashtra and others vs. State of Maharashtra & Others (Writ Petition Nos. 3701 and 5855 of 2007) in order to understand the legal position with regard to appointment of distribution franchisee in urban area. Hon'ble Bombay High Court (Nagpur Bench), while rejecting this Writ Petition has observed that :

"57. For the reasons stated hereinabove, the contention canvassed by the learned Counsel for the petitioners that respondent No. 2 does not have power to appoint distribution franchisee under the provisions of Act of 2003, in our view, is misconceived and hence, rejected. Similarly, argument of the learned Counsel for the petitioners that action of respondent No. 2 in appointing respondent No. 4 as distribution franchisee in the urban area is inconsistent with the provisions of Section 5 of the Act of 2003, which is the only enabling provision in the Act of 2003, which permits appointment of distribution franchisee only in rural area, is also, in our view, devoid of substance and hence, rejected. The contention of the learned Counsel for the petitioners that distribution franchisee agreement dated 26.10.2007 is against the public policy, at this stage, does not hold merit. However, whether the procedures and methodologies evolved and adopted by the respondent No. 2 to achieve the objectives of the policy of privatisation, which are part of the agreement dated 26.10.2007, result in profit or loss in revenue of respondent No. 2 during the period of contract is required to be considered by the MERC as per our above directions and, therefore, though we vacate the interim order of status quo, we expect that

the State Government and Central Government shall take appropriate action according to law on the basis of decision/opinion/recommendations given by the MERC to the Government of Maharashtra.”

An extract of the other observations made by Hon'ble Bombay High Court (Nagpur Bench) is enclosed at **Annexure-X**.

From the judgement of Hon'ble Bombay High Court, on one side it is quite clear that appointment of distribution franchisee in urban areas is lawful and on other side it highlights the role SERC in ensuring that the procedures and methodologies to be adopted by the utilities to achieve the objectives of appointing distribution franchisee results in win-win situation for both utility and consumers.

4.3 Points raised by Advisor to Dy. Chairman (Planning Commission) on legal framework:

As mentioned at point 1.2 of this report, Advisor to Dy. Chairman (Planning Commission) in his presentation made in the round table held on January 4, 2011, raised concern over inconsistency of appointing franchisees in urban areas with the provisions under the Electricity Act 2003.

On the above issue, the view of the Ministry of Power was communicated to Planning Commission vide letter No. 20/16/2010-APDRP dated 14th March 2011 (copy enclosed at **Annexure-XI**) stating that view expressed by Advisor to Dy. Chairman, Planning Commission was an erroneous interpretation of law.

Advisor to Dy. Chairman, Planning Commission in reference to letter dated 14th March 2011 of Ministry of Power, again indicated his concern over legal framework for distribution franchisee vide his letter dated 7th April 2011 (copy enclosed at **Annexure-III**) as mentioned below :

- Section 12 prohibits any person from engaging in distribution of electricity without a licence;
- Section 13 provides that franchisee can be exempted from licensing in case they are distributing electricity in rural areas
- The seventh proviso to section 14 cannot be extended to cover a franchisee in urban areas so as to provide exemption from licensing.
- A franchisee cannot distribute electricity in urban areas unless he obtains a distribution licence. Consequently, any franchisee undertaking distribution of electricity in urban areas without a licence would be violating the mandatory provisions of Section 12.

With the aforesaid background considered view of the Department of Legal Affairs in the Ministry of Law and Justice was sought on specific queries discussed later in this section vide note dated 18.05.2011.

Considering the matter is sensitive and has wider implications at national level involving various State Governments, the Department of Legal Affairs in the Ministry of Law and Justice has referred the matter

to Additional Solicitor General, Shri Harin P Raval for his legal opinion. The legal opinion from the Ministry of Law and Justice has been received by Ministry of Power on 08.11.2011.

The details of specific queries on which legal opinion was sought from Ministry of Law and Justice and their opinion is enclosed at **Annexure-VI**.

The opinion of Ministry of Law and Justice was discussed in detail in the 2nd meeting of the Sub-Group held on 02.12.2011 and it emerged that Distribution Franchisee is consistent with provisions under the Electricity Act 2003. The matter regarding capital expenditure by DF and the legal opinion at sr. 4 & 5 of Table at **Annexure-VI** was also deliberated at length keeping in view various provisions of the Electricity Act 2003. As per the relevant sections of the Electricity Act, distribution of electricity has been identified as a single activity encompassing all aspects of distribution under Section 12 of the Electricity Act. Section 12 of EA is reproduced below:

“No person shall

- (a) Transmit electricity; or
- (b) Distribute electricity; or
- (c) Undertake trading in electricity,
unless he is authorized to do so by a licence issued under section 14 or is exempt under section 13.”

Further as per Section 14, the Appropriate Commission can grant the license to distribute electricity as a distribution licensee. Extracts of Section 14 are reproduced below:

“The Appropriate Commission may, on application made to it under section 15, grant any person licence to any person-

- (a) To transmit electricity as a transmission licensee; or
- (b) To distribute electricity as a distribution licensee; or
- (c) To undertake trading in electricity as an electricity trader,
in any area as may be specified in the licence.”

As per the above provisions there is no separation of various activities that a distribution licensee is expected to perform while undertaking distribution of electricity. It would, therefore, appear that the distinction made by the Ministry of Law and Justice in his above cited opinion pertains to the licensing aspect and would not exclude any activity undertaken by a franchisee on behalf of the licensee. The Ministry of Law and Justice has said “the franchisee cannot by himself develop, install or maintain a distribution system falling under the purview of Section 2(19) of the Act. He can only operate such a system which is developed or maintained by a distribution licensee. However, all auxiliary/ instrumental devices such as bill collection, metering, consumer services can be provided in respect of

things which are not covered by provisions of Section 42(1) read with Section 2(19).”

As per Section 42(1) of the Electricity Act

“it shall be the duty of a distribution licensee to develop and maintain an efficient, co-ordinated and economical distribution system in his area of supply and to supply electricity in accordance with the provisions contained in this Act.”

The Franchisee has been defined as per Section 2(27) of the Electricity Act as a person authorized by a distribution licensee to distribute electricity on its behalf in a particular area within his area of supply. The term distribution of electricity has nowhere been specifically defined and based on the provisions of the Electricity Act there is no rationale for making a distinction between various activities involved in distribution of electricity. As pointed out above the license given by the Appropriate Commission is for distributing electricity and not for developing or maintaining efficient, co-ordinated and economical distribution system separately and for supplying electricity separately. Therefore, the purport of opinion of Ministry of Law and Justice would be that the franchisee cannot by himself develop, install or maintain a distribution system if the distribution licensee is not licensed to do so. The opinion does recognize that the franchisee can render consumer services and it would appear illogical to distinguish maintenance of an existing system from consumer services.

In fact a closer look at the provisions of Section 14 regarding grant of licenses would further strengthen this argument. Section 14 provides that an Appropriate Commission “may grant a license to two or more persons for distribution of electricity through their own distribution system within the same area.” Thus the spirit of the existing provisions of the Act seems to be that a distribution licensee shall distribute electricity in the licensed area through his own distribution network. It is in view of this that a franchisee cannot by himself develop, install or maintain a distribution system. However, as a franchisee acts on behalf of a distribution licensee he could undertake all the activities that a distribution licensee is expected to perform as per the Act. The capital expenditure requirement based on the distribution licensee's assessment of his licensed area keeping in view modernization, upgradation and load growth has been made a part of the standard bid document developed by the Forum of Regulators. Further, this bid document along with capex would be approved by the Regulator before bids are invited. Therefore, asking the franchisee to make capital investment as per a predictable and approved plan is akin to the distribution licensee himself making that investment by passing on that responsibility to the franchisee in a transparent manner. If the opinion of Ministry of Law and Justice on capital expenditure is interpreted in a narrow sense to imply that a franchisee cannot undertake capital expenditure to develop, install or maintain a distribution system, it would amount to denying the distribution licensee from any form of financial engineering for incurring capital expenditure. For example, is it prohibited under any law or regulation that distribution licensee cannot float a EPC contract for setting up a distribution system with the responsibility of maintaining that system, say for 10 years, with the EPC contract and the terms of payment being spread over the period of the entire EPC contract? The answer to the question

is 'No', which would mean that it is the EPC contractor who develops, installs and maintains the distribution system but not by himself rather as an agent contracted to do so by the distribution licensee. The improvement in the Franchisee model is that the capex is done with specific regulatory approval.

Empirical evidence also suggests that the franchisee appointed in Bhiwandi has made capital investments even though it was not provided for explicitly in the bidding document. The High Level Panel (HLP) headed by Shri V.K. Shunglu, former CAG in their report on the Financial Position of Distribution Utilities has also concluded that “the experience of capital outlays has been extremely positive.” HLP has observed that the franchisee in the case of Bhiwandi had invested approximately Rs.500 crore in a period of five years and felt that capex has been the key factor in loss reduction besides better management and operational practices. In fact capex and operational and management practices are so interconnected that it is not possible to think of one without the other. By itself capex is not useful and without capex operational efficiency cannot be improved. It would be noticed that even without a contractual obligation the franchisee premised his strategy on undertaking this large capital investment.

In view of above, it can be concluded that the Act does not allow DF to develop parallel or substantially different distribution system; however, it does not prohibit capital expenditure by DF in maintaining, augmenting and upgrading existing distribution system as may be required to meet the growing need to perform his duties in an efficient and effective manner. Sub-Group concluded that appointment of DF is consistent with the legal framework and DF can incur capital expenditure on behalf of licensee in maintaining, augmenting and upgrading the distribution as transparently provided in the proposed Standard Bidding Document.

5 Perceived Gaps in Distribution Franchisee Model

Advisor to Dy. Chairman (Planning Commission), during discussion in the meeting of Task Force and communications to Ministry of Power, apart from legality of DF, has pointed out certain structural gaps in DF Model also indicated earlier in this report. The details are discussed below:

5.1 Distribution franchisee is accountable to utility only

The contention is that franchisee model is essentially a sub contract for discharging the O&M obligations of the Discoms and this would cause regulatory gap because even though the franchisee is distributing electricity it is not regulated by SERC and is accountable to Discom alone.

The matter was deliberated amongst members of the Sub-Group in view of legal opinion received from Ministry of Law and Justice which clearly endorsed the stand of MoP and indicates that though franchisee is not directly regulated by SERC and accountable to the DISCOM, the regulatory mechanism is enforced through licensee. Thus, the distribution franchisee is bound to perform in consonance with the performance standards as may be set out by the concerned SERC. Sub-Group is of the view that distribution franchisee as envisaged in the model developed by Ministry of Power would not cause regulatory gap as far as distribution of electricity and consumers services are concerned.

5.2 Distribution franchisee model provides little incentive for capital expenditure

As discussed above, SERC can exert regulatory mechanism on Distribution Franchisee through licensee and Distribution Franchisee will have to meet the performance standards as may be set out by SERC. In order to meet such performance obligations, distribution franchisee need to necessarily incur capital expenditure not only to upkeep distribution system but also to bring in improvements in services relating to distribution of electricity and the bidder is expected to factor the cost of such expenditure while bidding for the distribution franchisee. After detailed discussion on the matter, the Sub-Group found that the proposed model developed by Ministry of Power takes care of interest of all stakeholder viz. utility, distribution franchisee and consumers in this regard.

After detailed deliberations Sub-Group decided to incorporate necessary provisions in the proposed SBD for distribution franchisee in this regard as detailed below:

- (a) Distribution Franchisee shall provide for capital expenditure to improve efficiencies, augment and upgrade infrastructure, reduction in Distribution Losses and improvement in quality of supply in the Franchise Area as per Minimum Capital Investment Plan envisaged in the franchisee agreement for the contract period.
- (b) The Distribution Franchisee shall make a minimum investment equivalent to 50% of annual revenue for the Base Year spread over a period of 5 years. The franchisee shall roll out its investment in such way that at least 10% of the minimum investment plan is spent every year for the first five years of the contract period.
- (c) The input energy rates quoted by the Distribution Franchisee shall be deemed to have taken into account the cost of finance and depreciation on account of these investments.

5.3 Utility has no obligation to supply additional power

Under Distribution Franchisee model, for all purposes including supply of adequate power, the consumers in the franchised area remains consumers of the licensee and the franchisee is authorized to distribute electricity on behalf of licensee to those consumers. Therefore, licensee cannot differentiate in any way including supply of power between the consumers in franchised area and consumers in other areas of licensee.

However, in order to explicitly address this issue, Sub-Group suggested following provisions in the proposed SBD detailed below:

- (a) Utility shall supply minimum energy at Input Points as agreed in the contract between the utility and franchisee. However, this supply may vary subject to SLDC Directives on load shedding.
- (b) Utility shall not discriminate in the supply of power between the Franchise Area and its other Distribution Divisions. However, if the hours of supply depends on loss level of that area, that policy may continue so that in the event of reduction of losses in the franchise area, it may get comparatively higher quantum of energy to meet the consumers' demand.

- (c) In case Utility is unable to provide sufficient energy to meet the requirement of the franchise area, the franchisee may request Utility to source the energy, that is in deficit, from the open market. As regards the mechanism, while the franchisee will identify and procure power from diverse sources, the agreements for purchase of power shall be executed by the Utility as the principal Party. Utility as per the proposed agreement will need to comply with Section 86(1)(b) of the Electricity Act, 2003 by making necessary applications to the SERC for scrutiny and approval even if the power is procured specifically for the Franchisee area. The DF will identify the additional sources of power purchase and the rate for the same, and Utility will enter into Power Purchase Agreements (PPAs) with contracted parties for power purchase. Utility will enter into tri-partite PPAs with the Franchisee as one of the Parties to the PPA. Such electricity purchase (including price) and power procurement process of the Utility will be subject to regulation by the SERC under the provisions of Section 86(1)(b) of the Act. The required quantum of additional power shall be allocated to the franchisee area. The cost of supply of additional electricity in Franchisee area will be recovered as reliability charges from the consumers of Franchisee area.
- (d) In case of procurement of power from sources other than Utility, the wheeling charges shall be payable by Distribution Franchisee for using the network other than that of the distribution network of the Utility for distribution of power in the Franchisee Area and shall be levied as per SERC regulations.

5.4 No Provision for impact of change in consumer mix

With every increase in tariff or change in consumer mix towards high tariff category, there is increased revenue for the utility. However, every downward revision of the tariff or change in consumer mix towards low tariff category means lower revenue for utility. Therefore impact of change in consumer mix and tariff need to be factored in order to ensure that interests of both parties i.e. utility and franchisee can be safeguarded. In view of this, the Sub-Group framed a mechanism for adjustment of the input energy rate to take care the change in tariff or consumer mix that may happen during the Distribution Franchisee Agreement period. To carry out tariff adjustment, a mechanism linking the Revenue from Input Energy Rate receivable by the Utility from the Distribution Franchisee due to change in tariff and/or consumer mix, has been proposed. Under the proposed arrangement, the Utility and the franchisee would share, any increase in revenue due to increase in Average Billing Rate (i.e. Average Billing Rate of the current period minus Average Billing Rate of the Base Year) in accordance with the predetermined formula. The rationale behind allowing the franchisee to retain part of the revenue on account of change in tariff or consumer mix is that with every increase in revenue, the collection responsibility, bad debts and consequent losses of the franchisee could also go up in absolute term and, therefore, the franchisee would need to be compensated in that regard.

Sub-Group has suggested to include necessary provisions in the proposed model to take care of the impact of change in consumer mix as well as applicable tariffs through appropriate tariff indexation as mentioned above.

5.5 DF model does not address open access

This issue was also discussed by the Sub-Group and it emerged that open access is regulated by SERC and licensee. As such, DF model does not prohibit open access. In the event that any HT/LT Consumer in the Franchise Area wants to avail Open Access under the relevant Regulations issued by SERC, the Distribution Franchisee shall retain the cross-subsidy surcharge paid, and adjustment for Distribution Losses of such Consumer. The wheeling charges for using the Distribution System shall be apportioned between utility and the Distribution Franchisee on the basis of a mutually agreed formula. However additional surcharges, if any, shall be remitted to Utility along with the regular payments.

5.6 DF model does not address competition

Sub-Group is of the view that DF Model does not prohibit SERC from granting license to others in same area and as such does not curb competition in any way.

5.7 DF model does not address quality of power

As discussed earlier in this report, DF, through licensee, is also bound by Standards of Performance notified by SERC and the regulatory mechanism can be enforced through licensee. It is clear from the experience of DF in Bhiwandi and other cities that in fact DF invest in improving customer satisfaction by providing better services, customized and user friendly service. Sub-Group also suggested following provisions in the proposed SBD in this regard:

In case of non-adherence of the supply code/standards of performance, any penalty levied by the SERC on the utility shall be recoverable from the franchisee against the Performance Guarantee on a back to back basis for which the franchisee shall have the authority to represent its case before the SERC or any other judicial or quasi-judicial body.

In view of the above, Sub-Group concluded that DF model as being developed by Ministry of Power *per se*, does not have any perceived operational weakness and also adequately addresses the concerns raised in this regard.

6 Standard Bidding Document (SBD) for appointment of Distribution Franchisee in Urban areas

6.1 Sub-Group noted that Ministry of Power is in the process of developing a Standard Bidding Document (SBD) for deployment of distribution franchisees by the utilities in a uniform and transparent manner. Ministry of Power has taken up the SBD prepared by Forum of Regulators (FOR) in September 2010, for appointment of urban distribution franchisee as the base document as this document is approved by 'FOR' and addresses most of the concerns regarding DF model.

The Sub-Group also discussed DF model of 'FOR' and suggestions given by various states, state power utilities and private utilities and suggested a few modifications in the SBD developed by FOR. Sub-Group decided that the modified document should be circulated to all States and power utilities for suitable adaption after obtaining necessary approvals in due course of time.

6.2 The salient features of the proposed model as discussed and modified by the Sub-Group are detailed hereunder :

6.2.1 **Franchisee Area:** The franchised area should offer the franchisee sufficient opportunities to work for the benefit of the utility and for itself. The areas with Distribution Loss level higher than 20% should be first picked up in following manner :

- Initially with input energy of at least 2000 MUs per annum or more than 500 MW load or more than 3 Lac consumers;
- Subsequently, areas which have input energy of at least 400 MUs.

6.2.2 **Contract Period:** A contract period of 15 years is considered appropriate for the franchisee to effect necessary improvement in the distribution system and also get adequate return on the investments.

6.2.3 **Pre-Qualification Criteria :** This was discussed in the Sub-Group at length and various options like mandatory experience in power sector or core infrastructure sector, consumer base, employee base besides financial parameters in terms of net worth, cash accruals were considered. After detailed deliberations, it has been decided that any prospective bidder meeting the criteria given below should be allowed to participate in the bidding process :

- (a) Public Limited Company meeting the conditions of Code of Conduct for grant of Distribution Business License under Section 14 of the Electricity Act, 2003;
- (b) Having experience of handling consumers of at least 20% of the total estimated number of consumers in the area to be franchised;
- (c) Net Worth - At least 50% of the Annual Revenue of the Franchise Area in base year;
- (d) Internal Resource Generation i.e. Cash Accruals of at least 25% of the Annual Revenue of the Franchise Area in base year.

Further, the Sub-Group has also recommended that all bidders, who qualify to the prescribed technical qualification, should be treated at par while evaluating the financial bid. No preference on account of better technical qualification should be given to any of the bidders in any manner in any case whatsoever.

6.2.4 **Bidding by Consortium:** After detailed deliberations on the matter, it has been decided by the Sub-Group that bidding by consortium should not be allowed keeping in view the possibility of disputes amongst various parties of consortium and other complexities involved in handling contracts with consortium.

6.2.5 **Baseline Parameters:** Third Party Audit of commercial data of at least last one year including Input Energy, Energy Sales, Amount Billed and Collected, Distribution Losses and AT&C Losses is mandatory. Average Billing Rate (net of Subsidy) for the Base Year should also be frozen and clearly indicated in the bid document.

6.2.6 **Bid Variable and Minimum Benchmark Rates:** Sub-Group decided that there will be only one bid variable i.e. Input Rate in Rs. per Unit for energy input in the area to be franchised and bid will be decided on the basis NPV. The issue of minimum benchmark rates was deliberated in the Sub-Group at great length and the consensus emerged that Minimum Benchmark Rates on year to year basis should be suitably specified in the bidding documents by the utility and the bidders should not be allowed to quote their bid below the specified Minimum Benchmark Rates. This would safeguard the minimum expectations of the utility and also prevent front/back loading of bid price during the contract period. Keeping in view the varying opinion on loss reduction trajectory to be considered while working out minimum benchmark rates, it was decided that flexibility may be provided to utility in this regard.

6.2.7 **Loss Reduction Targets:** In view of the decision to include minimum benchmark rates on year to year basis, it is recommended that specific provision for loss reduction target is not required as expected loss reduction will be factored in the minimum benchmark rates to be indicated by the utility in bid document and bidders will not be allowed to quote below the benchmark rates.

6.2.8 **Capital Investment:** The franchisee will be required to incur Minimum Capital Expenditure equivalent to 50% of Total Revenue Billed for the Base Year spread over first 5 years of the contract period (at least 10% each year). Investments to be made by the franchisee in the last 5 years of the contract period would require prior approval from SERC except the investments for release of any new consumer connections and for network upgradation to meet normal load growth. As a safeguard against gold plating of CAPEX, depreciation on investments made by the franchisee shall be higher of 8% per annum and the rate as approved by the SERC.

6.2.9 **Securities against Performance:** The following has been recommended by the Sub-Group :

- (i) **Bid Bond** - Rs.10 cr for every 250 cr of annual revenue
- (ii) **Performance Guarantee** - 1/5th of annual revenue out of which half shall be locked throughout the contract period whereas the other half shall be returned in proportion to the minimum mandatory investment done by the franchisee over the first 5 years. The portion of the Performance Guarantee that is not returned shall be liable to be invoked either in case of non-compliance of Standards of Performance or any other failures.
- (iii) **Payment Security** - LC equivalent to 60 days of average energy input in the franchise area. In case of non-adherence of the supply code/standards of performance, any penalty levied by the SERC on the utility shall be recoverable from the franchisee on a back to back basis. Accordingly, the franchisee shall have to be authorized to represent any such case before the SERC.
- (iv) **Escrow Account** : The Sub-Group also recommended for escrow arrangement on 90% of the receivable amount in revenue account of the franchisee to safeguard payments to be made by DF to utility and to avoid any possibilities of siphoning of funds by DF.

6.2.10 Supply of Energy & Procurement of Deficit Energy: The following provisions have been made in SBD :

- (i) The Utility should not differentiate between similar areas in the State as regards the supply of energy.
- (ii) In case, due to the power supply policy of Utility in vogue, the hours of supply depends on loss level of that area, the franchisee area will also be entitled to get higher quantum of energy at the franchisee's quoted input rates, to meet the consumers' demand.
- (iii) The licensee, upon being requested by the franchisee, shall procure the energy that is in deficit from the open market, for the franchisee area.
- (iv) In order to fully recover the cost of energy to meet such deficit, the franchisee may charge the consumers in the form of a Reliability Charge per unit and such charge could be decided through public hearing process and prior approval of the SERC.
- (v) Utility would have to enter into Power Purchase Agreements (PPAs) with contracted parties for power purchase. Utility can explore the option of entering into tri-partite PPAs with Franchisee as one of the Parties to the PPA.

6.2.11 Tariff Indexation: As discussed earlier in this report in para 5.4, necessary provisions have been made in the proposed model to take care the impact of change in consumer mix as well as applicable tariffs through appropriate tariff indexation, so that distribution franchisee does not loose revenue on account of increase in Average Billing rate and Distribution Franchisee does not gain for the factors which are beyond his control.

7 Conclusion

Sub-Group recommends that Distribution Franchisee model as discussed above should be suitably adopted by the States and State Power Utilities to induce private sector participation for bringing in desired level of efficiency and effectiveness in management of distribution of electricity in urban areas. Ministry of Power may finalise the Standard Bidding Document which should be circulated to all the States and State Power Utilities for suitable customization as per their need.

Annexure-I of Annex-VIII

(Same as page 20-23 of the Report)

Annexure-II of Annex-VIII

(Same as page 24-31 of the Report)

Annexure-III of Annex-VIII

No. N-14026/5/10-Infra
Government of India
Planning Commission
(Secretariat for Infrastructure)

Yojana Bhavan, Sansad Marg, New Delhi 110 001
April 7, 2011

To
The Secretary,
Ministry of Power,
Shram Shakti Bhavan,
New Delhi.

Sub: Legal framework for franchisee in distribution

Sir,

Please refer to letter No. 20/16/2010-APDRP dated March 14, 2011 addressed by the Under Secretary, Ministry of Power to Member (Energy) on the above subject.

2. The aforesaid letter conveys the views of the Ministry of Power about the legal validity of the franchisee model and requests that the views of the Ministry of Power may be kept on record. As desired, the aforesaid letter has been kept on record.

3. On the substantive points raised in the aforesaid letter, it is noted that reliance has been placed on the definition of franchisee as contained in section 2 (27) of the Electricity Act, 2003, which is reproduced below:

*(27) franchisee means a **person authorised by a distribution licensee to distribute electricity on its behalf** in a particular area within his area of supply;*

4. It is evident from the above definition that a franchisee can be authorised by the distribution licensee only to distribute electricity on behalf of the latter. As such, he cannot distribute electricity on his own behalf nor can he undertake the operation and maintenance of the distribution system or make investments in the distribution system and recover the same through tariff.

5. Further, in order to give effect to the aforesaid definition, it must be read with the substantive provisions of the Act. In fact, the entire Act contains only two references to the term 'franchisee'. The first reference is contained in section 5 which is reproduced below:

*5. The Central Government shall also **formulate a national policy**, in consultation with the State Governments and the State Commissions, **for rural electrification and for bulk purchase of power and management of local distribution in rural areas through Panchayat Institutions, users'***

associations, co-operative societies, non-Governmental organisations or franchisees.

6. It would be seen that Section 5 empowers the Central Government to formulate a national policy that would include local distribution in rural areas through franchisees. The relevant extracts of national policy notified by the Ministry of Power read as follows:

Rural Electrification

* * *

*5.1.6 Necessary institutional framework would need to be put in place **not only to ensure creation of rural electrification infrastructure but also to operate and maintain supply system for securing reliable power supply to consumers. Responsibility of operation & maintenance and cost recovery could be discharged by utilities through appropriate arrangements with Panchayats, local authorities, NGOs and other franchisees etc.***

7. It would be evident from the above that the Act as well as the National Electricity Policy notified thereunder confine the role of franchisees to rural areas and do not recognise any franchisee arrangement for urban areas.

8. The second reference to the term “franchisee” is contained in Section 13 which is reproduced below:

*13. **The Appropriate Commission may, on the recommendations, of the Appropriate Government, in accordance with the national policy formulated under section 5 and in public interest, direct, by notification that subject to such conditions and restrictions, if any, and for such period or periods, as may be specified in the notification, the provisions of section 12 shall not apply to any local authority, Panchayat Institution, users' association, co-operative societies, non-governmental organizations, or franchisees.***

9. The above section stipulates that the SERC may, in accordance with the national policy formulated under section 5, direct that subject to such conditions, restrictions and period as may be specified by the SERC, a franchisee may be exempted from the mandatory requirement of obtaining a licence. Since the exemption must conform to the national policy referred to in section 5, which applies only to rural areas, the provisions of section 13 cannot be applied to franchisees in urban areas. Consequently, a franchisee in urban areas cannot be exempted from obtaining a distribution licence as required under section 12.

10. Since the Electricity Act refers to franchisees only in the aforesaid two sections that apply to rural areas, franchisees for urban areas do not have any recognition in law. Moreover, in all the discussions, including the debate in the Standing Committee of the Parliament, any franchisee arrangement for cities was never contemplated. This is clearly an after-thought and that too of a recent origin. Pursuing such an arrangement is, therefore, fraught with several adverse consequences including challenge in courts.

Proviso to Section 14

11. The provision on which some of the States seem to be relying is the seventh Proviso of section 14 which is reproduced below:

14. Grant of Licence

The Appropriate Commission may, on an application made to it under section 15, grant a licence to any person

- (a) to transmit electricity as a transmission licensee; or*
- (b) to distribute electricity as a distribution licensee; or*
- (c) to undertake trading in electricity as an electricity trader, in an area as may be specified in the licence:*

* * *

*Provided also that in a case where a distribution licensee proposes to undertake distribution of electricity for a specified area within his area of supply **through** another person, that person shall not be required to obtain any separate licence from the concerned State Commission and such **distribution licensee shall be responsible for distribution** of electricity in his area of supply:*

12. It may be noted that the above proviso does not refer to a franchisee. If the legislature had intended this proviso as an enabling arrangement for a franchisee, it would have used this term as it is already defined in section 2(27). The fact that this term is used in section 5 and section 13, but excluded from section 14 clearly suggests that the franchisee model is not covered under the aforesaid Proviso to section 14.

13. It could be argued that the term 'person' could include a franchisee. However, such an interpretation would render section 13 redundant because all the restraints imposed by section 13 such as conditions of exemption from licencing, period, conformity with the national policy etc. can be avoided by simply taking recourse to the above Proviso. It could not have been the intention of the legislature to impose several conditions and restrictions on a franchisee in rural areas while imposing none for urban areas.

14. Further, the Proviso clearly mandates that the distribution licensee shall remain responsible for distribution of electricity even when distribution is undertaken **through** another person in a specified area. While this Proviso enables a distribution licensee to engage another person in a specified area, it must demonstrate that the licensee continues to be responsible for such distribution. As such, all the duties and responsibilities of a licensee under law, rules and regulations would continue to belong to the licensee who must remain in control and must also be liable for any breach or default of licence conditions by his agent. While this proviso may enable a distribution licensee to undertake distribution through another person in a specified area such as a residential or commercial complex even while

retaining its role and responsibility as a licence, it cannot be extended to handing over of all its responsibilities for the entire city to a franchisee. If that were permissible, a licensee would even be able to transfer its entire area and functions to another person. That could not be the intent of this Proviso.

15. The use of the word “through” is important here. It implies that the principal obligations remain with the licensee even when he is acting through another person as his agent. In the case of a city franchisee, however, the licensee would hand over almost all his functions to the franchisee who will virtually act as a distribution licensee. The distribution licensee cannot, therefore, be regarded as acting 'through' the franchisee. In fact, the franchisee would virtually substitute the distribution licensee, but would not have the responsibilities and obligations of a licensee, as they would continue to rest with the distribution licensee as per law. In effect, the licensee would remain responsible in law but would cease to have any wherewithal to discharge his functions whereas the franchisee who takes on the distribution functions will not be accountable to the Regulator or the consumers, as its only accountability will be to the licensee under a bilateral contract. The entire scheme of the Act would thus be jeopardised.

16. A plain reading of the aforesaid proviso would suggest that the distribution licensee can only engage another person to act as its agent for the sole purpose of distributing electricity in a specified area. Functions such as O&M, upgradation of the distribution system etc. must continue to remain with the distribution licensee.

17. From a perusal of the above, it is evident that:

- (a) Section 12 prohibits any person from engaging in distribution of electricity without a licence;**
- (b) section 13 provides that franchisees can be exempted from licensing in case they are distributing electricity in rural areas;**
- (c) the seventh proviso to section 14 cannot be extended to cover a franchisee in urban areas so as to provide exemption from licencing. Doing so would be far-fetched and incompatible with the scheme of the Act. Moreover, such a franchisee can only act as an agent for the sole purpose of distributing electricity in a specified area. This can not include other functions such as maintaining and developing the distribution system or exercising other powers of the licensee.**

18. It follows from the above that a franchisee cannot distribute electricity in urban areas unless he obtains a distribution licence. Consequently, any franchisee undertaking distribution of electricity in urban areas without a licence would be violating the mandatory provisions of section 12.

19. In view of the above, the Ministry of Power may please have the matter examined further.

Yours faithfully,
(Gajendra Haldea)
Adviser to Deputy Chairman

**Specific queries of MoP on which legal opinion was sought from
Ministry of Law and Justice**

1. Is the activity of undertaking of distribution of electricity by a distribution licensee through another person in a specified areas within his area of supply in terms of seventh proviso to Section 14 inconsistent with Sections 12 or 13 of the 2003 Act?
2. Is the exemption provided in the Seventh proviso to Section 14 of the 2003 Act from obtaining any licence under Section 12 or 14 of the 2003 Act inconsistent with Section 13?
3. Does the 2003 Act prohibit a Distribution Licensee to appoint franchisee in Urban Areas within its licensed area of supply ?
4. Can a franchisee be authorized by a distribution licensee to operate and maintain the distribution system within the Distribution Licensee's licensed area of supply?
5. Can a distribution licensee enter into appropriate arrangements with its franchisee to authorize it to augment/develop distribution system, undertake operation and maintenance of the distribution system, billing, collection metering, consumer services etc.?
6. Would the 7th proviso of Section 14 in appointment of an urban distribution franchisee cause a regulatory gap because even though the franchisee is distributing electricity, it is not regulated by SERC and is accountable to discom alone.
7. Any other matter on which the Ministry of Law ad Justice may wish to opine on?

**Comments received from States and Distribution Utilities on
Distribution Franchisee Model**

Sl. No.	Subject	Respondent	Comments
1.	Tariff Indexation : Sharing of increased / decreased revenue due to change in consumer mix and tariff	Himachal Pradesh	Entire amount should be to the account of utility in case of both increase and decrease in revenue.
		Bihar	Should be accounted for through pre-determined formula instead of fixed ratio of 75:25
		Gujarat	Provisions need modification. Fuel adjustment charges (fuel surcharge) is recovered from the consumers as pass through, now any sharing of increase in revenue to the extent of 25% with DF will lead to under recovery of fuel surcharge and loss to discom. Audit fees for all purposes maybe shared in the ratio of 75:25 between DF and utility.
		MSEDCL	ABR should be fixed and audited figures to be intimated to bidders at the time of issue of bids.
2.	Minimum Benchmark Rate	Bihar, Gujarat, CESU, PTC, Maharashtra	Minimum benchmark rate should be included in bid document and bidder should be allowed to quote equal to or above the minimum benchmark rate.
3.	Bidder Qualification and Bidding by Consortium	PTC	Participation by Consortium, subsidiaries may be allowed through SPV. Foreign Companies listed in recognized Stock Exchange may also be invited.
		PTC & NDPL	Technical Qualification to be prescribed based on Sectoral experience or experience in infrastructure with handing similar consumer base, employee base, revenue and services.
4.	Capital Expenditure	Gujarat	Capex to be bifurcated for various activities viz. metering, consumer services, revamping of lines and transformers, replacement / upgaration of lines & transformers etc. Capex through R-APDRP or other schemes should not be counted towards agreed capex.
		CESU	Approval of SERC required.
		Maharashtra	Committed and non-committed capex in detail to be categorically indicated in bid document.
5.	Penalties on default	Himachal Pradesh	Penalties for consumer service below satisfactory level, increase in AT&C loss to be included
		Gujarat	Penalty for not maintaining desired PF (power factor of 0.85) to be included.
		NDPL	No penalty, if AT&C loss reduction targets are not achieved as the bidder has already factored reduction in losses in its quote for input rate and bidder is automatically penalized if desired results are not achieved. Penalty charge for under investment and BG equivalent to agreed capex may be taken for recovery and may also be released in tranches in proportion to incurred capex.

In case of capex required beyond agreed capex, provision for adjustment of input rate may be included.

DF should not be penalized for non-performance if the same is due to shortage of power supply as committed by utility.

CESU No penalty for not achieving desired loss level if input rate > BSP plus operational cost

6.	Baseline data	PTC	Technical data to be verified through Accredited agency with ISO certification.
		CESU	Information of at least 3 to 5 years must be provided.
7.	Supply of Power	Gujarat	In addition to periodical (monthly, quarterly, annually) forecast of requirement of power, provision related to day-ahead declaration of drawal schedule on 15 minutes time basis may be included keeping in view intra-state ABT mechanism in force in Gujarat and likely to be enforced in other states, to effectively meet the demand of DF area on real time basis. DISCOM have to earmark the contracted quantum of power and in case DISCOM fails to provide power supply, DF will purchase power from outside resulting in reliability charges from consumers. Thus flexibility of utility is lost and additional burden to consumers.
		NDPL	Incase utility fails to supply committed power, input rate should be adjusted. Additional power procured should be to the account of utility.
8.	Contract Period	NDPL	25 years
		CESU	10-15 years depending upon amount of Capex required.
		MSEDCL	Should be re-looked.
9.	AT&C loss reduction trajectory	NDPL	@4% till 40%, @3% till 30%, @2% till 20% and @1% below 20% as per 'Abraham Committee Report'. Overachievement 25% of which can go towards creating a Reserve Fund for procurement of additional power and balance may be passed to consumers as rebate.
		CESU	@5% till 25%, @3% till 19%, @2% till 15%, @1% till 10%
10.	Depreciation Rate	NDPL	Rate approved by SERC may be informed beforehand and remain unchanged for contract period.
11.	Security	NDPL	Amount of PBG may be increased to safeguard committed capex.
		MSEDCL	3-tier security arrangements are suggested viz. EMD, Bank Guarantee and letter of credit.
12.	Evaluation of bids	PTC	Levelised tariff should be considered based on discounting rate notified by CERC for bidding process for procurement of power.
		CESU	May be based on how quickly an area becomes commercially viable i.e. it recovers the BSP plus Operational cost.

13.	Handholding through existing staff in initial period and deputation of staff	PTC	Initial handholding of at least 6 months instead of 3 months and DF may be allowed to terminate deputation before 5 years instead of fixed term of 5 years.
14.	Franchisee Area	CESU	To coincide with Electrical Circle / Division / Sub-Division/Section i.e. administrative unit of utility.
		MSEDCL	Provision made about flexibility of franchisee operations area in future due to change of Municipal area will be against the interest of both parties.
15.	Objectives	MSEDCL	Efficient demand side management and avail benefits of carbon credit may be included in objectives of DF. Benefits available under CDM must have a place in document.
16.	Information for bidders / franchisee	MSEDCL	<p>Details of civil structures concerned with distribution within operation areas should be defined including those which are not related with operations but existing within the operation area and will become redundant post handing over of area to DF.</p> <p>Calculation of ABR of previous years will be highly cumbersome and little use.</p> <p>Providing details for previous years in respect of category-wise consumer, load, sales etc. will be cumbersome.</p>
17.	Provision of renewal of agreement	MSEDCL	Should include provision for renewal.

Opinion of Ministry of Law and Justice on specific queries of MoP

Sl. No.	Queries	Legal Opinion
1.	Is the activity of undertaking of distribution of electricity by a distribution licensee through another person in a specified areas within his area of supply in terms of seventh proviso to Section 14 inconsistent with Sections 12 or 13 of the 2003 Act?	The activity of undertaking of distribution of electricity by distribution licensee through another person is not inconsistent with Section 12 or 13 of the EA 2003. However, the distribution franchisee can only be appointed for a specified area within the licensed area of supply of electricity by the distribution licensee.
2.	Is the exemption provided in the Seventh proviso to Section 14 of the 2003 Act from obtaining any licence under Section 12 or 14 of the 2003 Act inconsistent with Section 13 ?	The exemption contemplated in the 7th proviso of Section 14 of Act from obtaining any license in respect of DF (in view of Section 12 read with Section 14) is not inconsistent with provision of Section 13.
3.	Does the 2003 Act prohibit a Distribution Licensee to appoint franchisee in Urban Areas within its licensed area of supply?	On review of provisions contained in the Act there exists no prohibition where under the distribution licensee cannot appoint a franchisee in urban areas within its licensed area of supply.
4.	Can a franchisee be authorized by a distribution licensee to operate and maintain the distribution system within the Distribution Licensee's licensed area of supply?	A franchisee who is authorised by distribution licensee to undertake the task of supply of electricity can do so on a specified area within the licensed area. However, such a franchisee can only utilise or use the distribution system for the purpose of distribution of electricity in the area specified. In other words, the franchisee cannot by himself develop, install or maintain a distribution system falling under the purview of section 2(19) of the Act. However, all auxiliary / incidental functions such as billing, collection, metering, consumer services can be provided in respect of things which are not covered by provisions of Section 42(1) read with Section 2(19).
5.	Can a distribution licensee enter into appropriate arrangements with its franchisee to authorize it to augment/develop distribution system, undertake operation and maintenance of the distribution system, billing, collection metering, consumer services etc.?	
6.	Would the 7th proviso of Section 14 in appointment of an urban distribution franchisee cause a regulatory gap because even though the franchisee is distributing electricity, it is not regulated by SERC and is accountable to discom alone.	The seventh proviso of Section 14 where under appointment / engagement of urban distribution franchisee is envisaged did not cause the regulatory gap because though such franchisee is not directly regulated by SERC and is accountable to the DISCOM and regulatory mechanism can be enforced through distribution licencee.

Annexure-VII of Annex-VIII

(Presentation on the Franchisee Model - The points covered in the presentation are included in the main body of the Report of the Sub-Group on Franchisee in the Distribution of Electricity)

Minutes of Meeting of the Sub-Group on Distribution Franchisee in Urban Area held on 02.12.2011 at Ministry of Power

The meeting was chaired by Secretary (P), Ministry of Power, Govt. of India and Chairman of Sub-group on Distribution Franchisee constituted under the Task Force on Private Participation in the Power Distribution Sector. List of participants is enclosed.

JS (DS), Ministry of Power, Govt. of India, welcomed all the members of the Sub-Group and other participants present in the meeting. JS(DS) made a presentation on the subject covering details of constitution of Task Force and Sub-Group on distribution franchisee ('DF'), legal framework, experience so far, perceived gaps in DF model, stakeholder consultation, comments received from various stakeholders and important features of Standard Bidding Document ('SBD').

At the outset, the legal framework for appointment of distribution franchisee in urban areas was discussed in detail. JS(DS) mentioned that Ministry of Power had sought legal opinion from Ministry of Law and Justice in May 2011 on the legal issues raised by Advisor to Dy. Chairman, Planning Commission and their opinion has been received on 8th Nov. 2011. The members of the Sub-Group were apprised about the legal opinion received from Ministry of Law and Justice on appointment / engagement of distribution franchisees in urban areas. Their opinion clearly establishes that Distribution Franchisee is consistent to various provisions under the Electricity Act 2003. Part of the legal opinion says that "Such a franchisee can only utilise or use the distribution system for the purpose of distribution of electricity in the area specified. In other words, the franchisee cannot by himself develop, install or maintain a distribution system falling under the purview of Section 2(19) of the Act. However, all auxiliary / incidental functions such as billing, collection, metering, and consumer services can be provided in respect of things which are not covered by the provisions of Section 42(1) read with Section 2(19)".

This matter was discussed in detail in view of provisions Section 42(1) read with 2(19) of the EA 2003 and broad consensus emerged that the Act does not allow DF to develop parallel or substantially different distribution system; however it does not prohibit capital expenditure by DF in maintaining, augmenting and upgrading existing distribution system as may be required to meet the growing need to perform his duties in an efficient and effective manner. Bombay High Court (Nagpur Branch), while rejecting the Writ Petition Nos. 3701 and 5855 of 2007 on appointment of distribution franchisee by MSEDCL in urban areas of Maharashtra, has observed that "..... That distribution licensee is entitled to appoint franchisee in an area under its license for the purpose of distribution of electricity on its behalf without obtaining a separate license has merit and".

JS (DS) put forth important features of SBD and comments received from various stakeholders for deliberations amongst the members. Members of the Sub-Group expressed their views on the subject. Details of discussion are as under:

1. **Tariff Indexation:** It was decided that suitable provision for tariff indexation for sharing of increase/decrease in revenue due to change in tariff and consumer mix between licensee and DF may be incorporated in SBD keeping in view the interests of both licensee as well as DF. The subtraction method being proposed in SBD and ratio method as adopted by MSEDCL were discussed amongst the members of the Group in detail and it was decided that the method which is more beneficial to the utility may be adopted after analysing detailed calculations based on net effect on revenue sharing. MD, MSEDCL was requested to provide requisite data of Bhiwandi area for calculating the net effect on revenue sharing. It was also decided that the Annual Billing Rate ('ABR') for the base year should be finalised on the basis of third party pre-audit before inviting bids for DF and should be clearly indicated in the bid document.

2. **Qualification of Bidders and Bidding by Consortium:** The matter was discussed in detail and it was decided that technical qualification should be based on only number of consumers to be handled in the area proposed to be franchised and may not include criteria of experience in particular sector to foster greater competition. Further, it was also decided that bidding by consortium should not be allowed keeping in view the possibilities of disputes amongst various parties of consortium and other complexities involved in handling contracts with consortium. MD, MSEDCL mentioned that the financial capabilities of the bidders are important keeping in view the nature of functions to be performed by DF. It was decided that the net worth of the bidder should be more than 50% of the expected annual revenue in first year from the area proposed to be franchised. Similarly annual cash accruals should be more than 25% of the expected annual revenue in first year. It was also decided that escrow arrangement on at least 90% of the amount receivable in revenue account of DF is necessary to safeguard payments to be made by DF to licensee and to avoid any possibilities of siphoning of funds by DF. It was also made clear by the Sub-Group that all bidders, who qualify to the prescribed technical qualification, should be treated at par while evaluating the financial bid. No preference on account of better technical qualification should be given to any of the bidders in any manner in any case whatsoever. It was decided to amend SBD accordingly.

3. **Minimum Benchmark Rates:** After detailed deliberations, the consensus emerged that Minimum Benchmark Rates on year to year basis should be suitably specified in the bidding documents by the licensee and the bidders should not be allowed to quote their bid below the specified Minimum Benchmark Rates. This would safeguard the minimum expectations of the licensee and also prevent front/back loading of bid price during the contract period. MD, MSEDCL mentioned that while working out minimum benchmark rates, they have considered loss reduction up to 15% within 5 years and the same be prescribed in proposed 'SBD'. Some of the members were of the view that the recommendations of the Abraham Committee may be adopted. After deliberations, it was decided that flexibility may be provided to utility in this regard.

4. **AT&C Loss Reduction Trajectory:** Keeping in view the decision taken by the Sub-Group on minimum benchmark rates as indicated above at point (3), specific provision for loss reduction

trajectory is not required as expected loss reduction will be factored in the minimum benchmark rates to be indicated by the utility in bid document and bidders will not be allowed to quote below the benchmark rates.

5. **Procurement of Additional Power :** Sub-Group was of the view that the proposed arrangement in proposed SBD are adequate to cover this issue.

6. **Other Issues:**

(i) One of the members suggested incorporating incentive scheme for promoting energy efficiency. It was decided that a separate incentive scheme is not necessary as the proposed model does not prohibit better and effective demand side management including promotion of energy efficiency. Further, the Sub-Group was of the view that the proposed model should be as simple as possible.

(ii) MD, MSEDCL raised the issue of renewal/extension of contract on expiry of contract period with DF. Sub-Group was of the view that the licensee should rebid for DF on expiry of contract period.

(iii) MD, MSEDCL also raised the issue of value added services from the distribution system like advertising etc. Sub-Group was of the view that such possibilities can be explored at the discretion of utility as separate commercial agreement independent of this agreement.

(iv) It was decided that suitable provision for granting DF the right to mortgage the assets to be created by DF during the contract period should be made in SBD to facilitate financing of capital expenditure to be made by DF during the contract period. Though DF will be the owner of the assets created by him during the contract period, specific provision as suggested above by the Sub-Group shall be incorporated in SBD.

7. The meeting ended with the observation that the report of the Sub-Group may be finalised based on above discussions.

8. The meeting ended with vote of thanks to chair.

**Brief of initiatives taken by Distribution Franchisees in Nagpur and Aurangabad
Power Utility Management System**

- (i) Consumer Information System (CIS): It is an online module with snapshot of a consumer with complete details from the consumer address to current bill payment including connection details, current & past bills, charges, meter details.
- (ii) Consumer Complaints Management System: This includes the complaints related to power, bills, meters, payments till the closure of the complaints.
- (iii) Consumer Request Management System: This includes the request for new connection under door to door service to increase load, duplicate bills, etc.
- (iv) Meter Management System: It is used by meter installation team for installation of meter under new service connection and replacement of meters for existing consumers for cases like faulty meter, burnt meter, etc.
- (v) Vigilance System: It is used by the team that does the inspection of all types of meters, right from the functioning to detection of theft.
- (vi) Theft Management System: The system is used once the consumer is found in theft and booked under various section like 126, 135, 138 etc as per the Electricity Act 2003. The module takes care of the system generated assessment to FIR, compounding etc.
- vii) Internal Grievance Redressal Cell (IGRC): It is a module which keeps track of consumer grievances. The cell acts as an independent body to meet the consumers, do hearings, and issue orders.
- (viii) Outage Management System: The module keeps track of the existing outages (planned/unplanned) in Live mode and work done on these outages. The module also helps call center to answer the consumer queries from the areas affected by outages. Faults are also recorded to the component level under various categories such as 33 KV, 11KV, LT circuit or DT Center.
- (ix) Management Dashboard & MIS: It shows MIS report for various systems along with the snapshot for senior management in the form of dashboard for complete system.
- (x) Energy Accounting and Audit: The feeder energy is being noted every hour in the online system that can be used for doing energy accounting and auditing of the system.
- (xi) Call Center System: Equipped with state of the art technology such as ACD, IVR, CRM for effective handling of the call center.

**Extract of the judgment of the Hon'ble Bombay High Court
(Nagpur Bench)**

“44.It is no doubt true that Section 5 deals with national policy on electrification and local distribution in rural area. However, the said provisions cannot be considered in isolation without taking into consideration the provisions of Sections 2(27), 2(49), 3 and 14 of the Act of 2003. Section 3(4) of the Act of 2003 requires Central Electricity Authority to frame a national electricity plan once in five years and Clause 4.0 of the National Electricity Policy deals with issues required to be addressed by the National Electricity Policy. One of the issues is distribution of electricity. Section 5 of the Act of 2003 requires Central Government to formulate a national policy in consultation with the State Government and the State Commission for rural electrification in addition to the National Electricity Policy as contemplated under Section 3(1) of the Act of 2003. However, that does not take away the power of the respondent No. 2 (distribution licensee) to allot franchise in urban area.

45. Section 2(27) of the Act of 2003 stipulates that franchise means a person authorised by a distribution licensee to distribute electricity on its behalf in a particular area within his area of supply. Person as defined under Section 2(49) of the Act of 2003 includes any company or body corporate or association or body of individuals, whether incorporated or not, or artificial juridical person. A licensee, who has licence to distribute electricity under seventh proviso to Section 14 of the Act of 2003, is entitled to appoint another person for the purpose of distribution of electricity on its behalf and such person shall not be required to obtain any separate licence from the concerned State Commission for such distribution of electricity on behalf of the licensee. The contention canvassed by learned Additional Solicitor General of India that conjoint reading of Section 2(27), 2(49) and seventh proviso to Section 14 of the Act of 2003 demonstrates that distribution licensee is entitled to appoint franchisee in an area under its licence for the purpose of distribution of electricity on its behalf without obtaining a separate licence has merit and, therefore, contention canvassed by the learned Counsel for the petitioners that concept of appointment of franchisee is limited to rural area in reference to Section 5 of the Act is misconceived and hence, rejected.

46. Similarly, the provisions of Section 181 of the Act of 2003 deal with powers of the State Commission to make regulations and to issue notification consistent with the Act of 2003 and the rules to carry out the provisions of the Act. In view of provisions of Section 181 of the Act of 2003, the State Commission has framed Maharashtra Electricity Regulatory Commission (General Conditions for Distribution Licensee) Regulations, 2006. Regulation 8.3.7 empowers the distribution licensee to appoint franchisees to distribute and/or supply electricity in a particular area within his area in accordance with the provisions of the Act as well as Rules and Regulations made thereunder or orders issued thereunder. Similarly, policy advice to the Government of Maharashtra under Section 86(2) of the Act of 2003 though on distributed generation based electricity distribution franchisee shows that allotment of franchisee of electricity is done with the primary object of facilitating reduction of distribution losses

and improvement in collection efficiency. The different provisions under the Act of 2003 are expected to result in improving efficiency and reliability of electricity supply to all parts of the country. It further stipulates that the franchise agreement will primarily be governed by the terms agreed between licensee and franchisee and the franchisee will be required to supply electricity as per tariff approved by the Commission. Similarly, it also shows that private sector participation in distribution to reduce transmission and distribution losses and improving services to the customers is the object of allotting distribution franchise for distributing electricity, which is consistent with the National Electricity Policy of 2005. In the instant case, the act of respondent No. 2 in appointing respondent No. 4 as distribution franchisee is consistent with the aims and objects of the National Electricity Policy and in view of provisions of Section 2(27), 2(49) read with Section 14 of the Act of 2003 does not suffer from lack of power.

47. We want to express that due to globalisation, the socioeconomic and political scenario of our country have been considerably widened and electricity being an essential requirement for all facets of our life, it has been recognised as a basic need. Supply of electricity at reasonable rate to all parts of the country is, therefore, necessary for overall development. Equally important is availability of reliable and quality power at competitive rates to Indian industry to make it globally competitive and to enable it to exploit the tremendous potential of employment generation. Considering these aspects and as per mandate of Section 3 of the Act of 2003, the Central Government has framed National Electricity Policy of 2005 and in order to achieve aims and objectives of the said Policy, private sector participation in distribution needs to be encouraged for achieving requisite reduction in transmission and distribution losses and improving the quality of service to the consumers. This aspect is enumerated in Clause 5.4.4 of the National Electricity Policy. Clause 5.4.7 of the National Electricity Policy contemplates that one of the key provisions of the Act on competition in distribution is the concept of multiple licensees in the same area of supply through their independent distribution systems. The State Government has full flexibility in carving out distribution zones while restructuring the Government utilities. This clause further stipulates that Government of India would notify the requirements for compliance by applicant for second and subsequent distribution licence as envisaged in Section 14 of the Act of 2003. With a view to provide benefits of competition to all sections of consumers, second and subsequent licensee for distribution in the same area shall have obligation to supply to all consumers in accordance with provisions of Section 43 of the Act of 2003. The State Electricity Regulatory Commissions are required to regulate the tariff including connection charges to be recovered by a distribution licensee under the provisions of the Act, which will ensure that second distribution licensee does not resort to cherry picking by demanding unreasonable connection charges from consumers. It is, therefore, evident that in changing political, economic and social environment, there is an urgent need to improve generation, transmission and distribution of electricity in a manner, which is more cost effective and reliable and, therefore, National Electricity Policy evolved by the Central Government has encouraged and promoted private sector participation in distribution for reducing transmission and distribution losses and improving quality of services to the customers.

48. Similarly, under Section 82 of the Act of 2003, it is mandatory for every State to constitute a Commission to be known as Electricity Regulatory Commission for the purpose of giving advice to the State Government in the matters of promotion of competition, efficiency and economy in the field of electricity industry, promotion of investment in electricity industry and re-organization and restructuring of electricity industry in the State. Similarly, Commission also needs to give advice to the State in the matters regarding generation, transmission, distribution and trading of electricity as well as any other matters referred to it by the State Government. The State of Maharashtra, therefore, constituted Maharashtra Electricity Regulatory Commission for this purpose. The contention of the learned Counsel for the petitioners that the Maharashtra Electricity Regulatory Commission has strongly recommended for appointment of distributed generation based electricity distribution franchisee for the entire State of Maharashtra and not allotment of franchise for distribution of electricity, in our view, is misconceived. Under Section 86(2) of the Act of 2003, it is the job of the Commission to give advice to the State Government on the above referred matters. One of them is generation of electricity and, therefore, policy advice given on the issue of generation of electricity by the Commission to the Government of Maharashtra is in the form of recommendation in the field of generation and, therefore, it cannot be either construed or interpreted that policy of appointing franchisee for distribution of electricity by the distribution licensee is against the policy advice given by the Commission to the Government of Maharashtra nor there is any material placed on record to show that it is inconsistent with the provisions of the Act of 2003 or National Electricity Policy. On the other hand, on conjoint reading of provisions of Section 2(27), 2(49) and seventh proviso to Section 14 of the Act of 2003, it is implicitly clear that distribution licensee is legally competent to appoint a franchisee in the area under its licence and such franchisee does not have to obtain a separate licence and, therefore, appointment of distribution franchisee by the respondent No. 2 for the three Divisions of Nagpur Urban Circle for distribution of electricity, in our view, is consistent with the provisions of Act of 2003 as well as National Electricity Policy."

Annexure-XI of Annex-VIII

No. 20/16/2010-APDRP
Government of India
Ministry of Power

Shram Shakti Bhavan, Rafi Marg, New Delhi 110001
Tele No. 23705957
Date: March 14th, 2011

To
Member (Energy)
Planning Commission
Yojana Bhavan
New Delhi

Sir,

Please refer to the Minutes of the Round Table on Private Participation in Distribution of Electricity held under the Chairmanship of Deputy Chairman, Planning Commission on 4.1.2011.

2. Para 4 of the Minutes mentions that “Analysing the Franchisee Model adopted by few States, Adviser to Deputy Chairman stated that this model is essentially a sub-contract for discharging the O&M obligations of the Discoms and is sought to be covered under the 7th proviso of Section 14 of the Electricity Act, 2003 which is not meant for such cases. This would cause a regulatory gap because even though the franchisee is distributing electricity, it is not regulated by the SERC and is accountable to the Discom alone. This is also inconsistent with Section 12 & 13 of the Act.”

3. The considered view of the Ministry of Power in this matter is that this is an erroneous interpretation of the law. Section 12 defines inter alia 'Distribution' as one of the licensed activities and provides that only the person authorized by license under section 14 or exempt under section 13 can perform such licensed activities.

The argument that the concept of Distribution Franchisee (DF) defined under Section 2(27) of the Act is consistent with section 12 and 13 because it is neither authorized by licence to distribute under section 14 nor exempt under section 13 is fallacious. There are 9 provisos to Section 14 and they are part of the Electricity Act. Therefore 7th proviso, providing for distribution franchisee is very much part of the Electricity Act. For that matter, proviso 8, exempting provision of license for generation and distribution of electricity area is also part of Electricity Act. If we consider proviso 7 to be inconsistent with Section 12 & 13 of the Act, proviso 8 should also be considered inconsistent with the Act, which is not tenable. Section 14 not only provides for authorization/grant of license but also makes several exemptions in

provisos. Section 14 needs to be read harmoniously with these exemptions/provisos. Proviso 7 of Section 14 clearly provides that DISCOM can choose to distribute through DF. This proviso read with section 2(27) is very much in consonance with section 12 of the Act.

4. It is also brought to your kind attention that various initiatives taken under the reforms in the power sector like unbundling of utilities are also based on the 3rd proviso of Section 14 and Section 131 of the Electricity Act, 2003. Moreover, under Rajiv Gandhi Grameen Vidyutikaran Yojana (RGGVY), which is one of the flagship programmes of the Ministry of Power and approved by the Cabinet, establishment of the distribution franchisee in rural areas is a mandatory condition.

5. Accordingly, the view of the Ministry of Power is that the argument that distribution franchisee is not consistent with Section 12 & 13 of the Electricity Act, 2003 is not correct. This may please be taken on record.

Sd/-

(Ramesh Chand)

Under Secretary to the Govt. of India

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