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Government of India

Report of the Sub-Group on

Public Private Partnership in the Distribution of Electricity

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Preface

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 this shortage, the distribution utilities are forced to buy power at high rates from unregulated producers and traders. These purchases have added to the financial distress of a large number of distribution utilities in the recent years, virtually forcing them to the brink of bankruptcy. 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.

A Task Force on Private Participation in the Power Distribution Sector was constituted under the chairmanship of Member (Power), Planning Commission, 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. The Task Force, in turn, constituted two Sub-Groups to examine and evolve the frameworks for Public-Private Partnership (PPP) and Franchisee models respectively. This volume carries the Report of the Sub-Group on PPP in the Distribution of Electricity.

The proposed Public Private Partnership (PPP) Model in the distribution of electricity encompasses all functions and obligations relating to distribution of electricity in a 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. The objective would be to ensure zero power cuts, reduced T&D 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.

After detailed deliberations, the Task Force on Private Participation in the Power Distribution Sector supported the PPP Model and recommended its adoption by the States. The Report of the Sub-Group on the PPP model is being published to disseminate its salient features with a view to encouraging its adoption by the States.

Gajendra Haldea
Adviser to Deputy Chairman
Planning Commission

April 14, 2012
New Delhi

List of Abbreviations

AT&C	Aggregate Technical and Commercial
DBFOT	Design, Build, Finance, Operate and Transfer
Discoms	Distribution Companies
IDFC	Infrastructure Development Finance Company
MCA	Model Concession Agreement
NDPL	North Delhi Power Limited
PPA	Power Purchase Agreement
PPP	Public Private Partnership
SERC	State Electricity Regulatory Commission
T&D	Transmission and Distribution
UERC	Uttaranchal Electricity Regulatory Commission
VGF	Viability Gap Funding
WPI	Wholesale Price Index

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 Viability Gap Funding (VGF) and identification of cities and towns where Aggregate Technical and Commercial (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 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 Operation and Maintenance (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 also reflect 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 to10 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. The concessionaire would utilize the assets during the concession period 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 State Electricity Regulatory Commission (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 licencee 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 support by the State Government. The level of these subsidies may not exceed the present burden being borne directly or indirectly by the Government. This would imply that the 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 change 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 upgrading 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 a 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 Saving 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-I

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

Yojana Bhavan, New Delhi
Dated, the 09 November 2010

OFFICE MEMORANDUM

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

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)

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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

ANNEX-II

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 licnesee 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.