APP Comments on Draft GERC (Multi Year Tariff) Regulations, 2021

The Commission has proposed to introduce major changes in terms of RoE, Additional Power Purchase, Income tax etc., many of which seem to be contrary to either the EA, 2003, Tariff Policy or Regulations of CERC / other State Electricity Regulatory Commissions.

Some of these changes go against the fundamental doctrine of Regulatory Certainty, which is envisaged under the Electricity Act. Existing investments have been made based on the doctrine of Regulatory Certainty and hence any major changes against this fundamental principle would impact existing investments significantly. The impact of Tariff Regulations on the Generators/licensees and general investor sentiment is not just limited to the Control Period but continues for much beyond it.

Further, some of the proposed provisions in the draft document extend into the realm of micro-management. For example, proposed provisions asking Generators / Licensees to submit DPR with BOM, Lenders Term Sheet, Contractors Details for in-principle approval, constituting Capex Progress Monitoring Group and periodic review etc., amounts to taking on the role of managing business rather than regulating it.

Investment sentiment in our power sector is already at historical lows and this sentiment has been further battered and bruised by the ravages of the COVID-19 pandemic.

In this backdrop, considering that the draft Regulations are substantially different from the existing Regulations and also not in line with the National Tariff Policy or certain judgements of APTEL or the Regulations of the Hon'ble Central Commission or other State Commissions, we humbly submit that the draft Regulations may be reconsidered as it will significantly affect investor sentiment.

Given its history of being a progressive Regulator, we are confident that the Hon'ble GERC will see merit in our submissions and address these concerns in its final regulations.

With this background, our comments on important aspects of the Draft Regulations are provided on the following pages.

Summary of key changes proposed:

Clause No/ Proposal in Draft Regulation		Suggestions
2(1)	**Accounting Statement (Additional Certification)** Reconciliation Statement, duly certified by the statutory auditors, showing the accounting statement under Indian Accounting standard (IND AS) and Generally Accounting Accepted Principles (GAAP) for reconciliation between the total expenses, revenue, assets and liabilities, of the entity as per financial statement and Regulatory format.	• Such Reconciliation certificate is uncalled for as Auditor is not the authority to interpret Regulations and certify the data furnished in Petition Format. Further, Petitioner is required to submit data and reconciliation with the Accounts on Affidavit. Petitioner is responsible for submission of data and Commission is the sole authority to interpret and decide in accordance with Regulations. Even if utility demands for such certification, Auditor will qualify that Utility is responsible for preparation of such formats. • Neither CERC/any other State Commission has asked for such Auditors' certification for reconciliation in terms of IND AS and GAAP as per Regulatory Format. • Therefore, it is suggested to remove the provision for submission of such certification from Auditor.
2(19)	**Change in law impact in O&M Expense** GERC has proposed to disallow change in taxes / duties in O&M Expenses though it is allowed in capital cost	• For O&M Expense, Utilities operate based on established practices for supplies and services. Similar to the impact on supply and services in capital cost, there is no control for additional impact of change in law. • Such provision of giving different treatment of same item under Capital Expenses and O&M Expenses is contrary to the principles of justice. Therefore, we humbly request to remove the provision for such

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<tr><td></td><td></td><td>disallowance of changes in taxes/ duties in O&M Expenses else it may lead to under-recovery.
• We suggest amending the proposed clause and allow change in law impact even in O&M Expenses.</td></tr>
<tr><td>21.6
(c)</td><td>Carrying Cost
GERC has continued with existing provision of Carrying cost allowing it at simple average interest rate of SBI MCLR (1-year).
For Gap, it is mandatory to provide Documentary proof whereas for Surplus, there is no such requirement.</td><td>• APTEL has clearly held that Gap/ Surplus is derived based on Revenue and Expense which are approved by the State Commissions based on audited accounts during Truing up exercise. Hence, such resultant derivation need not be required to be substantiated with documentary proof. Therefore, continuing with such provision is contrary to the settled principle by APTEL.
• Also, in catena of judgments of Supreme Court/ APTEL, it is held that Carrying cost has to be reimbursed on the principle of time value of money. Accordingly, CERC or any other SERCs do not ask for such documentary evidence to allow carrying cost. Therefore, we suggest to remove such requirement of seeking documentary evidences.
• As regard Rate of Interest for Carrying cost, APTEL has observed that rate for carrying cost has to be short term working capital interest rate. Therefore, while framing Regulation, such clear observations by APTEL should be considered. Even CERC has specified Bank Rate i.e. SBI Base rate + 350 basis points for delayed payments.
• Even otherwise, lending rate for Utilities depends upon number of factors and is always higher than the</td></tr>
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		MCLR. MCLR is only a reference rate for bank below which it cannot lend. • Hence, **we suggest to consider carrying cost at rate of 1 year MCLR + 350 basis points in line with CERC Regulations**.
24	**Sharing of Gains & Losses for Performance Parameters** Proposed Regulations provide for sharing of Gains of performance parameters between utility & Consumers in the ratio of 1:1 and losses in the ratio of 2:1. Existing Regulations provides that both gains and losses are to be shared in the same ratio of 2:1 between utility & consumers.	• At present, sharing of gains and losses is in the ratio of 2:1 between licensee and customers. The Generating Companies/ Utilities in the State have achieved comparatively superior performance than other States. • Further, GERC has kept on improving the norms and very little margin is left for further improvement. Once the desired level of efficiency is achieved, it cannot be improved further. It is not correct to penalize the performing utility by raising the efficiency bar, which is also contrary to the provisions of the Tariff Policy. • Even after tightening of norms, the proposed change of sharing gains Regulations further provides for inequitable sharing i.e. gains to be retained one half portion whereas losses 2/3rd portion. • Such revision in percentage is contrary to the intent and penalizing the performing utilities. In fact, in State like Gujarat, the Commission should encourage the Generating Companies/ Utilities to maintain higher level of performance. Therefore, there is a need to design an incentive mechanism for maintaining the performance level instead of reducing the existing incentive

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		• Hence, we **suggest that existing ratio of sharing of gains & losses in ratio of 2:1 between utility and consumers is continued and mechanism for incentivizing Utilities to maintain existing level of performance may also be introduced**.
33.2	**Sharing of Gains & Losses for variation in capitalization** For variation in capitalization, it is proposed that gains due to saving in Capex is to be passed on as rebate whereas losses due to increase in Capex is to be shared as decided by GERC on case to case basis.	• The Regulation provides for prudence check of capital cost and not allowing any time/ cost overrun due to reason attributed to Generating Companies/ Licensees. Under the circumstances, it is incorrect on part of GERC to introduce uncertainty for Utility about the treatment of losses due to increase in Capital cost for the reasons not attributable to Utility. • It may be appreciated that any project is subjected to variation in capex due to number of reasons such as difference in actual contract price as against cost estimate, changes made in the Scheme during execution based on development/ issues being faced etc. All these factors are beyond control of the Utility. • Hence, there is no reason to adopt different method for sharing of gains & losses in case of variation in Capitalization. Such a provision results in Regulatory uncertainty. Hence, **it is required to be clarified to the Utility that entire losses due to variation in capitalization will also be passed on to the beneficiaries on the line of gains**.
33, 48, 69, 93,	**Capital Investment Plan** GERC has introduced concept of DPR requiring details such as supplier/ contractors, material details/	• As pointed out in the preamble, the new provisions is completely opposite to the principle of "less Government and more governance". It is observed that existing Regulations were simpler yet effective in dealing with any capex proposal. Therefore, there

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100, A-III	cost, identified lenders, term sheet of financing agencies etc. A detailed Guidelines for Capital Investment Schemes in included which mainly focuses on procedural aspects and compliance. Introduced new concept of reducing capital cost for the Assets 'Not in use' at any point of time during useful life after COD. Brought in discrepancy in treatment of gains and losses for variation in Capitalization even though it is beyond control of the Licensees.	is no such requirement to bring in new set of norms and complicate / delay the process. • Further, proposal of mandating project monitoring group to review/ track progress is akin to managing functions of the Generating Companies/ Utilities instead of regulating it and also contradictory to the scheme of Electricity Act and amounts to micro-management. • It seems that mandates of the entire guidelines will not only delay the process but also increase the expenses. It will make it impossible for utilities to carry out their business activities efficiently. • Till date, the Commission has been carrying out Prudence Check of capital cost but the proposed methodology amounts to managing the business of Utility which is uncalled for. • Further, for Utilities, Capital work has to be planned considering number of factors such as long term demand growth, planning to ensure Universal Service Obligation, dealing with issues of availability of land/ corridors in developing areas, Statutory approvals etc. However, the Guidelines provides for approval only for 1-3 years. Also, unlike generating/ transmission projects, Capex scheme in Distribution has to be dynamic to take care of actual growth as against anticipated growth at the time of approval. If it is sacrosanct, it may prove to be inefficient in terms of cost and time. Therefore, the whole set of criteria introduced to ensure timelines may actually prove to be counter-productive.

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		• Further, Details of Contract/ suppliers, Identified source of Financing, Draw down schedule, Rate of interest etc. are finalized post approval and hence providing such details at DPR stage is impossible. • Further, the scheme of Electricity Act does not provide for separate approval process for Capital cost apart from determination of tariff. • Based on above, we are of the opinion that the proposal is neither in the interest of Generating Companies / Utilities nor the end customers and therefore, **proposed guidelines for Capex approval should be dropped**.
36.2	**Debt: Equity Ratio** Submission of Board Resolution for infusion of equity through Internal Accruals.	• Utility is required to submit the Accounting / Financial Statement duly certified by the Statutory Auditors of the Company. Hence, **there is no need for such additional certification**.
37	**Return on Equity** The Commission has proposed to reduce base ROE from 14% to 13% for Generation 13.5% for distribution and introduced concept of performance linked Additional RoE at 1% and 0.5% for Generation/Transmission and Distribution respectively. This Additional ROE shall be allowed during true-up. Further, the equity	• At the outset, we would like to submit that impact of these proposals is not limited only in terms of reduction in RoE but will have larger impact in terms of credit rating of the Generating Companies/ Licensees which will indirectly increase the tariff further. • We understand that RoE allowed by GERC i.e. 14% for Generation, Transmission and Distribution is already lowest in the Country. Therefore, further reduction in base RoE and making balance part of RoE variable is uncalled for. • It is pertinent to note that the Judgment of the Hon’ble Supreme Court in the Civil Appeal Nos. 5399-5400 of 2016 dated 11.04.2017 (the Energy

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<tr><td></td><td>base of the existing asset is proposed to be reduced after completion of normative loan. For additional CAPEX except change in law and environment norms, reduced rate of RoE in terms of weighted average rate of loans is proposed.</td><td>Watchdog Case) held that even a letter issued by the Government Instrumentality has force of Law. Therefore, Tariff Policy enacted under the Electricity Act, 2003 has force of Law and mandatory upon the Regulatory Commissions. Tariff Policy clearly stipulates the State Commissions to <u>adopt</u> the RoE prescribed by CERC for Generation and Transmission. Therefore, there is no discretion available with GERC but to follow the same. For Distribution, the discretion available is only to the extent of appreciating the risk involved in the Distribution Business. Therefore, it is imperative that for Distribution, GERC is required to consider RoE greater than 15.5%.
It may be appreciated that GERC is required to adopt RoE prescribed by CERC in letter and spirit. Even after considering ROE of 15.5%, if we consider impact of reduction of equity base by depreciation once the normative loan is completed, effective rate of RoE will be below 15.5% which is not allowed. Therefore, we also request GERC to remove the provision of reducing equity base by depreciation.
It may be appreciated that equity does not earn Return during construction period. Therefore, considering time value of money, RoE even at 14% would be effectively lower than 14%. Hence, further reducing it to weighted average rate of loan is not justified.
Further, differentiating Capital expenditure in terms of after cut-off date within or outside original scope of work, is also not provided in Act/ Tariff Policy. Further, such additional capitalization</td></tr>
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		is admitted/approved only if it is reasonable and after prudence check by the Commission. Also, Investments which were already a part of original scope of work of the projects, sometimes get capitalised after cut-off date due to reasons beyond the developer's control. However, such capex is also eligible for same rate of ROE instead of giving returns at weighted average Interest rate. • Hence, it is suggested to make necessary amendments in the proposed Regulations as detailed hereinabove to ensure earning of legitimate RoE.
38	**Interest and finance charges** Draft Regulations propose to cap the rate of interest for new loans after 31.03.2021 based on market conditions.	• Interest rate is governed not only based on market conditions but also based on credit rating. Generating Companies/ Utilities do not have any control over such rate. Reduction on RoE coupled with such cap on interest rate would have cascading effect on the credit rating which will impact the existing loans and consequently the tariff for end consumers. • We would like to draw attention of the Commission on the Interest rates notified by REC and PFC which clearly demonstrates that rate of interest is inter alia dependent on credit rating apart from other factors. Hence, it is clear that capping of interest rate for new loans is not in the interest of Generating Companies/ Utilities and end consumers. • In any case, Generating Companies/ Utility always try to get lower interest rate as it helps in reducing its overall cost. Also, the Commission can demand justification in case, it finds the rate of interest rate higher. We also understand that no Commission in the country/ CERC, has any such provision.

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		Therefore, we suggest to **drop the provision of capping Interest rates for new loans.**
39.2 (c)	**Depreciation** GERC has proposed Auditor certificate for capping depreciation at 90% of the allowable capital cost.	• There is no need for such requirement for separate certification of capping depreciation at 90% of capital cost. Such declaration is always a part of Notes to Accounts and hence redundant.
41	**Tax on Income** GERC has proposed grossing up of the RoE with applicable Tax rate. Additionally, GERC proposed to cap Income tax upto actual.	• While grossing up RoE with applicable tax rate, it takes care of Income tax only for that particular year. However, the Utility will be required to pay tax on the deferred revenue recovered in a particular year along with carrying cost. • Grossing up of RoE as a concept is acceptable in case there is no deferment of revenue by Regulatory Commission as Utilities will not incur additional expense. • Hence, it is legitimate that Utility is compensated for factors not within its control i.e. deferment of revenue by Commission. • In order to remove such anomaly, we suggest to remove the ceiling of actual tax paid. Further, we **suggest that along with grossing up additional tax at the effective tax rate should be allowed on the amount of carrying cost**.
99.7	**Approval of Additional Procurement** Draft proposes prior approval of estimated variation beyond 5% in	• The Power Purchase cost is neither under control of Utility nor can it be anticipated as it depends upon the various uncontrollable factors. Further, the fixed / capacity charges are also determined by the

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	power procurement rate or quantum for the quarter though same is from approved sources.	appropriate Commission in accordance with the provisions of the Act. • We **suggest to delete this clause from Regulation**.