

Testing the Waters

UT discom privatisation could serve as a model for the states

In a key announcement made as part of the economic stimulus package last month, the central government has proposed the privatisation of power distribution companies in the union territories (UTs). The move, if implemented well, could serve as a model that can be emulated by the states to improve efficiency and address the segment's long-standing problems. Industry experts share their views on the impact of this decision on the power distribution segment. Excerpts...

Do you think the government's decision to privatise discoms in UTs is a welcome move?

Devtosh Chaturvedi

The government's decision to privatise the power departments of UTs is a move in the right direction. Apart from the obvious benefits of better consumer service and operational efficiency, this will be an ideal confidence booster, providing multiple successful case studies of private sector participation in the sector.

Amit Kapur

It is a welcome step for various reasons. First of all, it is in line with the policy underlying the Electricity Act, 2003 as well as the National Electricity Policy and the Tariff Policy. There are limitations on government (centre and state) spending as the governments are under significant pressure in the era of economic slowdown compounded by Covid-19. At this juncture, when the government is looking at fundamental structural reforms (Electricity Amendment Bill, revision to Tariff Policy, etc.) to restore the creditworthiness of the power

sector, inviting private sector participation is a timely measure. Besides getting private capital, the move will promote efficiency gains and delink operations from the political economy, due to which India loses an average of Rs 1.10-Rs 1.20 per unit of electricity generated and supplied across India. It is also a good idea to introduce this at the UT level since UTs are centrally administered and relatively smaller in terms of geographical size and investment needs. Once successful, this may encourage some of the states to open up areas for private sector participation.

Jayant Kawale

I would certainly welcome the move to privatise discoms in UTs. Many of them, except the newly formed UTs in the erstwhile state of Jammu & Kashmir (J&K), are small and manageable, and do not have the complications of significant agricultural loads, always a difficult consumer mix to handle in a privatised scenario. Such geographies could serve as a very good testing ground for replication elsewhere.

Ajay Mahajan

The power distribution segment has long been the Achilles heel in the power sector value chain of India. While the power generation and transmission segments have made rapid strides in the past 10-15 years, the distribution segment continued to lag behind, driven largely because of by political intervention, high aggregate technical and commercial (AT&C) losses, the absence of cost-reflective tariffs, etc. While most of the private distribution licensees have shown strong operational performance in Delhi, Mumbai, Kolkata, Ahmedabad, etc., the state government-owned ones, barring a few, have failed miserably. In this context, the recent government announcement to privatise discoms in UTs is a welcome move. It is believed that privatisation will improve service levels for consumers as well as the operational and financial efficiency of distribution companies.

Sabyasachi Majumdar

The introduction of reforms in the power sector at the start of this millennium led to the enactment of the Electricity Act,



Devtosh Chaturvedi

CEO and Head,
Distribution, FEDCO



Amit Kapur

Joint Managing Partner,
J. Sagar Associates



Jayant Kawale

Former MD, RattanIndia
Power Limited



Ajay Mahajan

MD and CEO,
CARE Ratings



Sabyasachi Majumdar

Senior Vice-President and
Group Head, Corporate
Ratings, ICRA Limited

2003, and bifurcation of the state electricity boards on functional lines. This led to large-scale private sector investments in the generation segment, followed by the transmission segment. However, the ownership of the distribution segment remained largely with the state governments, except in a few urban pockets like Delhi, Mumbai and Ahmedabad. With persisting high operating inefficiencies, delays in the issuance of tariff orders by the regulators, inadequate tariff rates in relation to the cost structure, and delays in receiving subsidy payments from state governments, the distribution segment remained the weakest link in the sector. This in turn led to regular bailout schemes to support the state-owned distribution utilities, the last one being the Ujwal Discom Assurance Yojana (UDAY) in 2015. However, the improvement in the financial profile of discoms as envisaged under UDAY could not be achieved as the reduction in AT&C losses was lower than expected in many of the key states and tariff revisions remained inadequate. This in turn resulted in continued losses

for discoms, leading to further accumulation of payments to power generating companies, which stood at Rs 940 billion as of March 2020, as per data from the PRAAPTI dashboard.

The Government of India (GoI) recently announced liquidity support of Rs 900 billion for discoms in the form of loans against receivables from the Power Finance Corporation and REC Limited. While this would enable the discoms to clear the outstanding dues to the power generators, a sustainable improvement

in discom finances would require proactive efforts by discoms to improve their operating efficiency, and timely and cost-reflective tariff determination by the regulators.

In this context, the government announced its decision to privatise discoms in UTs that are under the control of the central government. This would certainly be positive for the sector as it is expected to bring in greater efficiency in the electricity distribution segment and improve the financial viability of discoms. Further, this is likely to improve the overall customer service experience. The privatisation of discoms in UTs will serve as a template for states, including the model to be adopted – public-private partnership or full privatisation, bidding process, qualifying criteria and bidding parameters. The benefits of privatisation in UTs may convince the pro-reform state governments to consider privatising the larger discoms in the states.

Biswadeep Parida

It is indeed a welcome step at the right time. The first distribution privatisation under the Electricity Act, 2003 has been successfully concluded with the sale of the Central Electricity Supply Utility (CESU) in Odisha, nearly two decades after Delhi's privatisation. Its success has piqued the interest of Indian players as well as investors in Asia and Europe. This decision aligns well with the government's economic growth agenda of active participation in the private sector.

Anil Razdan

It is a positive move and is a signal that the GoI is willing to move away from the SEB model of the state-owned power distribution system, after the strong entry of the private sector in the generation segment, and a limited one in the transmission segment. Personally, I would have preferred an ownership-agnostic power distribution system with a selection based solely on the criterion of efficient management. In actual practice, the scope of privatisation of discoms in UTs would be relatively limited. Delhi has already undergone privatisation while Chan-

digarh and Puducherry are efficiently managed state-owned distribution businesses. I do not know whether the GoI will succeed in privatising the distribution business in the Andaman & Nicobar Islands, Jammu & Kashmir and Ladakh in the near future. I wish they had given an indicative benchmark of AT&C losses in the electricity regulatory commissions (ERCs), warranting or necessitating a change in the failing or ailing discom as a country wide discom transition indicator. The onus of change lies squarely with the ERCs.

What will be the likely hurdles in implementing the move? What checks and balances should be in place to attract prospective bidders for these discoms?

Devtoosh Chaturvedi

The first stage of private sector participation in UTs is expected to get through with the right balance of participation. A couple of suggestions to make the process more balanced are:

- An institutional process of appointing experienced consultants will help create a balanced structure in the concessionaire agreement to ensure a win-win for both the power department and the private player.
- Audited baseline parameters are equally essential for private players to ascertain the accurate ground conditions.

Amit Kapur

The likely hurdles are bound to be concerns for the existing electricity utilities (employment and accountability issues), as well as regulatory concerns regarding sudden tariff hikes. Besides, bidder worries around risk allocation, given the deep political economy at the retail supply level, include past dues, unpaid subsidies and liabilities owed to gencos and transcos. The base case for privatising each UT will require a robust base case analysis of the current state of affairs, which must be shared with the citizens, consumers and potential bidders. Ideally, the Delhi model must be evaluated from the perspective of giving an assured and legally binding five-year transition path to steadily generate efficiency gains



Biswadeep Parida
Associate Director,
Power & Utilities, PwC



Anil Razdan
Former Secretary,
Ministry of Power

to address consumer and investor concerns, besides securing the rights of employees. This can also draw upon the regulatory sandbox.

Jayant Kawale

Some of the UTs are remote and geographically difficult places to handle. Each of them has its unique cultural, administrative and topographical peculiarities, and therefore a common model cannot be imposed on all of them, and each deserves a model tailored to its own characteristics, something that may not be appreciated by decision-makers as they may not have the required experience and exposure to these geographies. Instead of outright privatisation on a permanent basis, a beginning can be made with the various franchisee models that are available and working elsewhere in the country. After gaining experience, they can move to the next stage of privatisation.

Ajay Mahajan

One of the biggest hurdles in such privatisation initiatives pertains to employees, who fear retrenchment and change in their service conditions. The takeover of the liability of retirement benefits of the existing employees and retirees is also an obstacle. Another likely hurdle could be the subdued interest of investors given the small scale of opportunity with eight UTs, which account for only 2 per cent of overall revenue generated from electricity sale in the country. From the perspective of making privatisation an attractive proposition for bidders, the government will have to ensure that risks and rewards are adequately balanced and the deal is suitably sweetened to ensure strong participation in the privatisation process. The study of earlier privatisation initiatives reveals that the following points should be kept in mind by the administrators to make the exercise a win-win for all:

- Certainty regarding the regulatory environment in the area; multi-year tariffs (MYTs) have been a key feature of successful privatisation.
- Provision of support/safety net in initial operations for prospective investors.

- The concerns of employment and service conditions should be addressed.
- Terminal liabilities should be retained by UTs, giving the new investor a clean slate to start with.
- Accurate assessment of baseline data including AT&C losses for the area being bid, supported by third-party verification.

Sabyasachi Majumdar

The major hurdles in discom privatisation pertain to the political willingness of the state government, the resistance from the employees of state discoms and the treatment of outstanding liabilities. The employee unions of the state discoms resist privatisation efforts because of concerns over job security and continuation of benefits. Apart from convincing the employee unions, state government support will be required to control power theft and ensure timely release of subsidy payments. Also, the privatisation model should include enabling factors in the form of penalties through 'upfront performance' guarantees for non-compliance with targets for distribution losses and collection efficiency, and delays in filing of tariff petitions. This would ensure participation from serious players.

Biswadeep Parida

Each of the UTs under consideration has its unique characteristics and the privatisation model to be adopted has to be

different. Jammu & Kashmir is a border state, which is spread out, has high AT&C losses and needs investment for significant upgradation of infrastructure, whereas Dadra & Nagar Haveli, Daman & Diu and Chandigarh are contained urban areas with low AT&C losses and a favourable consumer mix. Island UTs consisting of several islands have their own challenges, pertaining to the consumer mix, sources of energy and the cost to serve. Puducherry being a UT with legislature may have different challenges. Some of the checks and balances that need to be in place are:

- A balanced risk-reward profile, uniquely designed for each distribution licensee on offer. The transaction structure and bidding parameters must be customised depending on its profile – sales and consumer mix, level of financial and operational losses, existing cost structure, etc.
- The functions of electricity generation, transmission and distribution with government departments should be unbundled and corporatised prior to privatisation. The need to integrate discom licences to achieve feasibility and scale in terms of revenue size, number of consumers and quantum of energy sale may be explored.
- Treatment of past liabilities, especially in the case of Jammu & Kashmir and Puducherry, needs careful consideration.
- The government should take stakeholder engagement measures to allay the concerns of employees and customers.
- Transitional financial support may be needed for managing the turnaround.
- Ensuring an active role of the regulator in the privatisation process, in accordance with business and investment plans and operational efficiency improvement commitments by private players.
- Ensuring only credible investors with suitable financial strength and past experience participate in utility operations and customer management.

Anil Razdan

The likely hurdles in implementing the



move could be a political fallout in the UTs and finding alternative employment for the existing distribution employees, unless the private entities are asked to deploy the existing employees on their rolls as a condition in the transition, which has precedents and should not be a hurdle. The pernicious regulatory assets and accumulated dues will have to be absorbed or resolved by the GoI so that the discoms can commence business on a clean slate. The existing physical assets, if pledged to financial institutions, will probably need to stay as such and the loans serviced by the discoms from the running of the business. An issue that is bound to arise is that of tariff subsidy. In my view, cross-subsidy by another section of consumers should be avoided or shunned. This makes the industry and other businesses non-competitive and unviable, and is a hindrance to enhancing job opportunities including the Make in India initiative, particularly in the context of international as well as interstate competitiveness. Subsidy should be given to deserving beneficiaries through direct benefit transfer from the concerned host government.

Alternatively, the subsidy portion of the tariff can be assigned and recovered directly from the host government in the tariff order of the ERCs. Consumers should be advised to go for prepaid meters unless they are willing to deposit at least two months' average billing as security deposit. It will be worthwhile not to allow any carving out of rural areas, or their separation from the discom, otherwise it will not serve as a replicable model in the states. The ERCs would be well advised to ask for a quarterly review of the financial and technical performance of discoms. Outages, interruptions and breakdowns in power supply to consumers should be penalised. The quality of supply to consumers has to be accorded high priority and enforced, so as to eliminate the installation of gensets and backup power, which is often a polluting and wasteful investment.

What lessons can it offer to states looking to

implement the privatisation model?

Devtosh Chaturvedi

The entire privatisation process has a dual-powered model set-up – the licensee and the distribution franchisee model. The real test of taking the present endeavour of UT privatisation to states will be private player participation in rural-urban areas. As of now, mostly all examples of privatisation are in urban-centric areas (except a few instances in Odisha, Meghalaya, Tripura). The real reforms required in discoms are in rural-centric areas, where losses and efficiencies are an area of concern.

Amit Kapur

As a wise man is credited with saying, "The proof of the pudding is in the eating." If successful, this move can be a complete game changer. It will offer a set of models (each UT may have a divergent model to choose from) not only for the privatisation of discoms but also for giving a boost to franchisees and sub-distribution licensee-based outsourcing of defined areas. That will increase benchmarking and competitive pressures, and improve efficiencies.

Jayant Kawale

States are not uniform in character within their geographies. Urban, semi-urban, industrial and rural areas are combined in one state jurisdiction. For private involvement to be successful, such areas need to be disaggregated into suitable units with uniform characteristics, which are easier to handle. Again, the path has been shown by the various franchisee arrangements implemented all over the country in smaller jurisdictions. We need to build upon that experience and allow successful franchisees to graduate to full-scale licensees.

Ajay Mahajan

Over the past 15 years, various privatisation models have been implemented, be it distribution licensee or input-based distribution franchisee. Each privatisation exercise has provided lessons, which can be modified/suited as states proceed along the privatisation journey.

It is believed that various public-private partnership (PPP) models will be further tested with the privatisation of discoms in these eight UTs. With improvement in operational efficiency and better customer service, as also evident from previous other privatisation initiatives, larger states will get confidence to undertake privatisation.

Sabyasachi Majumdar

The GoI has proposed significant reforms in the electricity distribution business through draft amendments to the National Tariff Policy and the Electricity Act including an emphasis on quality and reliability of supply by discoms, stricter operating norms, direct benefit transfer for subsidy payments and moving consumers from post-paid to prepaid. Given the less-than-satisfactory track record of discoms across most of the states over the past two decades, their privatisation would be crucial for the successful implementation of these reforms.

Biswadeep Parida

The success of the privatisation of discoms in UTs will attract the attention of stakeholders at the state level and build consensus around the various transaction frameworks that can be leveraged for their state discoms. It would also help the states in building trust and confidence with consumers and employees. The recent success of CESU privatisation in Odisha has generated a lot of interest among private investors in the subsequent sale process of three discoms in Odisha.

Anil Razdan

If the principles of a sagacious and robust distribution model based on the sound principles of business and equity are laid out in the UTs, it could serve as a replicable model of efficiency, financial viability and equity. The GoI could even attempt to launch the multiple-source power supply model for consumers in some areas to carry out a viability and competitiveness exercise as compared to the currently prevalent single-supplier model. This could test the waters and induce hot competition. ■