

Before the
MAHARASHTRA ELECTRICITY REGULATORY COMMISSION
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Case No. 33 of 2005

In the matter of
Government of Maharashtra Government Resolution dated 24th August 2004
in the matter of continuation of Mula-Pravara
Electric Co-operative Society (MPECS).

Dr Pramod Deo, Chairman
Shri A. Velayutham, Member
Shri S B Kulkarni, Member

ORDER

Dated: 16th December, 2005

The financial viability of continuation of the Mula Pravara Electric Co-operative Society Ltd (“MPECS”) as a licensee, ability to pay its dues to the Maharashtra State Electricity Board (“MSEB”), consequences for non-payment of dues and other related issues, had been the subject matter before the Hon’ble High Court of Judicature at Bombay at its Aurangabad Bench at Aurangabad and thereafter with the Nagpur Bench hearing W.P. No. 3399/2000. The Hon’ble Court was also seized with the matter of recovery of arrears by MSEB from its top-one hundred HT consumer-defaulters, which have accumulated over the years.

2. The Commission notes that, although, the Hon’ble High Court by Order dated 24th July 2002 (in W.P. No. 3399/2000) directed MSEB to submit to the Court the list of its top-one hundred HT consumer- defaulters and a status report of progress made by MSEB towards recovery of such arrears, MSEB were also directed to submit a list of electricity bills outstanding against public institutions which are discharging sovereign functions and dealing with health care and education including local bodies, essentially being those who depend on State Grants to make such payments. The High Court observed that such list was required so that the State could be called upon to discharge its obligation of releasing grants so that electricity supply to these institutions is not disconnected as it would effect the society at large as they will be deprived of basic and essential services for want of electricity.

3. Further, by Order dated 30th April, 2003 in W.P. No. 3403 of 2002, the Nagpur Bench of the Hon’ble High Court of Judicature at Bombay directed the State Government to examine the issues inter alia of functioning of MPECS and the ability to discharge its liabilities and take a decision in this regard, that is either :

- (1) *to revoke the license and take over MPECS and hand it over to MSEB; or*
- (2) *initiate a proceedings for liquidation of MPECS in accordance with the Maharashtra Co-operative Societies Act under which MPECS is registered; or*

(3) *to appoint the Maharashtra Electricity Regulatory Commission (“the Commission”) to examine as to whether MPECS should be allowed to continue its operation or whether it should be wound up and advise the State Government accordingly.*

4. The High Court also specifically directed the State Government to file an affidavit stating as to which option suggested by the Commission the State Government wants to exercise and what would be the reasons or otherwise the Government is not prepared to exercise any of the options. The High Court also directed the State Government to pay the bills of MPECS (which in turn the State could recover from MPECS) in case the State Government does not exercise any of the options suggested by the Commission.

5. The High Court recorded in its order dated 25th June 2003 in W.P. 3403 of 2002 that the State Government has filed an affidavit stating that, out of three options given by the Hon’ble High Court vide its order dated 30th April 2003, the State Government has taken a decision to seek advice of the Commission under section 22(2)(p) of the Electricity Regulatory Commissions, Act, 1998 as to whether the Society should be allowed to continue its operations or whether it should be wound up. The State Government had also stated in their affidavit that, after receiving recommendation of the Commission, the State Government shall decide the further line of action in the matter. Besides other observations, the Hon’ble High Court also observed that “... *the Government of Maharashtra has chosen the third option which indicates that, without making any commitment to liquidate huge arrears of energy bills it wants the Society to carry on its business at the cost of MSEB which will not be able to recover its arrears but is forced to continue supply of energy though the Society and Government of Maharashtra has not made any financial commitment even to pay current energy bill*”.

6. The Commission received a letter dated 6th June 2003 from the Government of Maharashtra requesting the Commission to examine as to whether and under what conditions MPECS should be allowed to continue its operations and to make recommendations to the Government in the matter and to submit its findings, advice and recommendations on the following:

“1) *Are the Society’s operations at least as efficient as, if not more efficient than those of MSEB in a comparable distribution area in term of T&D losses, collection efficiency, administrative and other costs, and level of service in terms of parameters such as transformer failure, response time in fuse calls, time taken to grant new connections, etc ?*

2) *In order to improve the Society’s viability, whether a time bound programme listing out specific milestones to be reached can be prescribed and made conditional for the continuation of its distribution licence as well as for support for Govt. and MSEB. If so, what would such a programme be ?*

3) *For various socio political reasons, it may not be possible for a licensee in a rural area to charge tariff higher than that of MSEB. If the Society’s operations are more efficient or can be made more efficient than MSEB’s, there would be a case for allowing the society to continue and for ensuring that if tariff for sale of power cannot be adjusted, at least the tariff for purchase of power by the Society should be a “viable” one. In such a case, what would be the viable bulk rate that MSEB should charge to the Society ? In this connection, the Commission may take into consideration the GR of 1999 which laid down principles for working out a viable tariff and may, if necessary, recommend a new formula for working out such a viable rate of bulk supply. The formula may also incorporate the improvement programme referred to in 2) above.*

4) *If the Commission comes to the conclusion that by taking over the distribution area of the Society, MSEB is likely to suffer the same level of losses or even increase its losses, would it be desirable to make such a viable bulk rate applicable for sale of electricity by MSEB to the Society ? In such a case, the subsidy to be paid by GOM to the Society would be limited to the difference between MERC rates for agricultural consumers and the rate at which MSEB is asked to sell power to these consumers. If the Commission comes to the conclusion that it would not be justifiable to impose such a viable bulk tariff on MSEB, what would be the extent of annual subsidy that would be required to sustain the Society ? In such a case, GOM would have to take a view as to whether it would undertake to provide this subsidy or to go for other two options suggested by the Hon. High Court”.*

7. Thereafter, the Commission vide its letter dated 27th January 2004, submitted to the State Government of Maharashtra a detailed Note containing the analysis, findings and recommendations of the Commission in respect of MPECS referred to the Commission by the Government. A summary of such analysis, findings and recommendations of the Commission are as under:

- a) MPECS's operations are more efficient than MSEB in comparable distribution areas on key performance and service parameters such as distribution losses, collection efficiency, average billing rates, consumer receivables, operation and maintenance costs, and distribution transformer rates.
- b) The Commission suggested a time bound improvement programme with components and milestones for establishing the sustained viability of MPECS. The Commission suggested that the GOM may consider providing capital subsidy for installation of decentralized energy supply systems based on local resources by MPECS to meet its demand which would enable self sufficiency and long term sustainability of its operations and reduce MPECS's dependance on GOM for revenue subsidies during the transition period.
- c) Being *prima facie* of the view that MPECS should continue to operate in its supply area, the Commission observed that there are three options that emerge. The three options were as follows:

(i) MPECS to continue as licensee with transparent direct subsidy arrangements.

The Commission would fix the “Fully Allocated Cost” (FAC) based Bulk Supply Tariff (BST) at which MSEB or its successor entities would supply electricity to MPECS. The Commission would also determine the “viable” BST on the surplus cash revenue available towards power purchase. The difference between the FAC – based BST determined by the Commission and the “viable tariff” would have to be paid by GOM as subsidy to MPECS, subject to the performance parameters laid down in the time bound programme for efficiency improvement. If MPECS purchases energy over and above the permissible limit of power purchase in any specified time period, then such purchases would be charged at FAC based BST by MSEB. Such additional costs would have to be borne and recovered by MPECS through future efficiency improvements. The Commission provided the estimate of requirement of subsidy from GOM to the order of Rs. 72 Crores per annum, expected to decline progressively.

(ii) MSEB to continue as licensee with creation of Regulatory Asset

MSEB would be directed to supply power at the “viable tariff” to MPECS to the extent of power purchase limit as may be stipulated. The gap between FAC-based BST and the viable tariff would be treated as a “Regulatory Asset” in the books of MSEB (or its successor entities), to be recovered over a period of time, from MPECS.

(iii) MPECS as a Management Contractor / Franchisee

However, the Commission recommended its preferred option and suggested continuing MPECS as only a management contractor rather than a licensee in its present area of supply as the most tenable alternative, after considering all factors, including the financial requirements from GOM and the efficiency advantages of MPECS. The Commission suggested that, subject to GOM verifying applicable legal provisions, all MPECS's assets would be transferred to MSEB in lieu of its current dues, and MPECS would be allowed to operate as a long-term management contractor to MSEB or its successor entities for electricity distribution after the State Government issues an enabling notification under the 8th proviso to Section 14 of the Electricity Act, 2003 notifying the rural area for generation and distribution consequent upon which the entities intending to operate in such area would be exempted from requiring a license. The Commission was of the finding that MPECS would be, thus, compensated as a management contractor and no BST fixation would be required.

8. Thereafter, the Government of Maharashtra issued Government Resolution (GR) No. Mula-Pravara/2004/P.K. 242/Urja-1 dated 24th August, 2004, (hereinafter referred to as "GOM-GR"), conveying its decision as under:

- a) *MPECS has been allowed to continue its operations as 'Distribution Licensee'.*
- b) *In order to improve its operations further, the MPECS will have to adhere to the time bound action plan as per key recommendations given by MERC and GOM shall extend requisite subsidy support till such time turn-around in operations of MPECS is achieved.*
- c) *The quantum of required revenue subsidy support is estimated to be around Rs 72 Crore per annum, which GOM shall provide to MSEB directly.*
- d) *In order to enable MPECS undertake time bound action plan as recommended by MERC and to undertake rural electrification works and other capital expenditure schemes, the GOM shall extend capital subsidy support to MPECS of around Rs 4 Crore per annum.*
- e) *Further, MSEB shall treat the past arrears from MPECS as 'Regulatory asset' in its books and not to charge any further interest on the past arrears henceforth. MSEB shall recover the said regulatory asset from MPECS upon turnaround of operations of MPECS.*

9. Thus, the Commission observes that the aforesaid GOM-GR emanated, firstly, pursuant to the Hon'ble High Court's Order dated 30th April, 2003 (which was initiated under Writ Petition: 3399/2000 filed by Grahak Panchayat, Nagpur) directing the Government of Maharashtra to exercise certain options required to examine issues inter alia of functioning of MPECS and the ability to discharge its liabilities and thereafter, the analysis, findings and recommendations of the Commission vide its letter dated 27th January 2004, upon request of the Government. Since, it was felt necessary in the interests of justice the Commission vide its letter dated 26th August, 2004 sought detailed comments from MSEB and MPECS on the decisions contained in the GOM-GR.

10. MPECS, vide its letter no. MPECS/MERC/4207/2004 dated 17th September 2004 (as reiterated vide their letter No. MPECS/Legal/1814/05 dated 10th June 2005) submitted their in-principle detailed comments on the various issues associated with the implementation of the said GOM-GR. MPECS submitted that the mechanism as proposed in the GOM-GR together with the conditions entails several regulatory issues that would require approval of the Commission. MPECS also requested that they be granted an opportunity to present their case and to provide additional information and clarifications since they were submitting their in-principle comments. MPECS also submitted that, while the Commission decides on the Annual Revenue Requirement ("ARR") and

determines Tariff as per the forthcoming (indicated filing by 13th June 2005) ARR and Tariff petitions for FY 2003–04, FY 2004–05 and FY 2005-06, being filed with the Commission uniform retail tariff philosophy and trajectory would need to be considered while ascertaining the level of subsidy requirement of MPECS and amortization of 'regulatory asset' by MSEB.

11. MPECS further submitted that the bulk supply tariff determination by the Commission (in line with multi-year tariff principles) for MSEB would have critical influence on the power purchase cost, determination of requirement of subsidy and hence long term viability of operations of MPECS rendering regulatory certainty (and not subjecting MPECS to tariff shocks). They submitted that the appropriate performance targets would require to be set by the Commission upon detailed scrutiny of submissions of MPECS including in the ARR and Tariff petitions. In relation to amortization of 'regulatory asset' MPECS submitted that this would be required to be in line with the long term tariff principles determined by the Commission.

12. MSEB, vide its letter no. PLE-AR-CO.OP/37471 dated 24th December 2004 submitted its comments on the GOM GR. Besides various submissions, MSEB submitted that they have moved the Government of Maharashtra for compensation to the tune of Rs. 222 crores on account of loss of revenue sustained by MSEB due to retrospective revision in tariff as was applicable to MPECS during the period April 1977 to April 2000. MSEB submitted that the decision of the State Government in respect of creation of 'regulatory asset' can be implemented only after the same is duly approved by the Commission. MSEB further submitted that they have requested the State Government to approach the Commission for necessary approval and direction to the State Government to review its decision about treating the arrears of MPECS as 'regulatory asset'.

13. The Commission vide its letter dated 27th April 2005, forwarded to the State Government a copy of MSEB's letter No. PLE-AR-Co-op/10885 dated 8th April, 2005 regarding recovery of arrears from MPECS and seeking a direction to the State Government and MPECS to pay the outstanding liabilities in a specified time limit, or else to appoint an administrator as per the provisions of Section 24 of the Act. The Commission requested the State Government to provide its comments/views in the matter, and also noting that the State Government's views on certain aspects of the GOM-GR was pending for long, as a result of which the hearing of the matter has had to be postponed on several occasions (5th January 2005, 15th February 2005, 13th April 2005, 25th April 2005, and 14th June 2005).

14. The Commission, finally held a hearing in the matter on 5th October, 2005. The following points emerge from the submission of various parties (MSEB, MPECS) and observations of the Commission:

15. Ms. Deepa Chavan, learned Counsel for MSEB, submitted that having directed financial assistance by revenue subsidy support (estimated to be around Rs 72 Crore per annum), and extend capital subsidy support to MPECS of around Rs 4 Crore per annum, it was contradictory that the State Government decided as under:

“Further, MSEB shall treat the past arrears from MPECS as ‘Regulatory asset’ in its books and not to charge any further interest on the past arrears henceforth. MSEB shall recover the said regulatory asset from MPECS upon turnaround of operations of MPECS.”

16. Counsel for MSEB also submitted that the Commission, in its analysis, findings and recommendations to the State Government did not recommend that 'regulatory asset' be created in terms of the past dues.

17. Shri. Balwant Joshi, from DTT (consultant to MPECS), submitted that the State Government being the sole shareholder of MSEB is entitled under law to direct MSEB to create 'regulatory asset' in its books of the past dues of MPECS and amortize the same over a period of time. Mr. Joshi also submitted that considering the requirement to evolve a "separate mechanism to discharge the past power purchase dues and accumulated losses of MPECS" suggested by the Commission at para 7.2 of its analysis, findings and recommendations to the State Government, there are only two ways of resolving the issue of recovery of past dues, viz., (i) creation of 'regulatory asset'; and (ii) direct subsidy provision by the Government to MSEB and writing off of all the dues of MPECS. He submitted that the Government has opted to direct MSEB to 'create regulatory asset' as one of the mechanism. He, however, submitted that instead of directing MSEB to 'create regulatory asset' the Government should have rather directed MSEB to approach the Commission for its approval to 'create regulatory asset'.

18. Ms. Chavan referred to an order passed by the Division Bench of the High Court at Bombay in MERC Appeal No.s 4 to 6 of 2002 in the case of MSEB vs. the Commission, wherein the High Court observed that 'regulatory asset' should be created only as an exception with a direction to the Commission to consider the creation of one time 'regulatory asset'. She also refuted the statement that State Government being the sole shareholder can direct MSEB in this regard. She also refuted the statement that State Government being the sole shareholder can direct MSEB in this regard.

19. During the hearing, Shri P.B. Patil, Deputy Secretary, GoM submitted that the State Government vide its said GOM-GR, keeping in mind arrears due to MSEB, has opted for continuation of MPECS as a licensee by providing transparent subsidy mechanism subject to the condition as prescribed by the Commission for efficiency improvement of MPECS. In addition, he submitted that the State Government had also decided to treat the arrears payable by MPECS to MSEB as 'Regulatory Asset'.

20. Upon an enquiry by the Commission, on whether the GOM-GR can be binding to the extent it deals with the issues in the regulatory domain. Shri Patil submitted that the process to remedy the said GR through Cabinet approval has been initiated and would require some time.

21. In the above circumstances, the Commission is of the view that the functions of the Commission under sub-sections (1) and (2) of section 86 of the Act are distinct and the GOM-GR would not be operative as regards creation of 'regulatory asset'.

22. The Commission hereby advises the State Government to expedite the process to remedy the said GOM-GR as submitted by Shri P. B. Patil, Deputy Secretary, in view of the above observations of the Commission.

Sd/-
(S.B. Kulkarni)
Member

Sd/-
(A. Velayutham)
Member

Sd/-
(Dr. Pramod Deo)
Chairman

Secretary, MERC