

**Before the
MAHARASHTRA ELECTRICITY REGULATORY COMMISSION
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CASE No. 123 of 2016

In the matter of

**Miscellaneous Application of Maharashtra Electricity Distribution Co. Ltd. in its MYT
Petition (Case No. 48 of 2016) for revision of the Operation & Maintenance Expense
norms**

Coram

**Shri. Azeez M. Khan, Member
Shri. Deepak Lad, Member**

Maharashtra State Electricity Distribution Co. Ltd.

Petitioner

Appearance

For the Petitioner:

Shri. Satish Chavan (Rep)
Shri. Milind Digraaskar (Rep)

Consumer Representatives:

Shri. Prasad Kokil, CMIA

ORDER

Dated: 23 October, 2017

1. The Maharashtra State Electricity Distribution Co. Ltd. (MSEDCL) filed a Miscellaneous Application on 20 September, 2016 in its Multi Year Tariff (MYT) Petition filed in Case No. 48 of 2016. Since the public consultation process on MYT Petition had been completed when MSEDCL filed this Application, it has been registered as a separate Case.

2. MSEDCL's prayers are as follows:

- a) *"To admit the Misc. Application as per the provisions of Regulation 101 and 102 of the MERC (MYT) Regulations 2015;*
- b) *To consider the submissions made by the Applicant and consider the same positively while deciding the MYT Petition in Case No. 48 of 2016;*
- c) *To expedite the matter at the earliest;*
- d) *To modify the MYT Regulations, 2015 to the extent applicable for MSEDCL for determination of O&M Expenses so as to cover the expenditure as submitted under Para 3.3;*
- e) *To allow the O&M Expenses for third Control Period considering realistic trend as proposed by MSEDCL in its MYT Petition in Case No. 48 of 2016..."*

3. MSEDCL's Application is summarized as follows:

- 3.1. On 7 June 2016, MSEDCL has filed its revised MYT Petition in Case No. 48 of 2016 in which it has sought tariff revision for the Third Control Period, i.e. FY 2016-17 to FY 2019-20.
- 3.2. The Commission notified its MYT Regulations, 2015 on 8 December, 2015. The norms for calculation of Operation and Maintenance (O&M) Expenses have been significantly changed in the new MYT Regulations, 2015 as compared to the previous MYT Regulations. They also differ from the O&M norms proposed specified in the Draft MYT Regulations, 2015.
- 3.3. As per the revised norms in the MYT Regulations, 2015, the escalation factor for the O&M Expenses calculation is based on 60% weightage for the point to point inflation over Wholesale Price Index (WPI) in the previous year and 40% weightage for the actual Consumer Price Index (CPI) for Industrial Workers (all India) in the previous year, as reduced by an efficiency factor of 1%. This works out to 2.76% based on the parameters of FY 2014-15.
- 3.4. This provision in the MYT Regulations, 2015 does not capture the expenditure that is required to be incurred due to increase in activities. The base figure for calculating escalation is fixed irrespective of natural growth in sales, consumers and network (Gross Fixed Assets (GFA)), etc.
- 3.5. The provision for O&M Expenses as per the earlier MYT Regulations, 2011 permitted recovery on the basis of wheeled energy, consumer base and opening GFA.

This principle is applicable at present also, and must be the factor for deciding the base for the respective years.

- 3.6. The WPI/CPI methodology provided in the MYT Regulations, 2015 covers the aspects of inflation/deflation only. This norm does not consider the increase in consumer base which necessitates increase in the number of offices, sales and distribution network, i.e. GFA. Such norms based on WPI/CPI are suitable for stable networks or for Licensees whose boundaries are not expanding such as the Mumbai Licensees. In Mumbai, the number of consumers is increasing within the selected Distribution area, whereas MSEDCL has been extending supply to remote uncovered areas also and strengthening its network and presence in hitherto scantily covered areas. Through various Schemes, it has been intensifying electrification in scantily covered area as well as reaching new uncovered areas.
- 3.7. Moreover, employee cost constitutes around 75% of the total O&M Expenses. Employee Expenses do not escalate at a lower rate worked out as per the norms specified in the MYT Regulations, 2015. Rather, they increase periodically related to Pay Commission Reports applicable to Government Employees. Therefore, this important aspect also needs to be considered while deciding the norms.
- 3.8. As per the methodology prescribed by the Commission, the O&M Expenses for the base year works out to Rs. 5786 crore, which is lower than the approved O&M Expenses approved for FY 2015-16, i.e. Rs. 6712 crore. The base figure of O&M Expenses for FY 2015-16 is required to be retained at least equal to the approved figures of Rs. 6712 crore for FY 2015-16 before applying the escalation.
- 3.9. As per the MYT Regulations, 2015 for calculation of O&M Expenses, the permissible YoY rise for year 2016-17 will be only 2.76% over the base year (FY 2015-16) Expenses, whereas there is a historical trend of increase in O&M Expenses by 16% to 27% due to increase in number of consumers, increase in distribution infrastructure and increase in sales.
- 3.10. Methodology/procedure notified in the MYT Regulations, 2015 will lead to projection of O&M Expenses which is much lower for the Control Period due to lower inflation factor/ index. Considering past trends and inflationary indices, an increase of 2.76% per annum will lead to under-estimation which may not be realistic and will become impossible for MSEDCL to sustain.
- 3.11. Employee Expenses are linked only to CPI and Administration and General (A & G) Expenses are linked only to WPI. Therefore, 100% CPI for Employee Expenses and 100% WPI for A & G Expenses should be considered. The average of CPI and WPI can be considered only for Repairs and Maintenance (R&M) Expenses.

However, the Commission has linked CPI and WPI for the entire O&M Expenses. This will result in lower recovery compared to actual escalation.

3.12. O&M Expenses being a controllable cost, any variation will add a financial burden for no fault of MSEDCL. Considering the increase in number of consumers, sales and distribution infrastructure, the O&M Expenses are bound to increase. The reduced O&M Expense norm imposes severe restrictions on the O&M works and adversely impact the quality of power supply and consumer services.

3.13. Therefore, the Commission may not apply the provisions of the MYT Regulations, 2015 to the extent of determination of O&M Expenses based on norms for MSEDCL. The Commission may allow O&M Expenses based on the historical trends and considering the increase in sales, number of offices, distribution infrastructure and such other parameters.

3.14. The Commission is vested with sufficient powers to deal with the matter and issue orders as deemed appropriate. Therefore, the Commission may approve the O&M Expenses considering the realistic trend as proposed by MSEDCL in its MYT Petition as below:

(Rs. Crore)

<u>Ensuing Years</u>	<u>FY 2016-17</u>	<u>FY 2017-18</u>	<u>FY 2018-19</u>	<u>FY 2019-20</u>
Projected O&M Expenses	7,388	8,192	9,410	10,394

3.15. The above projections of O&M Expenses have already been published in the Public Notice and were a part of the Public Hearing proceedings of the MYT Petition in Case No. 48 of 2016. These Expenses are absolutely necessary for the operations of MSEDCL and have been projected at a reasonable level and, therefore, may be considered sympathetically.

3.16. The Public Hearings on the MYT Petition are over and the final Order is expected very soon. Considering the urgency and the significant impact on MSEDCL, the Commission may expedite the matter.

4. Chamber of Marathwada Industries and Agriculture (CMIA), an Authorised Institutional Consumer Representative, vide its letter dated 7 January, 2017, has stated as follows:

4.1. The Commission pronounced the MYT Order in Case No. 48 of 2016 on 3 November, 2016. Hence, the present Petition has become infructuous and may be dismissed on this ground.

- 4.2. Employee Expenses and R&M Expenses increased abnormally from FY 2012-13. A&G Expenses steeply increased from FY 2013-14. During this period, the MYT Regulations, 2011 were in force, which had higher norms of O&M Expenses. Taking advantage of these norms, MSEDCL increased its O&M Expenses steeply without caring to achieve efficiency.
- 4.3. MSEDCL spends thousands of crores on capital expenditure schemes. The O& M Expenses should be reduced as a result of implementing these Schemes. However, the standards of service and quality of supply have deteriorated. The burdens of these Schemes are born by consumers. Imposing the further burden of abnormal increase in O&M Expenses and capital expenditure Schemes on the consumers is unreasonable.
- 4.4. In its MYT Order, the Commission calculated O&M Expenses as per the MYT Regulations, 2015, which are reasonable and correct. MSEDCL has to improve its efficiency and derive benefits from its Capital Expenditure Schemes.
5. At the hearing held on 12 January, 2017:
- 5.1. MSEDCL stated that:
- a. The present Miscellaneous Application has been filed in the MYT Petition (Case No. 48 of 2016) for modification in the MYT Regulations, 2015 so as to allow the O&M Expenses as projected in the MYT Petition. The Application was filed on 19 September, 2016, when the Commission had completed the Public Hearing process on the MYT Petition of MSEDCL. During the pendency of the present Application, the Commission has issued the MYT Order on 3 November, 2016. MSEDCL has also filed a Petition seeking review of the MYT Order on various issues, including O&M Expenses.
 - b. To a query of the Commission, MSEDCL stated that it is limiting the present Application to the prayer for modifying/amending the provisions relating to O&M Expenses in the MYT Regulations, 2015.
 - c. The norms for calculation of O&M Expenses in the MYT Regulations, 2015 are different from the norms in the earlier Regulations of 2011. They also differ from the O&M norms specified in the draft MYT Regulations, 2015 which were published for public consultation.
 - d. The MYT Regulations, 2015 do not give any weightage to growing consumer base, sales and network expansion. WPI/CPI methodology provided in the MYT Regulations, 2015 covers the aspects of inflation/deflation only.

- e. As per the methodology specified in the MYT Regulations, 2015, the O&M Expenses of MSEDCL for the base year work out to Rs. 5786 crores, which is lower than the O&M Expenses approved for FY 2015-16, i.e. Rs. 6712 crore. Further, the permissible YoY rise in O&M Expenses for FY 2016-17 will be only 2.76% over the base year (FY 2015-16) Expenses, whereas the historical trend of increase in O&M Expenses is much higher. Based on these Regulations, the Commission, in its MYT Order, has approved the O&M Expenses for FY 2016-17 to FY 2019-20. In that Order, the O&M Expenses approved for FY 2019-20 are Rs. 6455 crore, which is lower than approved for FY 2015-16. This is contrary to the accepted notion that O&M Expenses would increase over time.
 - f. Employee Expenses contribute 75% of the total O&M Expenses. The next pay revision for MSEDCL's employees is due in FY 2017-18. MSEDCL would not be able to meet its increased Employee Expenses with the lower O&M Expenses approved in the MYT Order. Being a Government Utility, it is very difficult for MSEDCL to make any drastic reduction in Employee Expenses.
 - g. O&M Expenses being a controllable parameter under the Regulations, any increase will add a financial burden on MSEDCL. The lower O&M Expenses allowed will take a toll on the quality of power supply and services to consumers.
 - h. Therefore, the provisions relating to O&M Expenses in the MYT Regulations, 2015 need to be modified.
- 5.2. CMIA stated that the MYT Order has been issued after a a due public consultation process, and hence this Application should be dismissed as infructuous. Moreover, the Employee Expenses of MSEDCL are increasing continuously whereas the quality of service is deteriorating. Increase in Employee Expenses needs to be controlled so that there is no impact on consumers.

Commission's Analysis and Ruling

6. **This Application was filed by MSEDCL in its MYT Petition in Case No. 48 of 2016 for supporting its claim for O&M Expenses as well as for amendment to the MYT Regulations, 2015, after the public consultation process was over. Thereafter, the MYT Order was issued on 3 November, 2016. Hence, at the hearing held on this Application on 12 January, 2017, MSEDCL stated that it is limiting its prayer to amendment of the provisions relating to O&M Expenses in the MYT Regulations, 2015.**

7. In the MYT Order of MSEDCL, the Commission had recognized the issues arising from the low inflation factor resulting from the normative provisions of the MYT Regulations, 2015. Hence, the Commission had invoked its power to remove difficulties and had modified the norms in their application to MSEDCL as follows:

“The Commission has analysed the WPI and CPI data for the previous year FY 2015-16. By applying 60% weightage to WPI and 40% weightage to CPI for FY 2015-16, the inflation factor works out to 0.74%. After applying the efficiency factor of 1%, the escalation factor for projecting O&M Expenses from FY 2016-17 works out to (-) 0.26%.

The Commission recognises that the escalation rates based on actual WPI and CPI have reduced significantly during the last two years as compared to previous years. It may not be appropriate to apply this negative inflation factor for projecting the O&M Expenses from FY 2016-17 onwards as some such Expenses are likely to increase on a year-to-year basis. The Commission also notes that, for the O&M Expenses for its Tariff Regulations, 2014, the CERC considered the escalation rate computed based on the 5-year average WPI and CPI from FY 2008-09 to FY 2012-13 applying 60% and 40% weightage, respectively, and compared these with the actual increase in O&M Expenses.

The inflation factor based on the provisions of the MYT Regulations, 2015 is negative due to the reduction in WPI in FY 2015-16 over FY 2014-15. The Commission is of the view that it would be more appropriate at this stage to apply the WPI and CPI variation over a period longer than a year so that wide fluctuations in any particular year are smoothed. Hence, the Commission has applied the three-year average variation in WPI and CPI to arrive at the inflation factor for projecting the O&M Expenses from FY 2016-17 onwards.

Based on this approach, the inflation factor considering 60% and 40% weightage to WPI and CPI, respectively, works out to 3.97%. After applying the efficiency factor of 1%, the escalation factor to be considered for projecting O&M Expenses from FY 2016-17 to FY 2019-20 would be 2.97%. Hence, in exercise of its powers under Regulation 102 of the MYT Regulations, 2015 to remove difficulties, the Commission has computed the O&M Expenses for FY 2016-17 to FY 2019-20 applying an escalation factor of 2.97% considering the three-year instead of one-year average variation in WPI and CPI.”

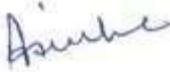
8. A similar dispensation was provided in the MYT Orders of other Licensees also. However, even thereafter, MSEDCL and other Licensees have formally approached the Commission for further relaxation or modification of the O&M Expense norms and an increase in the O&M Expenses allowed.

9. The Commission is of the view that reasonable O&M Expenses should be allowed to the Distribution and other Licensees. The Commission notes the anomalous situation in which, even with the relaxed dispensation and higher escalation factor of 2.97% (consisting of the modified inflation index as adjusted by the efficiency factor) allowed in the MYT Order of MSEDCL, for instance, the O&M Expenses approved for FY 2019-20 (Rs. 6455 crore) are lower than the level approved for FY 2015-16 (Rs. 6533 crore).
10. The weightage of 40% to CPI and 60% to WPI specified in the MYT Regulations, 2015 is based on the Tariff Regulations of the Central Electricity Regulatory Commission (CERC), though the CERC has considered a 5-year average as against one year in the MYT Regulations, 2015. However, considering the issues raised by MSEDCL and other Licensees, the Commission is of the prima facie view that these weightages and certain other stipulations may require to be revisited depending on the characteristics of generation, transmission and distribution activities. The Commission is separately considering the need to amend the MYT Regulations, 2015 suitably, in which case MSEDCL and others would have the opportunity to provide comments during the public consultation process.

The Application of Maharashtra State Electricity Distribution Co. Ltd. in Case No. 123 of 2016 stands disposed of accordingly.

Sd/-
(Deepak Lad)
Member

Sd/-
(Azeez M. Khan)
Member


(Ashwani Kumar Sinha)
Secretary

