

For the kind attention of:

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## Comments to MERC on the Draft Maharashtra Electricity Regulatory Commission (Multi Year Tariff) Regulations, 2024

### Background

We want to thank the Maharashtra Electricity Regulatory Commission (MERC) for this opportunity to comment on the Draft MERC Multi-Year Tariff Regulations, issued on March 7, 2024, which apply to licensees in generation, transmission, distribution, and retail supply.

The regulations are very comprehensive and cover a gamut of issues associated with determining Annual Revenue Requirement (ARR). We commend the MERC for developing these regulations and appreciate the chance to contribute the Regulatory Assistance Project's (RAP's) insights to advance this effort.

Our interest is solely to provide assistance to the MERC and Maharashtra state power sector decision-makers as you seek, through reform and regulation of the country's electricity systems, to make it more efficient, achieve important public policy goals, and to contribute to serving the public good in India. We trust that you will find our observations below to be objective, independent, and tailored to support MERC's guidance.

RAP wishes to offer some general comments and some specific comments on the draft regulations, plus some suggestions on the reforms articulated, as follows:

### **GENERAL COMMENTS**

- 1) The proposed regulations appear to cover only elements associated with determining the ARR. There is no discussion on Cost Allocation and Rate Design elements in determining tariffs as they seem to be covered in a different set of regulations. While determining the ARR is the first step, how the ARR would be allocated among service classes and then how tariffs in each service class are determined are the next two steps.

The cost allocation and rate design steps would be informed by cost allocation (embedded and marginal cost) studies, and these studies should be updated periodically to help design tariffs to increase efficiency. While determining the ARR is an important first step, Cost Allocation and Rate Design are also very important to increase efficiency in the sector.

- 2) Some elements of Performance Based Regulation (PBR) are specified in the proposed regulations and that is helpful to motivate the utilities to perform more efficiently and to provide better service. However, there are other elements missing, especially those associated with promoting clean energy goals, that MERC should consider, as further discussed below. This is critically important to harmonize the State process with the goals to promote clean energy resources. The incentives used for evaluating performance on various metrics are generally positive only and there should be consideration of penalties as well for failure to meet the goals/targets. In some cases, efficiency gains achieved by utilities are completely passed back to customers, without any sharing of the gains, thus potentially negating the incentive to the utility to be more efficient.
- 3) The proposed regulations, while thorough, due to their sometimes prescriptive nature, may also not allow the utilities to be innovative, as further discussed below. It appears many of the parameters have been decided by the regulator *a priori*, rather than requiring the utility to make proposals and justify them. This relieves the utility of its duty to study and make proposals on those parameters; it puts the burden unfairly on the regulator. This could also lead to the perception of the regulator micro managing the utility.
- 4) The MERC recognizes the value of getting public input in making decisions on the tariffs. There could be a significantly increased component of public involvement as discussed further below.

## **SPECIFIC COMMENTS**

- 1) **Revenue Decoupling Mechanism:** There are provisions associated with true ups associated with expense items including capital and Operation & Maintenance (O&M). However, there is no discussion associated with revenue variations. If a DISCOM loses sales because of implementing energy efficiency (EE) measures or promoting rooftop solar (RTS), it will be understandably reluctant to implement said measures as loss of sales will generally result in reduction of the utility's profits. In such a scenario, MERC can remove this disincentive by making the DISCOM *whole* for resulting losses through the implementation of a Revenue

Decoupling Mechanism (RDM) that removes the link between sales and profits. It should be noted that an RDM removes this disincentive but does not create a positive incentive in its place. A DISCOM's actual sales may be less or more than forecasts at the time tariffs are set for several reasons including economic factors, weather, implementation of energy efficiency or RTS etc., and a comprehensive RDM removes the risk to the utility from factors outside of its control. This would allow the DISCOM to be more receptive to promoting clean energy programs. In addition to an RDM, the DISCOM would still need further positive incentives to promote clean energy programs, as discussed further below.

- 2) DISCOM O&M Expenses: The regulations specify the level of O&M expenses a DISCOM is entitled to. For example, in Section 92.2, the O&M expense allowance for MSEDCL is specified as 8.2% of average Gross Fixed Assets (GFA) for FY 26, gradually decreasing to 7.87% for FY 30. While this norm can be used as a benchmark check, it is not clear if it should be the sole factor to be relied upon in determining the optimal level of O&M expenses a DISCOM should be entitled to. The MERC should ask a DISCOM to propose its O&M plan and a proposed budget for the tariff period for its review. The sole reliance on using the GFA as a yardstick could potentially incentivize the DISCOM to increase the level of GFA, notwithstanding the MERC scrutiny of the GFA. Further, there could be slippage in the GFA, especially in the outer years, given the uncertainty in forecasting capex out into the future.

The regulation, Section 92.6, does specify that any underspending on O&M expenses will be returned to the customers. While this will prevent any undue windfall to the DISCOM, it also removes any incentive for the utility to be efficient and productive to cut costs (without sacrificing quality of service). Further, Section 92.5 allows for additional O&M expenses beyond the norm for "system automation, new technology and IT implementation, etc." Allowing additional costs associated with implementing new tools to improve efficiency is good and should lead to lower O&M costs, all else equal. Considering these factors, MERC may want to rely on a more extensive scrutiny of the DISCOM's O&M budget by having a utility file one to begin with rather than simply relying on the GFA yardstick. Further, to motivate DISCOM to be more efficient and reduce O&M costs that would ultimately inure to the benefit of customers in the long run, MERC may also want to consider some sharing of savings between customers and utilities, if the savings result from DISCOM productivity and efficiency actions.

- 3) Performance Linked Incentives: Section 123 of the proposed regulations describes the incentives tied to MSLDC performance on Key Performance Indicators (KPI). The categories span the categories of Stakeholder Satisfaction, Financial Prudence, Learning Growth, and Internal Process.

While these are good, the MERC may want to consider additional KPIs, especially those associated with achieving clean energy goals. Given India's ambitious goals for clean energy, it would only be fitting for the DISCOMs to play their role in promoting energy efficiency, demand response, distributed energy resources (DER). As the DISCOM is the closest to the customer, it has the wherewithal to affect customer behavior, and to reduce current barriers for the entry of DERs<sup>1</sup>. It should be noted that many customers are already investing in equipment behind the meter to become more efficient, reduce energy consumption and to generally reduce polluting emissions. These could be harnessed by the DISCOMs to optimize their system if they are motivated through regulatory actions. There are immense benefits of cost savings, increased innovation, pollution reduction and improved customer satisfaction to be gained with the implementation of these clean energy initiatives. MERC should consider KPIs to motivate utilities to promote such clean energy goals.

Another aspect MERC should consider is in the area of economic dispatch. In line with the KPI proposed for RLDC by CERC in the draft fees and charge regulation is "Optimization of scheduling inter-alia through SCED and Running SCUC for State entity generating stations." MERC should consider the incorporation of provisions for SCED and SCUC as KPIs, in page 195 of part J of the proposed regulations.

- 4) Performance linked incentives for Generators: Sections 50.2, 50.3 and 50.4 describe the way Capacity charges are to be paid during peak hours and non peak hours, providing incentives for generators to be available along the year, while target availability is set in sections 46.1 and 46.2.

Given the fact that MERC has published the Draft MERC Framework for Resource Adequacy Regulations, the publication of both regulations provides a significant opportunity to align generators incentives with the needs of the power system regarding Resource Adequacy, in particular in the time of operation. The RA regulations require the measurement of peak demand during the 250 most critical hours of the system in order to measure the peak capacity needs of the state, which is on our opinion a step in the right direction. Nonetheless, under the

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<sup>1</sup> For illustration, see the KPIs and incentives for DISCOMs used by New York electric utility regulator for promoting clean energy goals. There is significant detail on the design of each Earnings Adjustment Mechanism (EAM) metric provided in the NY Public Service Commission (NYPSC) regulatory documents (See Appendix 23 in the Joint Proposal<sup>6</sup> filed with the NYPSC on October 16, 2019 in Case 19-E-0065). <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={8DFF975D-C514-41C8-8E31-82C33318D898}>

proposed draft of the Multi- Year Tariff regulations, the capacity charges paid to generators are spread during the whole year, including during peak hours (1460 hours per year) and non-peak hours. We suggest to seize the opportunity to align incentives provided to generators to be available during the operation time by increasing the share of the revenue that would be earned during the 250 critical hours, and to reduce or eliminate the revenue paid in periods where there is enough capacity in the system, either seasonally or daily. There are many ways in which this can be done, including ex-post assessments of availability at the end of the year, or ex ante calls for the system operator depending on the forecast of the system conditions. We would be happy to develop this point further if this is of MERC's interest.

- 5) Capital Expenditures: Section 22.5 requires utilities to submit capital expenditures projections based on realistic expectations. If utilities spend more than 10% beyond their budget, those expenditures would be subject to further scrutiny by the regulator. Similarly, if utilities delay projects, they need to explain the rationale to the regulator. It also specifies that only assets 'used and useful' should be in the asset base subject to the application of return and depreciation. This is good practice.

Section 23.3 also provides the criteria for regulatory assessment of prudence of the capital spending including "scrutiny of the reasonableness of the capital expenditure, financing plan including the choice and manner of funding, interest during construction, use of efficient technology, cost over-run and time over-run, and such other matters as may be considered appropriate by the Commission." These criteria are helpful. However, we recommend the Commission also consider the deployment of a 'Non-Wires Alternative' (NWA) concept for the DISCOMs as an additional measure. Essentially, non-wires alternatives (energy efficiency, demand response, storage, distributed generation etc.) deployed in a portfolio manner can meet the same reliability needs of the DISCOM in a more cost effective and cleaner fashion than deploying traditional wires solutions. While NWAs may not work throughout a utility system for all its needs, they will work in certain areas to meet certain needs. DISCOMs should be required to look affirmatively to deploy NWA solutions where cost effective and report to the Commission their analysis. This approach will lead to lower consumer costs, cleaner environment, and better customer satisfaction<sup>2</sup>.

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<sup>2</sup> For illustration, see the NWA approach used by Con Edison utility. <https://cdne-dcxprod-sitecore.azureedge.net/-/media/files/coned/documents/business-partners/business-opportunities/non-wires/webinar.pdf?rev=0397f8e8f22f419981b2959ba210cd5a>

The section also appears to include an asymmetric of sharing of losses and gains. Any gains would be returned to the customer and losses would be shared between the customer and the utility. While this appears appealing, it should be noted that if all gains are taken away from the utility, the motivation to be efficient is being removed. If there is a way to assess whether the gains are due to efficiency of the utility, there could be some sharing of the gains with the utilities.

Section 25 discusses how consumer contributions, deposits and government subsidies will be addressed. Generally, it appears that utilities must deduct these amounts from the asset values as the utility is not footing the bill. While this is reasonable for customer deposits or any international donor funds, it is unclear whether the State/Central government subsidies should be deducted. First, by not including those amounts in the asset base, the true cost of the asset is not being reflected in the tariff, resulting in potential distortion in consumption. Second, the government is spending money in this sector at the expense of spending in another sector (education, health care etc.). There is an opportunity cost associated with the investment that should be recognized. It would be helpful to include in the tariffs an opportunity cost associated with such government subsidies.

- 6) Capital Structure: Section 26.1 provides a prescriptive capital structure of 70/30 Debt/Equity. Generally, the cost of debt is cheaper than the cost of equity. Utilities are relatively less risky and can carry more debt. However, the more leverage used in the capital structure, the higher the cost of equity. But using more equity, while reducing risk, could lead to higher costs to customers. It would be useful to conduct a study to identify an *optimal* capital structure that considers risk and cost and that minimizes cost to customers in the long run. The burden to conduct the study should be placed on the utility and to submit the study results to the regulator for its review.
- 7) Return on Equity (ROE): Section 28.1 specifies that the Return on Equity shall be allowed in two parts viz. Base Return on Equity, and Performance Linked Return on Equity linked to actual performance. It appears that the base return is specified as 11% for DISCOMs while the performance-based return is capped at 4.5% for a total of 15.5% annual ROE. Providing a performance-based return to motivate the utility to perform on criteria important to the regulator is a good practice.

Generally, return should be commensurate with the risk in investing in the asset/security. There are different models used in the utility industry to assess 'required rate of return on

equity,' including Capital Asset Pricing Model (CAPM), Discounted Cash Flow Model (DCF), Multi-Factor Model etc. Typically, the responsibility to assess the risk and the required return is placed on the utility. Regulators must review utility proposals and make decisions based on public interest.

- 8) Public Involvement: Section 14 states that the regulator has a six-month period in issuing Tariff Orders in response to petitions from utilities. The Commission will consider all suggestions and objections received from the public in determining its Tariff Orders. There is no explicit discussion as to how the public will be engaged in this process. Perhaps it is in a different set of regulations. It would be helpful for the Commission to articulate how it will engage the public. Ideally, the Commission should require the utilities to discuss their petitions in a public forum where the public can ask questions. Further, there should be an opportunity in the process for formal stakeholders to send information requests to the utilities to solicit clarifications of the petitions. There should also be funding made available for formal stakeholders (especially consumer groups) to allow them to hire expertise to evaluate utility petitions, so they can make more informed comments to the Commission.

We hope the comments above assist with finalization of the Draft MERC (Multi-Year Tariff Regulations).

Once more, we wish to applaud MERC for developing these critical regulations, and we lend our support to the reforms and advances articulated therein.

Thank you for this opportunity to comment. If we can be of further assistance, please don't hesitate to ask. We would be keen to collaborate with MERC on these and related matters.

Sincerely,  
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