PRESS RELEASE
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Graded tariff hikes, lower AT&C losses and optimisation of power purchase cost key to reducing the cost and revenue gap for discoms: ICRA

- ***Progress in issuance of tariff order improved post the General Elections with 22 out of 28 states issuing tariff orders at the end of July 2024***
- ***Outlook on power distribution segment remains Negative as losses continue to remain high in a few large states***

The performance of state-owned distribution utilities (discoms) remains constrained by inadequate tariffs relative to the cost of supply, higher-than-regulator-approved aggregate technical and commercial (AT&C) losses, and a considerable debt burden. Further, delays in realising payments from state government departments for power supply constrain the discom finances. Except for discoms in Gujarat, most state-owned discoms remain loss-making despite the recent reduction in AT&C losses. The all-India AT&C losses for state-owned discoms declined from 23.0% in FY2021 to 16.5% in FY2022 and further to 15.8% in FY2023 led by infrastructure upgrades and higher subsidy pay-out. Despite this progress, losses remain particularly high at over 20% for the discoms in Bihar, Jharkhand, Madhya Pradesh, Odisha and Uttar Pradesh. ICRA's outlook for the power distribution segment remains Negative amid limited tariff hikes and continued loss-making operations.

Commenting on the progress in issuance of tariff orders**, Vikram V, Vice President & Co-Group Head - Corporate Ratings, ICRA,** said: "*The tariff-determination process for state discoms has improved following the General Elections, with 22 of the 28 states issuing the orders for FY2025 as of July 2024 against only 11 states as of May 2024. However, the tariff hikes remain modest with a median rise of 1.7% for FY2025, lower than the 2.5% approved for FY2024. Despite an uptrend in tariff hikes in a few states in recent years, discoms continue to incur losses due to increase in power purchase costs, operating inefficiencies in a few large states, and a high debt burden. The median 5-year CAGR for power purchase cost was over 5.0% for the period leading up to FY2023, whereas the increase in tariffs has been lower."*

The median-approved power purchase cost (PPC) for FY2025 by the state electricity regulators in 13 key states stood at Rs. 5.4 per unit against the actual median PPC of Rs. 5.7 per unit in FY2023, which increased from Rs. 5.0 per unit in FY2022. The PPC for FY2023 increased across the states and remained higher than approved, driven by increased dependence on imported coal amid elevated global coal prices and a rise in tariffs in the short-term market. While coal prices have moderated from the peak in FY2023, short-term tariffs remain elevated, maintaining upward pressure on PPC. In this context, the discoms' ability to optimise power procurement through higher sourcing of cheaper renewable power along with storage and reducing dependence on costlier sources remains important.

The regulatory asset (RA) position remains high for discoms at over Rs. 2.8 trillion, with discoms in Tamil Nadu, Uttar Pradesh, and Rajasthan accounting for close to 70% of this amount. Recovery of such large RAs, even over a 5-year period, would result in a significant tariff shock to consumers in these states. Consequently, the State Electricity Regulatory Commissions (SERCs) in these states have not identified any clear path for the recovery of these RAs and have acknowledged that state government support is required to resolve this issue.

Reforms are underway to address the challenges faced by the distribution segment, including the Revamped Distribution Sector Scheme (RDSS) to reduce AT&C losses, the late payment surcharge (LPS) rules to reduce dues from discoms to generators, and the Fuel and Power Procurement Adjustment Surcharge (FPPAS) to ensure the regular pass-through of variations in power purchase costs. The LPS scheme has enabled a significant decline in dues pending from discoms to power generating companies.

However, there is mixed progress in the implementation of FPPAS rules notified by the Ministry of Power, Government of India in December 2022. Within the nine states of Andhra Pradesh, Gujarat, Karnataka, Madhya Pradesh, Maharashtra, Rajasthan, Tamil Nadu, Telangana, and Uttar Pradesh, which account for over 70% of electricity consumption in the country, the implementation of the rule has commenced in only three states and it is pending in the balance six states.

Commenting on the gap between the average cost of supply (ACS) and the average revenue realisation (ARR)**, Vikram** said: *"The ACS-ARR gap per unit of power sold by the state owned discoms remains high at 73 paise per unit in FY2023, with the gap being well above the national average in Uttar Pradesh, Maharashtra, Telangana, and Tamil Nadu. The hike required to reduce this gap to zero varies from 12% to 25% in these four states. This apart, the discoms would need to resolve the large regulatory asset position, which necessitates support from the state governments. Overall, the discom finances can be improved through a mix of measures such as graded tariff hikes, reduction in AT&C losses, and optimisation of the power purchase cost."*

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