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INDIAN POWER SECTOR

Significant tariff hikes required to liquidate discoms' regulatory assets in line with apex court directive

September 2025

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Highlights

Highlights

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Tariff hike as high as 20-40% is required to liquidate the existing ~Rs. 3 trillion regulatory assets across key states, in line with the Supreme Court's order.

23 of the 28 states have issued tariff orders thus far for FY2026. However, tariff hikes remain modest in most states over the last two years.

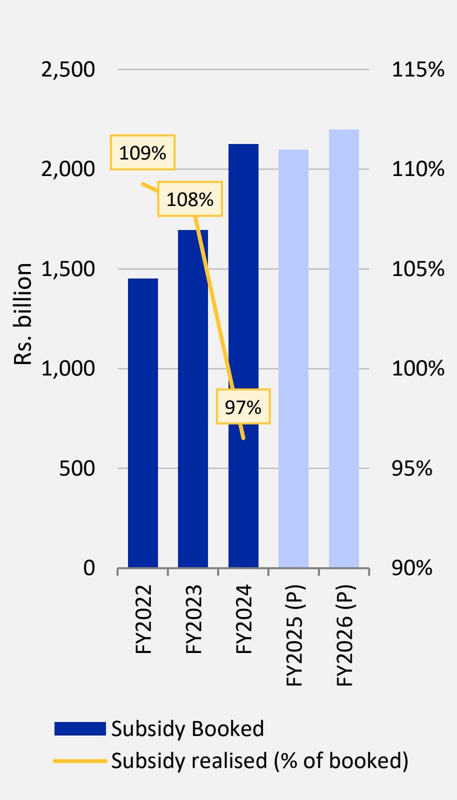
- **The performance of state-owned distribution utilities (discoms) remains constrained by weak operating efficiencies,** as reflected by higher-than-regulator-approved aggregate technical and commercial (AT&C) losses, inadequate tariffs relative to the cost of supply, a high debt burden and delays in payments from state government departments for power supply. Except for discoms in states like Gujarat, state-owned discoms in most large states remain loss-making, despite recent reduction in AT&C losses.

- **Regulatory assets (RAs) remain high at Rs. 3 trillion, led by Tamil Nadu, Uttar Pradesh, and Rajasthan due to cost-recovery gaps.** While some states avoid RA creation, others are pursuing phased recovery via tariffs and state support. A Supreme Court order now mandates liquidation of legacy RAs in four years and caps new RAs at 3% of the annual revenue requirement, reinforcing cost-reflective tariffs. This would require implementing steep hikes of 20–40% in ICRA's assessment, which may be politically difficult, therefore, state aid remains key.

- **The progress in issuance of tariff orders for state distribution utilities (discoms) in FY2026 remains moderate** with 23 of 28 states issuing them as of August 2025. The median tariff hike for FY2026 remains modest at 1.9%, lower than 2.1% in FY2025, based on orders issued as of August 2025, owing to several states approving nil or very low hikes, despite the persistent gap between tariffs and cost of supply.

- **In FY2024, the gap between average cost of supply (ACS) and average revenue realization (ARR) for state discoms averaged at 46 paise per unit, with wide variation across states—**Telangana at Rs. 1.72 and West Bengal at 25 paise. ICRA's analysis shows that bridging this gap requires tariff hikes of 3–25% across states and 4.5% at all India level, alongside reducing AT&C losses below 15%, highlighting the need for both tariff reforms and operational efficiency.

Highlights



- **The approved power purchase cost (PPC) for FY2025 and FY2026 is lower than the actual PPC in FY2024,** which rose due to continued reliance on expensive imported coal and high tariffs in short- and medium-term markets. Although coal prices have eased from the FY2023 peaks, persistently high short-term tariffs kept PPC elevated. The median 5-year PPC CAGR till FY2024 for key states is around 2.5%, outpacing tariff growth.

- **Subsidy dependence for FY2026 is estimated to rise to Rs. 2.2 trillion, up from Rs. 2.1 trillion in both FY2024 and FY2025,** driven by a moderate increase in the cost of supply and the expansion of subsidy schemes by certain states, including Rajasthan, Maharashtra, and Telangana. This estimate excludes the loss funding support provided by state governments as agreed under Central Government schemes. The loss funding support remains quite large in some states, like Tamil Nadu.

- **Various reforms such as the Revamped Distribution Sector Scheme (RDSS), Late Payment Surcharge (LPS) rules, and Fuel and Power Procurement Adjustment Surcharge (FPPAS) aim to address these issues.** However, the outlook for the power distribution segment remains negative, and timely implementation of these measures is critical to improving discoms' financial health.

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Thank You!