

PROCEEDINGS OF THE GOVERNMENT OF KARNATAKA

Subject: Karnataka Power Reforms - Policy documents reg.

READ

1. Government Order No. DE 99 PPC 96 dated 30.01.1007.
2. Karnataka Electricity Reform Act, 1999.
3. Government Order No. DE 17 PSR 99 dated 27-1-2000.

PREAMBLE

1. Government of Karnataka in its first policy statement on power reforms announced on 30th January 1997 read at (1) above, envisaged setting up of an Independent Regulatory Commission, reorganization of KEB, separation of Transmission and Distribution functions, followed by reorganization of the distribution function into several economically viable units, and privatization.
2. Karnataka Electricity Reform Act, 1999 read at (2) above was passed and brought into force on and with effect from 1st June 1999.

(1) A Three-Member Karnataka Electricity Regulatory Commission was established and constituted under the provisions of the Karnataka Electricity Reform Act, 1999, during October 1999 and made fully operational.

(2) Karnataka Power Transmission Corporation Limited (KPTCL), a principal Transmission Company and Visvesvaraya Vidyuth Nigama Limited (VVNL), a Generating Company were incorporated under the Companies Act during July 1999, as immediate successors to the erstwhile Karnataka Electricity Board and made functional under a statutory transfer scheme.

(3) All these new entities have been made fully functional during last one year through several institutional strengthening measures and the support being extended by the Government.

3. Government of Karnataka have in January, 2000 vide its order dated 27-1-2000 read at (3) above approved subsequent steps for private sector participation in power distribution in the State through competitive bidding process, with the assistance of suitable Consultants. The Consultants would prepare the proposals relating to financial restructuring, delication of distribution entities etc as well as assisting the whole process of privatization. A Steering Committee constituted under the Chairmanship of the Chief Secretary to Government has been authorized to take all decisions relating to Consultancies as well as reform and restructuring activities of the power sector.

4. In spite of these measures, the Government is concerned with the deteriorating financial and institutional capabilities of Power Sector, obviously due to various deficiencies in its systems as well as operations. Hence, there is an urgent need to put in place certain firm measures to achieve the overall objectives of the power sector. Hence, the following order.

**GOVERNMENT ORDER NO DE 14 PSR 99
BANGALORE DATED 8TH JANUARY 2001**

In the circumstances explained in the preamble, Government are pleased to approve the detailed Power Policy Statement to undertake various reform and restructuring measures in the

power sector as appended to this order.

**BY ORDER AND IN THE NAME OF
THE GOVERNOR OF KARNATAKA**

**(B.K.SRINIVASA RAO)
UNDER SECRETARY TO GOVERNMENT
ENERGY DEPARTMENT**

DETAILED POLICY STATEMENT

KARNATAKA POWER SECTOR RESTRUCTURING AND PRIVATIZATION PROGRAMME

PREAMBLE

1. In order to sustain the growth of its economy and reduce poverty, Karnataka needs to implement an indepth reform of its power sector. In spite of some impressive achievements, power sector has become a major bottleneck to the economic development of the State and has not been able to meet the needs of the people of Karnataka, in particular, that of rural population and the poor. Power sector is also exerting a considerable drain on Karnataka's public finances, which in turn reduces capacity of the State Government to address social needs, notably for the most vulnerable segments of population. The indifferent status of availability, quality and reliability of power has reduced the competitiveness of the Karnataka industry; Rapid increase in consumption by irrigation pumpsets has imposed high costs on KPTCL with regard to its agricultural and rural operations. High costs on consumers are also attributable to high T&D losses. The poor quality of power, and resultant damage to their machinery, has left a vast number of consumers dissatisfied. Furthermore, too large a part of rural population still does not have access to electricity services.

2. In particular, Government of Karnataka recognizes the need to have specific energy policies and aims to achieve the following three priorities:

- a. Ensuring that people of Karnataka have equitable access to basic and reasonably priced electricity services, in that to electrify all the remaining households and hamlets by the year 2010;
- b. Providing electricity supplies that industry and commerce need to achieve economic growth;
- c. Promoting the kind of energy use that will not damage our environment.

3. Government of Karnataka recognized this situation and, following a careful analysis of its root causes and a wide debate on options available has decided to accelerate the reform process of power sector which commenced in 1995 itself. In this direction Karnataka Electricity Reform Act was enacted. In November 1999 the Karnataka Electricity Regulatory Commission was constituted. As a Second step, the Karnataka Electricity Board was dissolved, and in its place, Karnataka Power Transmission Corporation Limited (KPTCL) has been incorporated under the Companies Act. These are important steps, which have laid foundations for further reforms aimed at resolving the problems faced by the sector. Government of Karnataka has decided to launch a new wave of reforms, and complete the reform process in the shortest possible time.

OBJECTIVES OF RESTRUCTURING AND PRIVATIZATION PROGRAM

4. Next stage of reforms of Karnataka's power sector will include further restructuring, of KPTCL into several utilities and their privatization thereafter. The objective of these measures is to promote the development of an efficient, commercially viable and competitive power supply industry, which can provide reliable quality supply, at competitive prices, to various classes of consumers in the state, which would in course of time, develop into a net contributor to the State budget. Government of Karnataka is at the same time particular to ensure that the social and environmental aspects are fully taken into account during and after restructuring. Upon completion of the reform process, it is expected that adequate power supply will be available to all the consumers without interruptions. Consequent to introduction of efficient management and rationalisation of tariffs Government hopes that it would not be necessary to provide subsidies to the power sector operations. The sector will be a net contributor to the State's financial resources. Power utilities are expected render good service to the consumers, by arranging power supply expeditiously, and attending promptly to their complaints and power generation, transmission and distribution in Karnataka will be carried out in socially responsible and environmentally sustainable ways.

5. In order to achieve these objectives the primary task is to restore the financial health of the power sector, so that it acquires creditworthiness, which in turn will attract private investments and management skills. Such an environment will ultimately promote competition and efficiency; and will be conducive to healthy development of the power sector.

STRUCTURE OF THE SECTOR

6. The ultimate goal will be to offer maximum choices to end-users in obtaining electricity services, achieve maximum competition in all the segments of the power industry, be it generation transmission or distribution and supply to consumers.

a. In this direction, the distribution and transmission businesses presently managed by Karnataka Power Transmission Corporation Ltd (KPTCL) will be disaggregated; and separate distribution companies (DISCOS) will be established. These discos will in turn be privatized.

b. Several hydropower stations and one diesel generation, which belonged to KEB were transferred to a separate company called Vishveshwaraya Vidyuth Nigam Ltd., (VVNL) at the time of its Corporatisation. It is now proposed to transfer all the hydro stations for strategic investors, following a competitive and transparent solicitation procedure. The proceeds of this divestment will be credited to the pension fund, which is proposed to be created to meet pension liabilities in respect of retired employees of KEB and KPTCL.

c. After the power sector is stabilized, the issue of restructuring KPCL will also be considered and this may consist of disinvestment, or formation of separate companies. However for the present, KPCL would play a key role in power augmentation particularly when IPPs cannot provide the desired quantum of power.

d. In the medium to long run, when the basic restructuring process is completed and the transition to a competitive industry is ensured, the sector's reform will be further deepened with the progressive segregation of the various functions that KPTCL has been initially entrusted with (for example trade and transmission of power, and system operation).

7. During transition period, KPTCL will act as a wholesale trader, buying power from KPCL, the

central generating stations, IPPs and others, and selling it to the distribution companies. After privatization of the distribution companies, these will be enabled to purchase bulk power from any generating company, private or public, in the state or outside the state and KPTCL would collect wheeling charge. Any new power purchase agreement by KPTCL will have to be concluded after consultation with the distribution companies.

8. In the ultimate stage, a consumer need not buy electricity from the local distribution company, but from any body, but will have to pay wheeling charges to the transmission licensee/s as also to the distribution companies, associated with such transaction.

9. KPCL and its successors (in the event of restructuring) will be able to participate in any competitive solicitation engaged by the distribution companies, end users or any other entities authorized to enter into the trade business. KPCL has been the mainstay of power generation in the State, and the State Government appreciates the key role KPCL has played in fulfilling the energy needs of the State in an efficient manner. However, in the competitive environment, which is being envisaged, KPCL must establish its continued role through being competitive in comparison with other players. In the past, KPCL was given Government guarantees for its borrowings, but little protection in the matter of tariff revision and prompt payment from KPTCL. Government will ensure that KPCL does not face a disadvantage in comparison with private producers of power. At the same time, KPCL and its successors will not benefit from any advantage which could distort competition; in particular, after the transition period of power reforms is crossed, the State Government will not provide nor arrange any financing (except the equity contribution as owner of KPCL) or guarantee to lenders, which will be the policy applicable to all generating companies. The size and power market of KPCL and its successors will need to be reviewed in due time with a view of ensuring fair competition among different industry participants. Until then, KPCL may for augmentation of capacity have to play a key role in the programme for development for several years till the power sector is stabilized.

10. Government of Karnataka will require that the procurement of additional power, whether from independent power producers (IPPs), KPCL, central, regional or other state utilities, would be consistent with the financial capabilities of the utilities and would be carried out with prudence and efficiency. Government will not provide any guarantee nor allow provision of any escrow facility to IPPs, barring any arrangement to ensure adequate liquidity through cash support, as part of the Financial Restructuring Plan during the transition period.

REGULATION OF THE SECTOR

11. After enactment of the Karnataka Electricity Reform Act in 1999, the Karnataka Electricity Regulatory Commission (KERC) has been established and is now fully operational. Government of Karnataka would ensure independent functioning of KERC as per the spirit inherent in the legislation; GOK intends to take timely actions for selection of qualified and competent members for the Commission. In case Government considers that it is necessary to subsidize the supply of power to specific groups of consumers, it will make provisions in the budget which will be passed on to the utilities as worked out by the Commission.

12. The State Government, as owner of the utilities and policy maker, endeavors to promote a constructive dialogue with the Commission. The forthcoming years will be critical to consolidate thorough changes undergone by the industry, attract private investors, and ensure that all the newly created institutions operate along the principles and the spirit of the reform program and relevant legislation. Government of Karnataka endeavors to take all the necessary steps to provide a stable and predictable environment for all the sectors' entities, and to minimize the perception of risks by all potential investors, by encouraging, for example, multi-year

arrangements, notably for power tariffs and state subsidies.

CORPORATIZATION AND PRIVATIZATION

13. During the transition period, KPTCL and other utilities will be given maximum autonomy to manage their business along commercial lines. The Boards of these companies will be reconstituted so that at least half of the directors will be persons from outside the government and who are having expertise in technical, managerial, financial, and administrative matters. The chief executives of these companies will be appointed on tenure basis. Appointment of senior managers will be based on merit and not seniority; if necessary professional and managerial personnel will be drawn from outside the companies. Incentive systems rewarding risk-taking, innovation and efficiency will be implemented for all the staff, including senior managers and executives.

14. Government recognizes that privatization of distribution and generation is not an end per se, but a means to achieve better efficiency and to mobilize resources required for development and strengthening the system. It is hoped that the Privatization of distribution will improve the quality of service to all consumers. This is proposed to be carried out by disinvestment or outright sales. In either case, transparent procedure will be followed. For this purpose, assistance of consultants will be taken. The objective is to implement privatization of distribution at the earliest, with aid and advice of the consultants being appointed for the purpose. Government of Karnataka will take advantage of the experience in other states of India, where the reform process is in more advanced stage.

TARIFF RATIONALIZATION AND SUPPORT TO NEW UTILITIES

15. One of the main factors for the poor financial situation of the power sector is the tariff structure. It is expected that the regulatory commission will bring about rationalization of tariffs taking into account, inter-alia, the extent of subsidy the Government provides, the inherent operational efficiency of the utilities and the capacity to reduce T&D and commercial losses.

16. Efforts will be made to ensure that as far as possible the newly formed utilities are not burdened with historic liabilities. It is the intention of the Government of Karnataka that the utilities, particularly distribution companies, start their operations with a clean balance sheet.

METERING AND BILLING

17. KPTCL is presently serving about 10 million consumers of all categories. About 30% of them supplied power without any metering (mainly irrigation pumpsets, and Bhagyajyothi installations). KPTCL would provide in future meters for all new connections. It will also be required to install meters to bill the unmetered consumers before 2004. It will implement tariffs which are reflective of costs of supply and which discourage use of electricity during peak hours, thus strengthening Energy Conservation and DSM Measures. Effective measures to implement the existing provisions under the I.E. Act, 1910 for theft of energy are proposed to be introduced.

18. The elements of cross subsidy in the present tariff structure are very substantial, and the burden is taken by industrial and commercial consumers. As a result many industries resorted to captive generation, and sales to this category has come down over the years. This has resulted in the worsening of the financial health of KPTCL. This distortion is proposed to be rectified and the element of cross subsidy will be minimized. As indicated earlier, tariffs will be designed to reflect costs. Wherever the tariff has to be kept low, for social and economical reasons, the Government would intervene and provide subsidies.

DEMAND-SIDE MANAGEMENT

19. The reform program will also focus on demand side management (DSM) with the objective of improving efficiency in supply and end-use of electricity. All resources, including energy conservation and use of non-conventional and renewable energy sources, will be considered in the process of power planning to manage the power demand effectively and reduce the need for additional conventional generation capacity. The main focus of the strategy for demand side management will be on: (i) introduction of tariff linked demand side management and disincentives to waste power; (ii) improvement of efficiency of agriculture tube wells and industrial installations; and (iii) launching of consumer awareness campaign on various energy conservation measures. Various options to bring in demand side management measures will be explored and suitable policies will be notified in consultation with KERC. Energy efficiency and DSM programs will be promoted through developing bankable strategies and programmes in consultation with the stakeholders.

PROTECTION OF STAFF

20. A provision has been made in the Karnataka Electricity Reform Act, 1999, that the continuity of the services of employees of the erstwhile KEB will be maintained, their service conditions will be fully safeguarded, and they would be employed in the successor utilities. Tripartite agreements have already been entered into between Government, KPTCL and Employees' Union/Associations. Because of the policy adopted by erstwhile KEB, the staff strength remained more or less the same for more than a decade. Therefore the successor utilities of KPTCL are not likely to be burdened with excess staff. However, after formation of distribution companies, they will be allowed to develop their own service conditions and recruitment procedures, subject to the condition that the interests of existing employees opting to serve in these companies are not jeopardized. One of the key objectives of restructuring is to create a culture where customer service and commercial functioning are paramount. Employees will have new opportunities to undertake greater responsibility, be accountable for delivering results and have higher opportunities for career advancement.

SOCIAL AND ENVIRONMENTAL ASPECTS

21. Government of Karnataka (GOK) is committed to protect the environment and ensure that power sector reforms take place. Keeping the environmental impacts to the barest minimum, Government of Karnataka is formulating a Safeguard Policy to outline the principles and support mechanisms to be provided to the persons affected by land acquisition. The Social safeguard policy will describe the methods and procedures to be followed for compensation payment for various losses, entitlement framework for different type of losses, special assistance for women, poor and vulnerable sections, improving access to common properties and protecting and managing cultural properties. For this purpose, the Government would be engaging the services of consultants who are experts in these areas.

MANAGEMENT AND MONITORING OF THE PROGRAM

22. Government of Karnataka attaches highest importance to the successful implementation of this reform program. Difficulties which will be experienced by all during the transition period require that every effort is made to minimize costs and maximize the expected benefits. Government of Karnataka will carefully manage and monitor implementation of this program. A Steering Committee under the chairmanship of the Chief Secretary will regularly review its progress and take all necessary decisions. Utilities and the state administration will secure the services of consultants and advisors, from India and abroad to take full advantage of the

experiences. Government of Karnataka will take note of the results of and difficulties experienced in other states in the implementation of reforms and modify the strategies now conceived, if needed.

23. Government of Karnataka will pursue the implementation of reforms, which as indicated earlier comprises, unbundling of KPTCL, creation of distribution companies, and their privatization in a time bound manner, with the main intention of ensuring adequate power availability, minimum interruption, quality service to the consumers and rational tariffs to different classes of consumers.

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