POLITY

Supreme Court Orders DISCOMs to Clear Regulatory Assets: Balancing Affordability and Sustainability in India's Power Sector

1. Why in news

The Supreme Court directed State Electricity Regulatory Commissions and DISCOMs to liquidate existing regulatory assets within four years, cap new assets at 3% of Annual Revenue Requirement, and ensure transparent recovery mechanisms.

2. Understanding Regulatory Assets

- Regulatory assets represent the revenue gap between **Average Cost of Supply (ACS)** and **Annual Revenue Requirement (ARR)**.
- Example: If ACS is ₹7.20/unit but ARR is ₹7.00/unit, the loss is ₹0.20/unit. For 10 billion units, the gap is ₹2,000 crore.
- Instead of burdening consumers with immediate tariff hikes, regulators allow these gaps to be carried forward as deferred costs (regulatory assets), to be recovered later with interest.

3. Causes of ACS-ARR Gap

- **Non-cost reflective tariffs** due to political considerations.
- **Delay in government subsidies**, particularly for agriculture and low-income households.
- **Fuel price volatility**, causing higher power purchase costs.
- **Inefficiencies in distribution** including high transmission and distribution losses.

4. Magnitude of the Problem

- Delhi: Regulatory assets of ₹36,057 crore (BSES Rajdhani), ₹22,040 crore (BSES Yamuna), and ₹8,226 crore (Tata Power-DDL).
- Tamil Nadu: Regulatory assets reported at ₹89,375 crore in FY 2021–22.
- Punjab: Early documented case (2003–2006) where ₹150 crore was converted into regulatory assets.
- Recovery within SC's four-year window requires Delhi DISCOMs to mobilise ~₹16,580 crore annually, translating into an extra ₹5.5/unit if directly passed to consumers.

5. Impact on Stakeholders

- **Consumers:** Initially shielded from tariff shocks but face higher future costs with interest. Rising arrears risk affordability and public discontent.
- **DISCOMs:** Struggle with cash flow, leading to delayed payments to generators, higher debt, and reduced investment in grid modernisation or renewable integration.
- **Power Sector Chain:** Liquidity stress cascades from DISCOMs to generators and suppliers, threatening sectoral stability.
- **Governments:** Rising subsidy commitments burden fiscal health and delay reforms.

6. Supreme Court's Directives

- Clear existing assets within four years.
- Liquidate new regulatory assets within three years.
- Cap regulatory assets at 3% of ARR.
- Intensive audits for DISCOMs with persistent unrecovered assets.
- Transparent roadmaps for recovery.

7. Pathways to Bridging the Gap

- **Cost-reflective tariffs:** Rationalise tariffs while protecting vulnerable groups through targeted subsidies.
- **Timely subsidy release:** States must release committed subsidies to prevent arrears.
- **Fuel cost adjustment:** Automatic adjustment mechanisms align tariffs with input cost fluctuations.
- **Regular true-ups:** Annual reconciliation of projections and actuals prevents backlog accumulation.
- **Regulatory discipline:** Ensure that regulatory assets remain temporary, not systemic.

8. Global Best Practices

- **Regulated Asset Base (RAB):** Utilities recover investments with assured returns, creating predictable revenue streams.
- **RIIO framework (UK):** Revenue linked to outputs like reliability, customer service, and carbon reduction, incentivising efficiency and accountability.
- **Digital Grids and Energy Stack (India's innovation):** Can enhance transparency, asset valuation, and recovery planning.

9. Strategic Significance for India

- The SC's order is a push towards sustainable electricity governance.
- Aligns with long-term goals of financial discipline, energy transition, and consumer affordability.
- Reinforces the need for systemic reforms integrating policy, regulation, and technology.

10. Conclusion

Regulatory assets expose the structural fault lines of India's power sector—tariff politics, subsidy delays, and inefficiencies. The Supreme Court's intervention seeks to restore financial health to DISCOMs while protecting consumers, demanding coordinated reforms to ensure affordable yet sustainable electricity supply.

PRELIMS PRACTICE QUESTION

Q1. Consider the following statements regarding regulatory assets in India's power sector:
1. Regulatory assets are created when the ARR is higher than the ACS of a DISCOM.
2. Regulatory assets allow DISCOMs to defer revenue gaps for future recovery from consumers.
3. The Supreme Court has capped regulatory assets at 3% of a DISCOM's ARR.
Select the correct options:
(a) 1 and 2 are correct
(b) 2 and 3 are correct
(c) 1 and 3 are correct
(d) All are correct

Q2. Consider the following pairs of global electricity regulation models and their features:
1. Regulated Asset Base (RAB) – Utilities recover investments through tariffs with assured returns.
2. RIIO framework (UK) – Links revenues to performance outputs like reliability and carbon reduction.
3. Fuel Adjustment Clause (USA) – Prevents tariff changes despite fluctuations in fuel prices.
Select the correct options:
(a) only one pair is correct
(b) only two pairs are correct
(c) all three pairs are correct
(d) none is correct

Q3. Consider the following statements:

1. The Union Public Service Commission was established under the Government of India Act, 1919.
2. Article 315 of the Constitution provides for Public Service Commissions for the Union and States.
3. The Pratibha Setu initiative provides opportunities for all candidates who cleared the preliminary examination but did not reach the interview stage.

Select the correct options:
(a) 1 and 2 are correct
(b) 2 and 3 are correct
(c) 1 and 3 are correct
(d) All are correct

PRELIMS PRACTICE QUESTION- ANSWER KEY

Q1. correct answer:
(b) 2 and 3 are correct
Explanation: Regulatory assets arise when ACS is greater than ARR, not the other way round. They allow deferred recovery of revenue gaps. The SC capped them at 3% of ARR.

Q2. correct answer:
(b) only two pairs are correct
Explanation: Pairs 1 and 2 are correct. The Fuel Adjustment Clause allows tariffs to change with fuel cost changes, not prevent it.

Q3. correct answer:
(a) 1 and 2 are correct
Explanation: UPSC was indeed established in 1926 under the Government of India Act, 1919. Article 315 provides for Union and State PSCs. However, Pratibha Setu is not for prelims-qualified candidates but for those who reached interview stage but were not selected.

MAINS PRACTICE QUESTION

POLITY

1. Examine the implications of large regulatory assets on India's electricity sector, highlighting their impact on consumers, DISCOMs, and overall energy security.
2. Critically assess how global models like RAB and RIIO can be adapted to strengthen regulatory asset management and long-term financial sustainability of Indian power utilities.
3. Discuss the significance of the proposed Centre of Excellence by UPSC in strengthening India's recruitment ecosystem. How can it contribute to federal cooperation and institutional reforms?