THE ESCROW COVER REPORT: A CRITIQUE

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Introduction

Cogentrix is already a forgotten issue, but the High Level Committee on Escrow Cover to Independent Power Producers to which it gave rise has produced its report. Unfortunately, notwithstanding all the talk by the present state government about transparent democratic functioning, the Escrow Cover (EC) report has not been made public. As a result, decision-makers (ministers, legislators, and bureaucrats) have denied themselves the opportunity of learning from a public discussion. And they badly need this education, judging from the blunders they have made in the past -- including the promise of escrow cover to several parties. On the other hand, concerned citizens have been forced to depend on news reports, knowledgeable journalists, grapevine, rumours, gossip, etc. At the end of it all, the EC Report is just like the proverbial good-news-bad-news joke -- a mixture of good news and bad news.

Good News

The best news is that the EC report has declared categorically that KPTCL has no escrow capacity because it has no revenue surplus. The possibility of escrow cover arises only if there is a revenue surplus, so that part of the revenue stream can be dedicated to pay the party being given escrow cover. The arithmetic underlying this assessment that KPTCL is too "broke" to enter the escrow game is so simple and straightforward that one wonders how it was missed by decision-makers in the past. In other words, if it is so easy to show that there is no escrow capacity, how was escrow approved in the first place? In any case, the EC report has effectively prevented escrow cover being given to Mangalore Power and Light, its successors and other IPPs.

What is more momentous is the EC report's view that, even if there was escrow capacity, escrow cover should not be given to any IPP. Escrow covers are the anti-thesis of market-driven reforms of the power sector and they hinder competition. It is ironical that companies that come into the country ranting against command-and-control economies, government intervention and cost-plus pricing, then demand state-backed counter-guarantees and escrow covers of a type that they would never dream of getting in their home countries. Escrow covers also militate against rational power pricing and undermine the autonomy of corporatised electricity boards and of regulatory commissions. There may also be legal complications from companies that are denied escrow cover, as happened in Madhya Pradesh. And, of course, they reduce expenditures that would have been devoted to other important requirements.

In 1997, the International Energy Initiative published a diagnosis of the ill health of what was then KEB that included the following:

- almost half of the electricity consumption in the state did not fetch revenues primarily because it was not metered;
- only the total quantity of this unmetered consumption was known;

- the individual constituents -- particularly, the consumption by irrigation pump sets (IPS) and the Transmission and Distribution (T & D) losses -- had to be guessed or fabricated every year
- if the upper limit of **technical** T & D losses was about 20%, then the balance (up to about 10% of Karnataka's electricity) was **commercial** loss (the euphemism for theft)
- T & D losses were responsible for the deficit in KEB's balance sheet because the net surplus from consumers could not offset the T & D losses
- some reductions in technical losses are possible with system improvements such as straightening lines, reducing low-voltage distribution, etc., but the real opportunities lie in reducing **commercial** T & D losses (theft, etc.)
- Karnataka's power sector used the IPS excuse to hide many of its technical and commercial shortcomings, in particular its commercial T & D losses.

Many of these observations, strongly objected to when they were published, have now become conventional wisdom repeated by the highest authorities in the power sector. The EC report too has implicitly accepted these observations. However, in its recommendations, it has only gone as far as compulsory metering.

Power sector reformers have shown great reluctance to talk of the shape of power prices to come. So, the EC report must be commended for arguing for cost-reflective tariffs (cleverly suggesting that it should be left to the KERC!).

To please the environmentalists, the EC report has recommended renewable energy and gone further and insisted on the right of independent power producers to wheel the output to consumers with power-purchase contracts.

Bad News

The Terms of Reference (TOR) for the EC Committee announced at the 14/1/00 NIAS workshop focused on the escrow capacity of KPTCL -- its magnitude, how it should be allocated, how it can be increased, and its wider implications. Since then, there appears to be a major distortion of the TOR to shift the focus from escrow to privatisation even though there is no mention of privatisation in the TOR. Much more space seems to have been devoted to privatisation than to escrow. In fact, escrow has become an excuse to preach privatisation, which has become the objective function and the touchstone to evaluate escrow.

Despite this preoccupation, there is no cast-iron justification for privatisation; it is supported only with handwaving. If efficient functioning of the power sector is the objective, there is no discussion of privatisation versus competition to achieve efficiency. There is no judgement on whether of privatisation or competition is fundamental and primary? The EC report shows no awareness of the important case of Norway where there is effective competition **without** privatisation. The report also does not prove that privatisation will lead automatically to competition and therefore efficiency. A recent article in ***Frontline*** on the Orissa privatisation shows that private distributors may not be interested in efficiency if it does not increase returns.

A great deal of wisdom on energy systems was generated in the 1970s and 1980s after the traumatic oil-price hikes. In particular, it was realised that what human beings want is **energy services** (e.g., illumination, space cooling, mobility, etc.), not **energy** *per se* (as kWh, calories, etc). The difference is not just semantics. Whereas a focus on energy consumption does not compel a scrutiny of end-use efficiency, an increase of energy services (e.g., illumination) can be achieved with an increase in energy supply and/or an improvement of the efficiency of lamps. All this wisdom has escaped the EC report, which is surprising considering that two of its members are engineers. It is astonishing that the EC report does not mention end-use efficiency-improvement and real demand-side management (as opposed to load shedding) and Energy Service Companies to disseminate these measures. When it talks of least-cost energy, the discussion is restricted to least-cost supply. It does not consider least cost energy services because then it would have to do a comprehensive financial analysis comparing the cost of supply with the cost of end-use efficiency-improvements and demand-side management.

The EC report does not make explicit the goal of its exercise. It is implicit, however, that its goal is economic growth. The EC Committee does not seem to have heard of Sustainable Development with its dimensions of economic efficiency, equity (distributional justice), empowerment, environmental soundness and concern for the long-term. There is no mention either of the social objectives of power sector and its role in improving the quality of life or of the "obligation to serve" the forgotten constituency of the unconnected.

The EC report has a faith in market forces that is touching, but naïve. It seems unaware of the colossal failures of demand forecasting by the private sector in the USA leading to over-estimation, construction of mega (nuclear) plants and dead investments. But its belief in the market is not consistent. Where it should be arguing for a level playing field for market competition, it demands command and control policies. For example, it recommends privatisation of existing generation capacity (as if KPCL is not doing an excellent job via PLFs at operating its stations). It also asks for new generation to be assigned to the private sector instead of asking for a level playing field in which there will be a competition with the public sector (KPCL).

After preaching privatisation, the report concludes without answering several crucial questions unanswered. (1) Who will bell the cat? Which organisation will correct the shortcomings of KPTCL -- metering of all connections, cost-reflective tariffs, reduction of technical T & D losses, elimination of theft: KPTCL itself? Or the private distribution companies? (2) In what sequence will the rectification be done? First clean up by KPTCL and then privatisation? Or straightaway privatisation followed by clean up by the private distributors? (3) When there are a number of generators, which agency will be responsible for dispatch to consumers? If the dispatch is to be in merit order, which agency does the comparative costing and determines the merit order?

A most unwelcome, perhaps even dangerous, aspect of the EC report is the contemptuous way it has dismissed Integrated Resource Planning. It has implied that once the energy system is privatised, the market takes over and the government vacates the scene, everything will be perfect in the power sector. In fact, notwithstanding all the advantages of the market as an allocator of manpower, materials, technology and investments, the market is notorious for its failure to safeguard equity, environment and the long-term. Its horizon is limited to the balance sheet. So, the state has an important role.

The energy ministry and department have crucial tasks to perform. They must prescribe the rules of the game for the market. They must formulate enabling policies. They must ensure a level playing field for candidate technologies. They must identify directions for research and development. They must identify a least-cost mix of centralised generation, decentralised generation and end-use-efficiency-improvements and demand-side-management measures. They must identify cost-effective end-use-efficiency-improvements and demand-side-management measures. They must identify a niche for decentralised generation. They must avoid gross excess capacity from centralised generation and the resulting stranded investments. They must guide public-sector investments in capacity expansion. Thus, the visible hand of government must assist the invisible hand of the market. Both the market and integrated resource planning are essential. The EC report has ignored all these issues.

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