

## PRINCIPLES FOR THE CONTROL OF PUBLIC UTILITY ELECTRICITY SUPPLY FINANCE\*

THE Advisory Board was constituted by the Government of India to examine the principles for the control of Public Utility Electricity Supply Finance, formulated by the Electrical Commissioner with the Government as to which of them should be adopted and to what extent and in what manner they should be enforced. The principles are to constitute the sixth schedule of the Electricity (Supply) Bill, 1946, and are to be incorporated as an amendment to the Indian Electricity Act, 1910.

The Advisory Board consisted of Mr. H. M. Mathews, Electrical Commissioner with the Government of India (Chairman); Mr. D. L. Mazumdar, Joint Secretary to the Government of India, Department of Works, Mines and Power; Mr. P. B. Advani, Special Officer (Electric Grid), Bombay; Mr. K. V. Karantha, Chief Electrical Inspector to the Government of Madras, and Mr. I. A. Macpherson, nominated by the Federation of Electricity Undertakings in India. The report of the Advisory Board was unanimous in every respect except for a note of dissent by Mr. Macpherson regarding "Standard Rate", mention of which is made in the relevant place.

2. The need for an effective and uniform method of control of Public Utility Electric Supply finance has been keenly felt, owing to the fact that under the existing conditions there are a number of factors which retard the development of the electric supply industry in India. The chief of them are: (i) A large number of small undertakings, the issued Capital of which is under Rs. 5 lakhs, exist, and their development has undoubtedly been impeded by difficulties experienced in raising capital and the high rate of interest demanded for its provision. (ii) The monopolistic character of such undertakings has led to many abuses in the absence of an adequate control. (iii) The amount of financial control which a Provincial Government can exercise under the Indian Electricity Act (1910) is inadequate. (iv) The interests of the consumer often take a second place to those of the shareholder.

The principles were, therefore, devised so as to fulfil the following objects:

- (a) To safeguard the interests of the consumer by limiting interest and dividends payable to shareholders to the minimum necessary to ensure an adequate flow of development capital, and thus effect a reduction in the selling price of electricity.
- (b) To safeguard the interests of investors (and, in the long run, of the consumers as well) by insistence on a properly devised system of compulsory depreciation and at the same time permit the earning of a "reasonable" or "fair" return on the investment.
- (c) To regulate the commission and expenses of Managing Agents within reasonable limits having regard to the special circumstances of the industry.

The salient features of the principles are as follows:—

### CAPITAL BASE

Under these principles the amount allowable as divisible profits will mainly depend on the size of the undertakings' "Capital Base" which is defined as "the depreciated cost of fixed and intangible assets plus working capital but exclusive of goodwill and non-compulsory investments, Debenture and Preference Capital". The Capital Base recommended will permit the various undertakings, who have indulged in the past in the capitalisation of revenue partly at the consumer's expense, to retain the assets thus acquired in the Capital Base. Once the Principles are enforced, however, this practice will automatically cease and when new development capital is required, instead of employing surplus profits, etc., it will be necessary for the undertakings to raise fresh capital from the Public or borrow from other sources.

The relation which the "Capital Base" will bear to the paid-up ordinary share capital will depend on several factors. The "Capital Base" may be greater than the paid-up ordinary share capital in the case of undertakings which have not been prevented from earning an unduly high profit and have been able to capitalize part of this; and conversely may be less for the reason, e.g., the profit and development of the undertaking may have been restricted. The amount in the "Capital Base" represented by the "ploughing back" of undistributed profits prior to the introduction of the principles will signify less and less, and as time goes on, because the tendency will be for the "Capital Base" to approximate more and more to the paid-up ordinary share capital, any excess in the long run being represented by the effects of efficient management.

### STANDARD RATE

3. The "yard-stick" which is used to measure what is considered to be a "Reasonable Return" on the "Capital Base" is the "Standard Rate" and the "Standard Rate" is taken to be—in respect of any accounting year the redemption yield of the longest dated terminable loan of the Central Government last issued prior to the last accounting year of the licensee, adjusted to the nearest one-quarter of one per cent., as declared for this purpose at the end of the Government financial year by the Reserve Bank of India to the Central and Provincial Governments, plus

- (i) 3.5 per cent. for the first Rs. 10 lakhs of the Capital Base;
- (ii) 3.0 per cent. for the next Rs. 40 lakhs of the Capital Base; and
- (iii) 2.5 per cent. for the balance of the Capital Base.

4. [Mr. Macpherson recommended in his note of dissent that (i), (ii) and (iii) should be 5.5 per cent., 5 per cent. and 4.5 per cent. respectively.]

### "REASONABLE RETURN"

is taken to be—

In respect of any accounting year, the sum of:

- (a) The amount arrived at by applying the standard rate to the Capital Base at the end of that year;

\* A Note on the Report of the Advisory Board on the Principles for the Control of Public Utility Electricity Supply Finance.

- (b) the income derived from investments other than Contingencies Reserve invested in Trustee securities as defined in the Indian Trust Act; and
- (c) half the difference between the interest payable on debenture capital and such greater amount as would have been payable had the money been borrowed at the "Standard Rate".

An important object of the principles is that the excess of the gross income over allowed expenditure, *viz.*, clear profits, shall not exceed the amount of the Reasonable Return. In view of the fact, however, that it may not always be possible for an undertaking to regulate its financial policy in such a manner that the clear profit does not exceed the reasonable return, when such an excess occurs, it is considered that it should to some extent at least be used to supplement the income of the undertaking in the years when the actual "clear profit" falls below the amount of the reasonable return. With this object in view it is proposed in the principles to create a reserve called Tariffs and Dividends Control Reserve. In those years when the undertakings' clear profit is in excess of the Reasonable Return, one-third of such excess shall be credited to this reserve and those years when the undertakings' clear profit is less than the reasonable return, the undertaking may draw from this reserve to make up their deficiency in whole or in part. It has also been provided for that one-third of the excess shall be used for a rebate to the consumers and the remaining one-third be made available to the undertaking as a bonus for efficient operation. Provision has also been made to prevent undertakings from earning a clear profit constantly in excess of the Reasonable Return permitted, by the provision for a Committee which may be appointed by the Provincial Government to examine the licensee's charges for electricity in accordance with the principles.

#### REMUNERATION OF MANAGING AGENTS

The remuneration drawn by the Managing Agent covers two separate items; firstly, commission and secondly, an allowance on account of office expenditure.

*Commission.*—Under the Principles the commission is based on "Clear Profit" instead of "Net Profit" and shall not exceed without the permission of the Provincial Government.

In respect of the first Rs. 5 lakhs of such profit—10 per cent.

In respect of all additional profit—7 per cent.

In view of the fact that in the early years of working, the clear profit of an undertaking may be small and inadequate to provide reasonable remuneration for the Managing Agents, provision has been made for the payment of a minimum amount as Managing Agent's commission based on the total issued capital.

In the absence of or inadequacy of profits the amount paid to a Managing Agent shall be subject to a minimum payment not exceeding two rupees per annum for each complete thousand rupees of paid-up share and debenture capital, provided that for purposes of computing the minimum payment, should the share and debenture capital be less than Rs. 5 lakhs, it shall be taken as Rs. 5 lakhs and

should the said capital be greater than Rs. 1 crore it shall be taken as only Rs. 1 crore.

*Office Allowance.*—An office allowance drawn by a Managing Agent which includes the salaries and wages of all personnel employed in the office of the Managing Agents with the exception of Engineering staff employed for the purposes of the undertaking is based upon a percentage of the operating expenditure during the year of account on capital works. The office allowance so drawn shall not exceed without the permission of the Provincial Government.

- (i) In respect of the first Rs. 1 lakh of operating expenditure—8 per cent.

In respect of the next Rs. 2 lakhs of the operating expenditure—5 per cent.

In respect of the next Rs. 7 lakhs of operating expenditure—2½ per cent.

In respect of all additional expenditure—1½ per cent.

- (ii) In respect of the first Rs. 1 lakh of capital expenditure incurred during the year of account—4 per cent.

In respect of the next Rs. 2 lakhs of capital expenditure incurred during the year of account—3 per cent.

In respect of the next Rs. 7 lakhs of capital expenditure incurred during the year of account—1½ per cent.

In respect of all additional capital expenditure incurred during the year of account—1 per cent.

As regards the proper application of the provisions of these principles it is stated that the Provincial Governments even now have the authority necessary to effect the required measure of general control, and when statutory electricity supply Boards are set up under the provisions of the proposed Electricity (Supply) Bill they will have the power to effect an adequate and detailed supervision of the accounts of the licensees under their jurisdiction.

For the industrial and agricultural development of the country an abundant supply of electricity at reasonable rates is the first essential; and in the post-war era the cost of electricity will be of great significance in the establishment of efficient and competitive industry. The enormous profits which the shareholders would have enjoyed will be divided, under the principles, between them and the consumers by way of reduced charges. It may be argued that with reduced charges demand will increase, which the licensee may not be able to cope up with the existing plant. This will result in expansion of the industry with a real "Capital Base" and not an artificial inflated one. The principles are not meant to restrict the sale of electricity but the profit on that sale. It can, therefore, confidently be stated that the Principles, by providing an effective and uniform method of control, would contribute in no small measure to the rapid development of the Electric Supply Industry in India.

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