

Supreme Court Directs DISCOMs to Clear Regulatory Assets

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DISCOMs Latest News

- The Supreme Court has ordered **DISCOMs and regulators to clear regulatory assets within fixed timelines**, capping their creation to ensure financial discipline in the power sector.

Introduction

- The Supreme Court has issued a landmark ruling directing **State Electricity Regulatory Commissions (SERCs) and power distribution companies (DISCOMs) to clear their accumulated regulatory assets within four years**.
- Any newly created assets must be liquidated within three years. The Court further advised capping regulatory assets at 3% of a DISCOM's Annual Revenue Requirement (ARR), making transparency and financial discipline central to the ruling.

- This judgment is a critical step toward addressing the long-standing issue of unrecovered costs in India's electricity sector, which has placed enormous financial strain on DISCOMs, distorted tariff structures, and affected consumers in the long run.

Understanding Regulatory Assets

- Regulatory assets represent the unrecovered revenue gap between the **Average Cost of Supply (ACS)** and the **Annual Revenue Requirement (ARR)** of a DISCOM.
 - **Average Cost of Supply (ACS):** The actual cost incurred by a DISCOM to supply a unit of electricity.
 - **Annual Revenue Requirement (ARR):** The revenue recovered from consumer tariffs and subsidies provided by state governments.
- When ACS exceeds ARR, DISCOMs incur a loss on every unit sold. To avoid imposing sudden tariff hikes on consumers, regulators allow the revenue shortfall to be recorded as a deferred cost, termed a regulatory asset, recoverable in the future, usually with interest.
- For example, if the ACS is Rs. 7.20 per unit and ARR is Rs. 7.00, the shortfall is Rs. 0.20 per unit. If 10 billion units are supplied, the revenue gap equals Rs. 2,000 crore.
- Instead of an immediate tariff shock, this gap becomes a regulatory asset.

Reasons for ACS-ARR Gap

- The persistence of regulatory assets reflects structural weaknesses in India's power sector:
 - **Non-cost reflective tariffs** – Tariffs often do not match actual supply costs due to political considerations.
 - **Delayed subsidy payments** – States frequently delay compensating DISCOMs for agricultural and low-income consumer subsidies.
 - **Fuel price volatility** – Sudden increases in coal or gas prices raise power purchase costs.
 - **Operational inefficiencies** – High transmission and distribution losses worsen the financial stress.
- The problem is systemic, with states like Tamil Nadu reporting regulatory assets of Rs. 89,375 crore in FY 2021-22, and Delhi DISCOMs collectively holding over Rs. 66,000 crore.

Impact on Consumers and DISCOMs

- **Impact on Consumers**
 - Initially, regulatory assets shield consumers from tariff shocks.
 - However, deferred recovery later leads to **steeper tariff hikes**, including carrying costs (interest).
 - For example, Delhi DISCOMs would need to recover Rs. 16,580 crore annually over four years, adding about Rs. 5.5 per unit to electricity costs.
- **Impact on DISCOMs**
 - Persistent regulatory assets create **cash flow crises**, making it difficult to pay power generators on time.
 - DISCOMs often resort to borrowing, adding to their debt burden.
 - With finances tied up in unrecovered costs, investment in grid modernisation, renewable integration, and consumer services suffers.

- This creates a **vicious cycle** of inefficiency and financial stress.

Measures to Bridge the Gap

- To reduce dependency on regulatory assets, multiple reforms are necessary:
 - **Cost-reflective tariffs** – Align tariffs with actual supply costs while protecting vulnerable consumers with targeted subsidies.
 - **Timely subsidy release** – State governments must ensure punctual disbursement of subsidy payments.
 - **Automatic fuel adjustment** – Mechanisms like Fuel and Power Purchase Cost Adjustment (FPPCA) can help tariffs reflect market changes quickly.
 - **Annual true-up exercises** – Regular reconciliation of projected and actual costs prevents large backlogs.
 - **Regulatory discipline** – SERCs must enforce transparent accounting, cap regulatory assets, and set strict recovery timelines.

Global Best Practices

- **Regulated Asset Base (RAB) model:** Allows utilities to recover investments through tariffs with assured returns, providing long-term revenue certainty.
- **UK's RIIO framework (Revenue = Incentives + Innovation + Outputs):** Links revenues to performance targets like reliability, service quality, and carbon reduction, incentivising efficiency.
- **Digital infrastructure:** Smart grids and India Energy Stack can improve transparency in asset management and efficiency-based recovery.
- These models suggest that regulatory assets should remain **exceptional tools** rather than recurring features.

Source: TH

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