REPORT OF THE CABINET-APPOINTED COMMITTEE ON POWER SECTOR REFORM

OCTOBER 20, 2022

ACRONYMS

BOO	-	Build Own Operate
CEB	-	Ceylon Electricity Board
CPC	-	Ceylon Petroleum Corporation
DGEU	-	Department of Government Electrical Undertakings
ERA2002	-	Electricity Reform Act No. 28 of 2002
ESG	-	Environment, Social and Governance
ESRA	-	Electricity Reforms Act
GoSL	-	Government of Sri Lanka
IPP	-	Independent Power Producer
KPI	-	Key Performance Indicators
LECO	-	Lanka Electricity Company Pvt Ltd.
NBV	-	Net Book Value
NEC	-	National Energy Commission
NEP	-	National Energy Policy
PPA	-	Power Purchase Agreement
PUCSL	-	Public Utilities Commission of Sri Lanka
SBU	-	Strategic Business Unit
SLEA2009	-	Sri Lanka Electricity Act No. 20 of 2009, as amended

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BACKGROUND AND CONTEXT

1. Sri Lanka's electricity industry is in crisis. Its immediate problems include the inadequate generating capacity to meet the increasing demand for electricity, which has led to daily power outages and high cost of electricity, results of the wrong generation mix, and historical underinvestment in diverse and low-cost generation resources. This situation has also exposed the sector and the country to external fuel price shocks and worsened Sri Lanka's current economic downturn.

2. The government-owned electric utility in Sri Lanka, Ceylon Electricity Board ("CEB") has a monopoly on power transmission and serves around 6.8 million retail customers. The state-owned distribution company Lanka Electricity Company (LECO) also serves around 608,000 customers. The CEB also owns and operates around 70% of the country's electricity generation capacity, while the remainder is sourced from privately-owned energy producers (a few large oil-fired thermal plants and over three hundred small renewable energy-based producers).

3. The CEB has accumulated massive and unsustainable debt obligations resulting from mismanagement, weak financial planning, continued reliance on government subsidies, government's policy inconsistences and the failure to implement cost-reflective tariffs. The public has been forced to absorb sudden and steep increases in electricity tariffs and endure daily power outages[1], lasting several hours. It is neither sustainable nor acceptable for the electricity sector to rely on the government for financial backing in the future. Policymakers and the public are now compelled to make the difficult choice of "expensive electricity" versus "no electricity".

THE NEED FOR SECTORAL REFORMS

4. The electricity industry in Sri Lanka is dominated by the CEB, which holds a statutory state monopoly in most parts of the electricity value chain. Because of this dominance, the electricity sector is inexorably linked to the CEB. The inadequate transparency, which is a hallmark of bundled service provision, has made it difficult to make the CEB management and governmental decision-makers accountable and responsive.

5. The traditional attitude of the government and its elected representatives of maintaining the CEB as a provider of affordable electricity to the masses, rather than a going business concern. The operating expenses of the utility have routinely exceeded its revenue as the retail electricity prices have been kept below production costs, while historical underinvestment in diverse and low-cost generation resources (including renewables) has resulted in steep power generation costs. Input cost variations, *ad hoc* government policy, disadvantageous terms of some Power Purchase Agreements ("PPA"s), sub-optimal power procurement and dispatch, and poor planning have resulted in high offtake of emergency power and high internal costs. The failure of regulatory adjustment of electricity tariffs to match

[1] The longest power cuts in the CEB's history in 1996 lasted seven months. Thereafter, rolling power cuts were imposed in 2001, 2002, 2012, 2016 and 2019. Since 2019 scheduled load shedding has continued to date.

the rising operating expenditure for almost a decade[2], and a weak and largely unresponsive corporate management culture insulated by the state monopoly status, have aggravated the CEB's financial situation, endangering the uninterrupted supply of electricity.

6. Owing to weak and sub-optimal long-term planning and failure to fully adhere to the tariff methodology, almost 70% of the present power generation capacity is based on imported liquid fuels and coal. The resulting high reliance on imported fuels for power generation makes the electricity industry vulnerable to fuel supply constraints, external price shocks, and balance of payment issues.

7. Hydropower, which supplied over 90% of the country's power generation until about the mid-1990s has continued to be a controlling factor in the country's generation mix. The power generation capacity has not been augmented over the years by timely capacity additions to match the growing electricity demand. Therefore, the CEB is forced to resort to expensive oil-based generation to make up for the low availability of hydropower during periods when hydro reservoirs do not receive sufficient water inflows. This additional expenditure on increased thermal energy production as well as the cost of hiring expensive short-term generating capacity exerts further pressure on the utility's already fragile financial conditions.

8. Investments in infrastructure expansion of the power sector have been financed traditionally through a mix of domestic resource mobilization (CEB funds), loan funding received from multilateral and bilateral sources (either as concessionary financing or on commercial terms), and direct government grants (such as for rural electrification). The cost of capital funding for large-scale projects in the sector is often opaque—with some reflected on the CEB balance sheet and some on the Treasury's accounts—and incorporates multiple terms.[3]

9. The continued reliance of Sri Lanka's electricity industry on GoSL for financial backing in the form of direct cash injections or subsidies (tax waivers on imports, foreign debt repayment, etc.) has become unsustainable[4]. It is highly unlikely that GoSL will be able to continue providing the CEB with loan guarantees, given the severe balance of payments and foreign currency issues, and the dismal state of CEB's balance sheet[5].

10. To manage the current crisis while meeting Sri Lanka's growing energy needs, the country needs to look beyond public financing and attract alternative investments through private sector participation in the sector. However, the debt overhang of the

[2] The regulator-approved tariff adjustment methodology has not been fully operational. The CEB's failure to establish the Bulk Supply Transaction Account (BSTA), and fully separate cost and revenue of all its licensees has prevented the full implementation of this tariff setting mechanism.

[3] Ascertaining the actual cost of financing of some power sector assets would not be possible without a forensic audit.

[4] The periodic fund transfers from state coffers, the last of which was around LKR 80 billion (USD 217 million) in 2022, the GoSL has not been able to stop the CEB's financial hemorrhage.

[5] As at August 31, 2022, the total debt of the CEB had soared to approximately LKR 333.5 billion (USD 904 million at the present exchange rate of USD 1 = LKR 368.9). These debts comprise payments (in both foreign currency and LKR) owed to suppliers of goods and services and outstanding payments for fuel and energy purchases (coal, CPC, IPPs and renewable-based energy producers) amounting to LKR 196.2 billion (USD 532 million), and outstanding loans (commercial banks and LECO) amounting to LKR 137.3 billion (USD 372 million).

CEB and the economic setbacks faced by Sri Lanka restricts severely the sector's ability to attract private sector investments in its current form.

11. Given the above background, it is imperative to reform the electricity industry to facilitate better mobilization of domestic and international commercial capital to meet its future investment needs. There is little dispute, therefore, on the grave and urgent need to reform and restructure the sector to bring back financial sustainability, create an operational and regulatory environment conducive to attracting investments from the private sector, and install a governance and ownership structure that respond effectively to these commercial and economic imperatives.

12. The electricity industry restructuring around the world has mostly involved the transformation of the industry structure from the traditional vertical monopoly answerable to the government to a decentralized industry consisting of organizations with various ownership structures having and commercial orientation. The traditional model often has one interface each with the end users and the government., while the decentralized structure has multiple interfaces with end users, government, and other participants in an industry controlled by a mix of competitive forces and regulatory intervention.

POWER SECTOR REFORMS COMMITTEE

13. The Cabinet of Ministers appointed this Committee on July 29, 2022, to submit recommendations to the GoSL within a short period of two months. The mandate, as understood by the Committee, was principally to review the scope and institutional framework laid down in Chapter VI of the Electricity Reform Act No 28 of 2002 ("ERA2002"), in the context of the present-day socio-economic and governance needs of the country, and to recommend an institutional framework suitable for Sri Lanka's future electricity industry. The Committee benefitted from the insights received from several main stakeholders (list given in Annex 2).

14. The Committee has determined that the key to the success of the proposed reforms of the electricity industry is the introduction of a robust governance structure and the provision of primary and secondary legislation necessary to orient the power sector towards growth and self-sufficiency. The Committee has identified the following key strategies for meaningful reforms in the power sector.

    - define a national electricity policy (Integrated Electricity Policy) that positions the private sector as the driver of the electricity industry on funding, innovation, and leadership, and creates an environment that fosters private sector participation;
    - establish independent entities to manage the generation, transmission, distribution, and sale of electricity, and to promote market competition in these subsectors;
    - ensure financial self-sufficiency of the new entities through a cost-reflective and transparent system of tariffs, and transparency in financial commitments, incurred liabilities and operations;

- institute an independent and transparent investment planning process based on the concept of integrated resource planning;
- improve the regulatory oversight of the electricity industry, preferably through the establishment of an independent regulator exclusively for the power sector;
- enhance the contribution of renewable energy in Sri Lanka's electricity generation mix;
- implement legal and regulatory changes necessary to facilitate the proposed restructuring, including the enactment of new legislation that harmonizes the Electricity Reform Act, No. 28 of 2002, with the Sri Lanka Electricity Act, No. 20 of 2009 (including amendments thereto of 2013 and 2022), and the functioning of the proposed new electricity sector regulator.
- establish a high-level committee under the Ministry in charge of the subject of Finance, similar to the former Energy Supply Committee, to direct and monitor the restructuring process proposed.

PRESENT-DAY ELECTRICITY INDUSTRY

15. With a history dating back to 1895, the electricity industry in Sri Lanka has undergone several key reforms including the establishment of the Department of Government Electrical Undertakings (DGEU) in 1927, and the present-day CEB in 1969 by the Ceylon Electricity Board Act No. 17 of 1969 as a statutory board to replace the DGEU. Further reforms took place in 1983 when the Lanka Electricity Company Pvt. Ltd ("LECO").was established under the Companies Act to take over the distribution of electricity in selected local authority areas.

16. The next phase of power sector reforms of the GoSL embarked in the late 1990s, recognized the need to establish a transparent regulatory framework and to enact necessary legislation "to provide a sound basis for the establishment of power sector economic, financial, environmental and service policies," enabling the power sector to "operate on sound commercial and business principles after identifying and removing constraints to achieving this objective." The objectives of this reorganization program were broadly outlined as follows[6]:

> *The power sector will be restructured to accommodate competition and to facilitate private sector participation in order to create a non-monopolistic situation within the power sector. The roles of the Government as owner, regulator and operator will be clearly defined and separated. Sector entities will be allowed to operate as independent autonomous bodies. The presently vertically integrated power sector will be decentralized. The decentralized units will be responsible for their profit and loss and they will be fully accountable. During this process generation, transmission and distribution functions will be separated. In the case of generation and distribution, the function will be sub-divided horizontally to form a number of entities to*

[6] Vision statement of the *Power Sector Policy Directions* (1998) published by the Ministry of the then Ministry of Irrigation & Power.

form strategic business units in accordance with the structure outlined above.

17. Hence, the stated objectives of this initiative are listed as, to have an efficient and dynamic power sector that would facilitate economic growth; a reliable supply of grid electricity to at least 80% of the population at affordable prices; reasonably priced reliable power supply to the industrial sector to sustain its competitiveness in the international markets; transparent regulatory processes where the interests of consumers, investors, and environmentalists will be adequately safeguarded; the non-monopolistic situation in the power sector to operate on sound commercial and business principles; substantial investments by the private sector; and reliable distribution and transmission system with losses reduced to internationally accepted levels.

18. The above sector objectives were restated as policy imperatives, and the Public Utilities Commission Act No. 35 of 2002 ("PUCSL ACT") and Electricity Reform Act No. 28 of 2002 ("ERA2002") were enacted, through which it was intended that;

    - the electricity industry will be restructured to accommodate competition and to facilitate private sector participation to create a non-monopolistic situation within the power sector;
    - the vertically integrated power sector will be decentralized, and generation, transmission, and distribution functions will be separated; and
    - several autonomous independent units will be established to take over the functions of generation, transmission, and distribution of electricity, and these sector entities will be made fully accountable and responsible for their profit and loss.

    The Minister was granted the power to operationalize these two Acts with a Gazette notification. The PUCSL Act was published in the Gazette in 2002 but not the ERA2002. Instead, seven years later, the Sri Lanka Electricity Act No. 20 of 2009 ("SLEA2009") was enacted.[7]

19. The principal intent of the ERA2002 promulgated in its Chapter VI, the reorganization of the electricity industry, was absent in the SLEA2009 and subsequent amendments thereto. Except for the formation of separate divisions under the CEB to take over the functions of generation, transmission, and distribution of electricity, there has been little progress in unbundling the sector to date.

20. The Public Utilities Commission of Sri Lanka ("PUCSL"), set up in 2002 as a multi-sector regulator was empowered by SLEA2009 to regulate the electricity industry. In 2011 PUCSL published *Tariff Methodology and Cost Reflective Methodology for Tariffs & Charges* in terms of Section 30 of the SLEA2009. However, only limited success in rationalizing the electricity tariffs has been achieved as full exercise of

[7] The Minister of Power and Energy published the *Scheme for the Reorganization of the Electricity Industry in Sri Lanka* in terms of Chapter VI of the Electricity Reform Act No. 28 of 2002 by Gazette Notification No.1321/21 dated January 02, 2004, although the Act was not made operational.

PUCSL's regulatory authority vested in it by SLEA2009, has not been implemented mainly owing to the insufficient commercial orientation and the weak response to independent regulatory oversight of the CEB. By 2022, the electricity industry had achieved only limited progress vis-à-vis the original policy goals for the sector, resulting in "incomplete sector reforms, weak regulation, and poor utility response to regulatory initiatives"[8]

21. The PUCSL has issued six separate licenses to the CEB (Generation Licensee, Transmission Licensee, and four distribution licensees). The General Manager of CEB is the Authorized Officer for all six licenses, and these licensees continue to operate under the CEB umbrella without the required level of financial separation, independence, or autonomy.

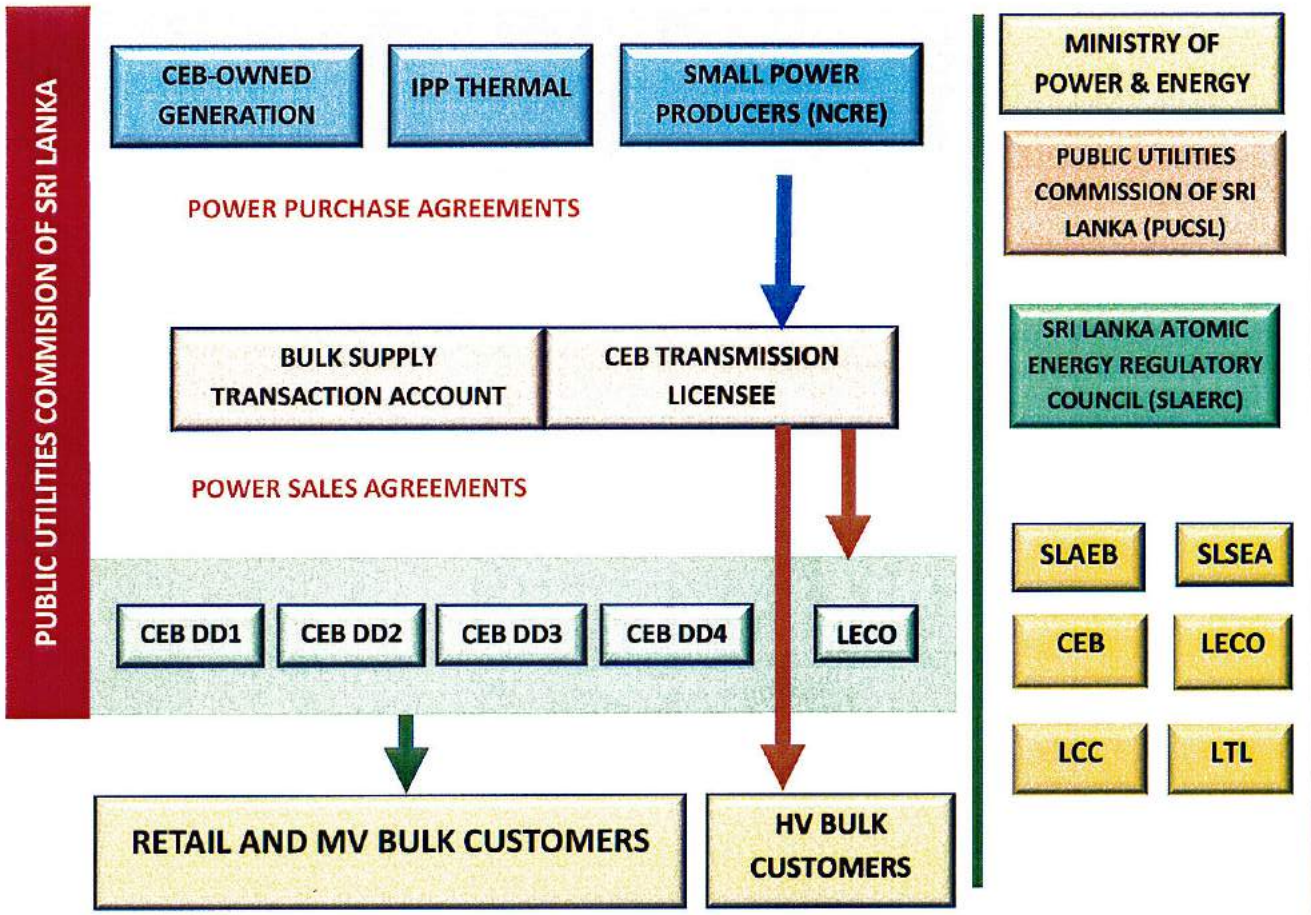
22. While the unbundling process remains incomplete, a few companies were incorporated to provide various services, but their ownership too was predominantly with the state. The status of the key electricity sector stakeholders as of 2002 is summarized below.

OPERATING ENTITIES	
Ceylon Electricity Board (CEB)	State-owned corporation established in 1969 by the Ceylon Electricity Board Act No. 17 of 1969, is engaged in the generation, transmission, distribution, and supply of electricity. It holds a dominant position in generation (generates around 70% of the total installed capacity connected to the grid) and distribution (holds 4 out of 5 distribution licenses) and a monopoly in transmission, which is also the single buyer. The CEB has five subsidiaries: Lanka Electricity Company (Pvt) Limited (LECO), Lanka Coal Company (Pvt) Limited (LCC), LTL Holdings (Pvt) Limited (LTL), and Sri Lanka Energies (Pvt) Ltd (SLE) and in addition the Trincomalee Power Company Limited, a joint venture set up in 2011 to build and operate the proposed Sampur Coal Power Plant.
Lanka Electricity Company (Private) Limited (LECO)	Private limited liability company incorporated in 1983 under the Companies Act for electricity distribution. 54.8% and 43.6% (a total of 98.4%) of the shares are held by the CEB and the Treasury respectively. Holds a Distribution License and purchases bulk power from CEB and distributes to areas in the Western and Sothern Provinces.
Lanka Coal Company (Private) Limited (LCC)	Incorporated under Companies Act No. 7 of 2007 to procure and supply coal for coal-fired thermal plants. Presently, the total coal requirement of the Lak Vijaya Power Plant (LVPP) at Norochcholai is supplied by LCC. Shares are held by CEB (60%), the Ministry of Finance, the Sri Lanka Ports Authority, and the Ceylon Shipping Corporation.

[8] Asian Development Bank; *Sri Lanka Energy Sector Assessment, Strategy, and Roadmap*; ADB, December 2019. ADB's country report *Assessment of Power Sector Reforms in Sri Lanka* published in 2015 has observed that Sri Lanka's "power sector remains neither independently operated nor independently regulated, pricing for electricity is still inefficient ..." The same observation is echoed in the subsequent ADB report of 2019 (referenced above), *Sri Lanka Energy Sector Assessment, Strategy, and Roadmaps*, wherein is has stated that the "...six licensed entities embedded within CEB do not have an independent ownership structure and management...."

LTL Holdings (Private Limited (LTL)	established in 1982 as a joint venture between CEB and European investors Bonar Long of Scotland. Manufactures high-quality transformers. Exports about 50% of the production after meeting the country's requirements. Has diversified into engineering, procurement, and construction contracting of major power projects, including transmission substations and power generating stations.
REGULATORY ENTITIES	
Public Utilities Commission of Sri Lanka (PUCSL)	Set up as a multisector regulator by the PUSCL Act No. 35 of 2002 but was unable to carry out its regulatory functions until the Electricity Act No. 20 of 2009 was enacted, as the ERA2002 was not made operational. Is the technical, economic, commercial, and safety regulator of the electricity industry. The five-member commission is appointed by the minister-in-charge of policy development (in agreement with the Constitutional Council, which existed before the 20th Amendment to the Constitution)
Sri Lanka Atomic Energy Regulatory Council (SLAERC)	Established in January 2015 under the Sri Lanka Atomic Energy Act No. 40 of 2014. As per the provisions of the Act, is charged with the responsibility for regulation of practices involving ionizing radiation, conducting activities for nuclear or radiological emergency management, ensuring the safety and security of radiation sources, and ensuring the carrying out of Sri Lanka's obligations under international conventions on nuclear safety, nonproliferation, and safeguards that to which Sri Lanka is a party.
Sri Lanka Atomic Energy Board (SLAEB)	A Statutory Body established by the Sri Lanka Atomic Energy Act No.40 of 2014. has a wide range of applications in many fields that can make a significant contribution to the development of sectors in Sri Lanka. The SLAEB has the responsibility of facilitating the utilization of radiation and radioisotope technology in medical, agricultural, industrial, energy, and environmental sectors. The original regulatory functions of SLAEB have been transferred to the Sri Lanka Atomic Energy Regulatory Council.
Sri Lanka Sustainable Energy Authority (SLSEA)	Established in 2007 by Sri Lanka under the Sustainable Energy Authority Act No. 35 of 2007. Its objectives are to, (i) assist in formulating the national energy policy; (ii) identify, conserve, and manage all renewable energy resources and appropriate conversion technologies, conversion, and utilization norms and practices; (iii) promote the development of renewable energy projects through private investment; and (iv) to conduct research on the development of indigenous resources.
OTHER GOVERNMENT ENTITIES	
Ministry of Power and Energy	Policy formulation in conformity with the prescribed Laws, Acts, and Ordinances.

23. As seen above, the electricity sector continues to be centralized and state dominated with answerability and accountability lines to the government, instead of the regulator and the customers of electricity. Like other countries, the sector has not been subject to rapid structural changes such as decentralization and vertical and horizontal unbundling. This has prevented the sector from introducing competition into a virtually monopolistic industry denying, ultimately to the public, economic efficiency gains, improved quality, and affordability. The current industry structure is given in Figure 1 below.



zFIGURE 1 – PRESENT STRUCTURE OF THE ELECTRICITY INDUSTRY

24. In summary, the Committee identified the following elements in the above structure during its deliberations:

- CEB has a (statutory)[9] monopoly in transmission and is the single buyer; hence, the CEB dominates the sector value chain.
- CEB is dominant in power generation as well, because of the high share of generation capacity owned and operated by the CEB's Generation Licensee.[10]
- Six Strategic Business Units ("SBU"s), each headed by an Additional General Manager of the CEB have been set up. They are under the administrative control of CEB's General Manager and the Board. The lack of legal and financial autonomy and separation impacts the accountability and transparency of the SBUs.
- CEB's influence and presence are felt even in ventures such as LTL and LCC by its shareholding in these companies.

[9] Section 9 (2) of the SLEA2009

[10] In 2021, CEB generated 76% of the country's total energy demand of 16,716 GWh, while the CEB and IPPs (including small power producers) owned 3,040 MW and 1,146 MW of generation capacity respectively.

RESTRUCTURING OF SRI LANKA'S POWER SECTOR - 2022 ONWARDS

25. Twenty years since the passage of the ERA2002, multiple crises faced by the electricity industry and the current economic challenges have made electricity industry reform an immediate priority for the GoSL. The GoSL has pledged to chart a new path towards converting the country's vertically integrated and largely inflexible state-owned utility into an efficient and dynamic organization, a requirement for separating and defining clearly the roles of owner, operator, and regulator.

SEQUENCING REFORMS

26. The Committee is of the view that the GoSL must pursue an overall "Reforms Package" and not engage in stand-alone *ad hoc* changes. Faced with the need to address immediately the current crisis in the sector, the Committee is also of the view that the GOSL must consider a four-pronged approach, but within a stated timeline of not more than 3 months.
    - Enact an "Electricity Sector Reforms Act" ("ESRA") for reorganizing the electricity industry by setting up the successor entities and repealing the Ceylon Electricity Board Act No. 17 of 1969 after the successor entities become operational. At the same time, the Sri Lanka Electricity Act No 20 of 2009 should be suitably amended to synchronize with the provisions contained in the ESRA.
    - After the proposed reforms are achieved under ESRA, a new Electricity Act should be enacted as single legislation that will deal with all aspects of the electricity sector.
    - At the stage of enacting the new Electricity Act, establish a dedicated independent regulator for the electricity sector, possibly by reassigning the PUCSL's mandate. At that stage, to ensure legislative integrity, the provisions relating to the functioning of this regulator can be incorporated into the new Electricity Act as a separate section instead of having multiple acts.[11]
    - In the interim, take immediate measures to deal with the cash flow crisis of the sector, and treat the accumulated debt in a way that such debt will not be a hindrance to the envisaged reforms. Reduce the exposure to fluctuating coal and fuel prices leading to some degree of tariff reduction on behalf of the public.

"MONETIZING" THE REFORMS PROCESS AND IMPROVING SECTOR GOVERNANCE

27. The Committee recognizes that a consensus has now been reached on the need to reform the sector. As attracting investment into the sector is a key priority and a desperate need, the GoSL must utilize the reforms process itself as a marketing tool and an invitation to investors. Clearly defined outcomes, a well-thought-out set of reform strategies to achieve those outcomes, and a clear and enforceable implementation schedule with legal provisions that makes the reform gains

[11] Similar models have been followed in most comparable jurisdictions, including India.

irreversible, and operationalized through a well-publicized transparent process will bring credibility and certainty. This in turn will enable the sector to attract the necessary funding and investor commitment from the early stages, without having to await the completion of the reforms.

28. The "Reform Process" itself is of value to enhance investor confidence and is much needed when looking back at the track record of the government in the past regarding its management of the sector. Designating a high-level authority to be accountable for implementing the reforms process, as suggested in paragraph 33 will complement this approach.

29. The GoSL must take tangible steps to enhance sector credibility to make it attractive to serious investors. Sri Lanka needs to move away from practices such as accepting unsolicited proposals towards a procurement framework that is transparent, fair, and competitive. Such a step will enhance the sector's ability to access financing from funding sources that prioritize environmental, social, and governance ("ESG") considerations. Projects that are procured through direct negotiations are viewed as high-risk projects due to the inherent political risks that come attached to such an arrangement. Following a transparent & competitive process will also enable attracting developers with strong repute & experience, which is another key consideration for the long-term financial sustainability of the sector.

ASPECTS OF AN ENABLING ENVIRONMENT

30. The broad policy environment for electricity industry reform must strive to achieve a market structure that,

    - does not allow for preferential treatment or advantaged positions of certain players relative to others in the market;
    - deals with barriers to entry for new market entrants;
    - supports pricing that is cost reflective and subject to the discipline of competitive market dynamics; and
    - has a strong regulatory and oversight regime, independent of government to guard against anti-competitive behaviors by industry participants.

31. Sri Lanka's existing model of a vertically integrated monopoly vested in a statutory board does not foster this market development. Operation and development of the electricity market envisioned cannot be realized without the creation of certain enabling conditions. This enabling environment entails a set of legal, regulatory and market rules, regulations, and instruments, which "operationalize" the sector policies and form the basis of the electricity market, as well as ancillary issues such as tax policy, exchange rate protection, etc. Some of the key characteristics relevant to the proposed electricity market include the following elements:

    - Tariffs based on prudent cost expenditure and efficiency through the electricity value chain, which reflect the cost of service, including the return of and on capital from equity and debt;

- Industry participants that respond to incentive-based electricity tariff structures including penalties attached to the quality of service expected;
- The elimination of conflicts of interest in the ownership and operation of assets;
- Transparency in sector financial commitments, and incurred liabilities;
- Use of integrated resource planning (long-term planning across the generation, transmission and distribution sectors) to align interments in the generation, transmission, and distribution assets;
- Commitment to the decarbonization of Sri Lanka's electricity industry, in keeping with Sri Lanka's international obligations and energy security needs;
- Transparent procurement processes aligned with technically driven long-term integrated planning;
- In regulated sectors of the electricity market, the procurement of electricity infrastructure that ensures cost efficiency and transparency, consistent with investments identified through the integrated resource planning process;
- Improved regulatory oversight;
- self-financed electricity sector that can attract capital;
- Equity, where low-income customers have equitable access to electricity;
- Background conducive to the future establishment of an efficient electricity trading market.

ASPECTS APPLICABLE TO GENERATION, TRANSMISSION & DISTRIBUTION

32. In addition to the overall enabling environment, the sector laws, regulations, and policies must also specifically target the unbundled elements that would take over the functions of generation, transmission, distribution, and sale of electricity. Key responsibilities of the successor entities will include the following:

GENERATION

- Energy security via the provision of adequate generation capacity
- Operational efficiency (e.g., heat-rate and duty cycling), including maintenance and spare parts acquisition;
- Utilize new technologies to increase reliability and resilience and reduce the requirement for spinning reserve, including from thermal generation stations;
- Economic security (balance of payments, exchange rate, etc.), via investment in and utilization of indigenous resources to reduce dependence on imported fuel;
- Align generation investment with climate commitments to meet international obligations.

TRANSMISSION

- Alignment of investments in generation, transmission and distribution infrastructure;
- Transparent generation dispatch on merit order of costs;
- Ensuring a flexible and resilient network capable (both in terms of physical and human capacity) of connecting distributed generation capacity, integrating intermittent resources (NCRE-based generation), and advanced technologies while maintaining system reliability;
- Efficiency transmission network (e.g., low technical losses).

DISTRIBUTION AND SALES

- Efficient revenue cycle, which includes strong billing and collections practices;
- Investment in technology to allow for efficient metering, billing, and revenue collection, and to encourage self-generation at the retail level;
- Efficiency in the distribution of electricity (e.g., low technical and commercial losses).

KEY POLICY OBJECTIVES

33. In its attempts to identify the scope and scale of the problem and to propose a pragmatic approach to restructure the electricity industry of Sri Lanka, as already explored in the discussion above, the Committee has identified the following key strategies as necessary for meaningful reform of the electricity industry:

- Define a national electricity policy (Integrated Electricity Policy) that positions the private sector as the driver of the electricity supply industry on funding, innovation, and leadership, and creates an environment that fosters private sector participation;
- Unbundle the sector to establish independent entities to manage the generation, transmission, distribution, and sale of electricity, and to promote market competition in these subsectors;
- Ensure financial self-sufficiency of the new entities through a cost-reflective and transparent system of tariffs, and transparency in financial commitments, incurred liabilities and operations;
- Institute an independent and transparent investment planning process based on the concept of integrated resource planning;
- Improve the regulatory oversight of the electricity supply industry, preferably through the establishment of an independent regulator exclusively for the power sector;
- Enhance the contribution of renewable energy in Sri Lanka's electricity generation mix;

- Implement legal and regulatory changes necessary to facilitate the proposed restructuring, including the enactment of new legislation that harmonizes the Electricity Reform Act, No. 28 of 2002, with the Sri Lanka Electricity Act, No. 20 of 2009 (including amendments thereto of 2013 and 2022), and the functioning of the proposed new electricity sector regulator;
- Establish a high-level committee under the Ministry in charge of the subject of Finance, similar to the former Energy Supply Committee, to direct and monitor the restructuring process proposed;
- Establish a dedicated tribunal for enforcement and resolution of disputes arising out of sector operations.

These items are discussed below in greater detail.

NATIONAL ENERGY POLICY, INTEGRATED ELECTRICITY POLICY, AND LONG-TERM PLANNING FUNCTION

NATIONAL ENERGY POLICY

34. The Committee recommends that for the long term GoSL considers setting up a National Energy Commission ("NEC"), including representatives from key stakeholders such as the Ministry of Finance and the Ministry of Power to carry out the overall national level planning function for the country's total energy aspects. The NEC will have a combination of appointed and *ex officio* members, with the former selected based on stated criteria relevant to the function of long-term energy planning. The NEC need not be a permanent body but be designed to be mandatorily and automatically constituted at specified intervals (e.g., once every 3 or 5 years) to formulate the (3- or 5-year) National Energy Policy ("NEP"). The law can include provisions relating to the constituent elements of the NEP and the criteria that should be followed in selecting the non-*ex officio* members of the NEC.

NATIONAL INTEGRATED ELECTRICITY POLICY ("NIEP")

35. The current legislation governing the electricity supply industry requires having in place a national policy. The PUCSL Act and SEA2009 are both premised on the pursuance of a coherent National Integrated Electricity Policy ("NIEP") and the need to regulate the generation, transmission, distribution, supply, and use of electricity in terms of that policy. Therefore, the Committee strongly recommends the formulation of the NIEP that reflect dynamically the changing socio-economic conditions and societal aspirations.

LONG-TERM PLANNING FUNCTION

36. Long-term planning of generation, transmission, and distribution will guide the development of Sri Lankan power and enable integrated resource planning. Demonstrating that the sector has a strong energy demand and supply planning process is critical to give comfort to investors including those willing to invest in renewable energy.

37. With the introduction of an Independent System Operator ("ISO"), as discussed below, the ISO should be designed to be capable of independently carrying out the

long-term planning function in close collaboration with the transmission licensee and other relevant entities.

STRUCTURE AND STATUS OF THE CEB

38. The CEB was set up in 1969 by an act of the Parliament with a separate legal personality. Being a state entity, CEB over the years easily retained, enhanced, and defended its monopolistic and dominant position. As a result, its ownership and operational structures, including the administratively set up SBUs,[12] do not render the CEB amenable to operate as a commercially viable entity responding to the laws and regulations of a regulatory model that seeks to attract much-needed financing from sources other than the government, whilst ensuring uninterrupted supply of electricity at sustainable costs.

39. The sector reforms to achieve these imperatives, as first envisaged under Part VI of the ERA2002, cannot be realized if the CEB is to continue in its current form. The emergence of new independent legal entities corresponding to an unbundled sector will result in the repeal of the Ceylon Electricity Board Act, No. 17 of 1969. Companies Act No. 7 of 2007 (as amended), has introduced a mature company law regime, with built-in checks and balances and accountability mechanisms, which can be speedily and easily resorted to. Sector entities, that are set up under the Companies Act, will be subjected to scrutiny, oversight, and accountability to a wider stakeholder group including employees and consumers, not only by the sector regulator but also under the Companies Act, which provides a direct accountability route, especially in governance, to the stakeholders. Public listing, if opted for, will further strengthen the oversight mechanism with an additional set of good corporate governance principles of a listed company becoming applicable. Share ownership by the State, therefore, should be carefully decided not to exclude other oversight mechanisms or take away the autonomy of an "independent commercial entity" or reduce entities' attractiveness to investors.

40. Targeted interventions must be in the context of the wider reform. For example, the decision on the status of the CEB must be made, considering the following as the key elements of a wider reform package.

    - Unbundle the sector as was also envisaged under Part VI of ERA2002;
    - Repeal of the Ceylon Electricity Board Act, No. 17 of 1969 to replace the CEB with separate independent legal entities to operate in an unbundled sector;
    - Introduce additional market participants, including those needed to take over existing assets and operations within the unbundled framework; and
    - Amend or introduce legislation to facilitate the opening of the sector to market competition and formalizes the roles, responsibilities, rights, and obligations of electricity market participants.

[12] The Board is appointed by and answerable to the Minister (§3 & §6) and can be removed by the Minister. He also can give general or special directions as to the performance of the duties and the exercise of the powers of the Board in relation to matters which appear to him to affect the national interest (§8)

A SINGLE PACKAGE: UNBUNDLING, CORPORATIZATION AND COMMERCIALIZATION

41. The Committee is of the view that for the required reforms to be successful and usher in a change of culture, unbundling, corporatization and commercialization must be done as a single package. Other countries' experiences demonstrate that competition alone will not lower tariffs, but efficiency gains would.

42. The CEB's, and therefore the electricity industry's operations, strategies, and behaviors are gravely influenced by the CEB's linkages to the government, especially given its legal structure is that of a "statutory board" and the legal state monopoly status it enjoys. The current structure provided little incentive for the CEB to act as a commercially viable or meaningfully accountable entity. A few strategically placed legal provisions in the SLE2009 insulate the CEB from having to respond to stakeholder requirements and prevent sector unbundling.

43. Repeal of the Ceylon Electricity Board Act will unentangle the sector, allowing the sector's unbundling into generation, transmission, and distribution. New legislation, based on the ERA2002, defining the structure, and functioning of the generation, transmission, distribution, and supply of electricity, system operations, and the regulatory arrangements enabling the PUCSL to manage the electricity industry of the country efficiently is proposed.

44. How the sector (and the CEB) is unbundled will have significant implications on the viability and financial sustainability of the unbundled components. Assessment of factors such as the allocation of customers, allocation of debt, allocation of generation capacity, etc., requires careful analysis and planning.

45. Based on Chapter VI of ERA2002, it is proposed to establish new independent entities under the Companies Act No. 7 of 2007 to take over the CEB's business of generation, transmission, distribution, and sale of electricity, as follows:

    - One independent system operator (ISO), as discussed below, vested with the power and responsibility of ensuring ultimately uninterrupted power supply and the necessary planning for such.
    - One Transmission Company initially to maintain, operate and develop the transmission network assets, and to provide non-discriminatory open access to the transmission system for use by any generating company, subject to payment of the transmission charges.
    - Four independent companies, initially to take over the electricity distribution and sale business of the CEB's current four distribution divisions. LECO will continue without a change to its corporate status as a separate distribution licensee, and the current demarcation of boundaries of these licensees can remain unchanged[13] at the initial stage.

[13] ERA2002 proposed to form the DISCOs companies after amalgamating distribution operations of CEB and LECO. Since the CEB has been functioning with four separate distribution divisions for many years already, it is advisable to keep the existing structure and the divisional boundaries undisturbed until a comprehensive financial and strategic assessment on the ideal demarcation is carried out.

- Six independent companies to take over the business of CEB's Generation Division comprising the Laxapana Hydropower Complex, Mahaweli Hydropower Complex, Samanalawewa, and other hydropower plants, Norochcholai Coal Power Plant, oil-fired thermal plants owned by the CEB (Kelanitissa, Sapugaskanda, barge, etc.), and the Mannar Wind Power Plant. In deciding the policy with regard to the ownership of these 6 companies, the Committee recommends that due regard be had to the multiple uses of water resources governed under different legal regimes including the Mahaweli Authority Act No. 23 of 1979 and the Irrigation Ordinance No. 32 of 1946 (as amended).

46. It is further proposed to establish two separate entities under the Companies Act No. 7 of 2007 as follows:

    - One company to act as the custodian trustee, and to manage the CEB Provident Fund and CEB Pension Fund of the CEB employees opting to take up employment in the successor entities discussed above, and
    - One company to take over those functions and activities of the CEB other than those entrusted to the successor companies under 45 above.

47. The Conversion of Public Corporations or Government Owned Business Undertakings into the Public Companies Act, No. 23 of 1987 can be used to transfer the assets of the CEB to these successor entities. These entities should be independent, managed by their own, and separate Boards of Directors, strictly in line with the corporate governance principles as enunciated in the Companies Act No. 7 of 2007. It is important that in the structuring of these new entities the following pre-existing conflicts of interest situations are eliminated.

    - Between the utility and the policy maker (through ownership)
    - Between the utility management and trade unions (through memberships)
    - Between planning and operations (through functions)
    - Between plant dispatch and ownership of generation assets (through function)

48. Legally unbundling the businesses of generation, transmission, and distribution of electricity under independent boards of directors would increase transparency as the separate functions would develop auditable independent financial statements and transactions governed by legal contracts. Further, tariff determination by the PUCSL would be direct and transparent, largely helped by the separate financial statements and the ease of determination of a reasonable rate of return based on the specific risk profiles of the businesses.

49. Upon the CEB's transition from a statuary board to several companies, 100% shares of these successor companies as well as the shares of other companies (LECO, LTL. LCC, etc.) presently held by the CEB, will be transferred to the Secretary to the Treasury. The Committee believes the current SBU structure should not be

replicated using the Companies Act by vesting the share ownership of the newly set up companies in one entity or person, government or otherwise.

50. Decisions such as the number of licenses, area demarcations for distribution licensees, etc., must be in principle made based on well-published intelligible criteria that are best calculated to achieve competition, a better quality of service, reasonable costs, and meeting of universal service obligations targeting the poor and the vulnerable. Some of the specific broad policy considerations relevant to generation and transmission are further discussed below.

TRANSMISSION NETWORK; SEPARATION OF TRANSMISSION AND BULK PURCHASE/SUPPLY SERVICES

51. CEB currently holds six licenses, including the Transmission License, which is also responsible for the bulk purchase (purchase from both CEB and privately-owned generation) as the "single-buyer" and bulk sales (bulk sales of electricity to the CEB Distribution Licensees and LECO). The transmission function and the bulk purchase and supply functions are different businesses with different risk profiles and are no compelling reason to keep these businesses bundled together.

52. The transmission function is a natural monopoly business and may be relatively easier to attract investments to the sector. The Transmission entity must be subject to appropriate regulations given such being a monopoly whilst ensuring that its independence to operate as a commercially responsive entity in a regulated sector is not compromised.

DISCONTINUING THE SINGLE-BUYER MODEL

53. The Committee proposes the discontinuation of the single buyer provision in the current structure, which restricts the sale of energy by the Generations Licensees only to the Transmission Licensee to provide for introducing wholesale competition and open access in the future.

54. It is proposed that the bulk power purchase and sale be carried out by the ISO with a mandatory Bulk Supply Transaction Account ("BSTA"), and a Transmission Licensee maintains and operates its network assets on a non-discriminatory basis, to ensure a level playing field. To achieve this objective, the law must enable Power Sales Agreements (PSA) that allow direct contracting between generators and distribution companies, or between generators and individual bulk customers, when the necessary conditions (preferably pre-determined) for a functioning bilateral market are achieved.

55. To avoid the risk of the "single-buyer" bulk purchase and supply licensee becoming an obstacle to achieving a functioning bilateral or wholesale market, it is proposed to limit the term of Power Sales Agreements (PSAs) for bulk sales to distribution licensees, and to allow Power Purchase Agreements (PPAs) for bulk purchase to be assigned or novated.

ESTABLISHMENT OF THE INDEPENDENT SYSTEM OPERATOR (ISO)

56. Currently, energy dispatch (e.g., the calling of generation stations to generate electricity to match the real-time system demand) is undertaken by the CEB's National Control Center functioning under the CEB Transmission Licensee. This presents a clear potential for conflict of interest as CEB also owns generation assets, resulting in allegations of possible anti-competitive behavior (such as preferential treatment of CEB-owned generation)[14].

57. The establishment of an ISO that is legally separate (including from the Transmission Licensee) would substantially reduce the potential for conflict of interest. The ISO will have the short- and long-term obligations that are customary for an ISO to perform, defined separately from the functions of the Transmission Licensee.

58. The ISO shall operate a transmission system to provide a non-discriminatory open transmission service for all generators. It should be a separate and independent legal entity with clear accountability to the regulator, generators, distributors, and consumers. Its accountability could be achieved largely by the publication of daily dispatch reports and accurate cross-boundary energy measurements. The functions currently performed by the National Control Center should be absorbed by the ISO.

59. The ISO must be specifically and strictly mandated and empowered to provide uninterrupted power and should be vested with appropriate budgets, human resources, and planning authority, to ensure that the ISO does not "shift or shirk" its responsibilities. The relevant laws and regulations should differentiate ISO's "planning authority" from that of the overall "sector policy and planning". The Authority of the ISO should include the power to develop formal rules, and regulations, using the enforced Self-Regulation method,[15] which allows the ISO to carry out its responsibilities in a transparent manner without interference from third parties. (ISO's links to long-term planning are further discussed in paragraph 64).

    In the above context, the proposed structure of the electricity industry is given in Figure 2 below.

ENSURING COST-REFLECTIVE TARIFFS

60. Cost-reflective tariff is already ensured under law. The issue has been the failure of the sector institutions to respond to this requirement commercially. Therefore, it is proposed to strengthen the legal provisions for implementing a cost-reflective tariff and adhere to the published Tariff Methodology for revising tariffs.[16] A tariff setting founded on the principles and assumptions of cost recovery and financial viability of

[14] Such problems are avoided by following the regulator-mandated merit order dispatch of generation. However, inability to audit the CEB's dispatch records has been a continued problem for the PUCSL, and the absence of independent verification of the plant dispatch calls into question the reliability of the process.

[15] A self-regulatory mechanism where the organization makes its own rules but must submit them to a regulatory agency for approval.

[16] It should be understood that a *cost reflective tariff* does not mean passing the costs, with inherent inefficiencies, bad planning and poor financial management to the electricity consumer.

all independent entities will be a prerequisite for attracting investments to the power sector. A tariff will ensure efficient use of the network, fair allocation of risks, and provide incentives for improving performance, transparency, and fairness, as well as adherence to prudent expenditure by the licensees.

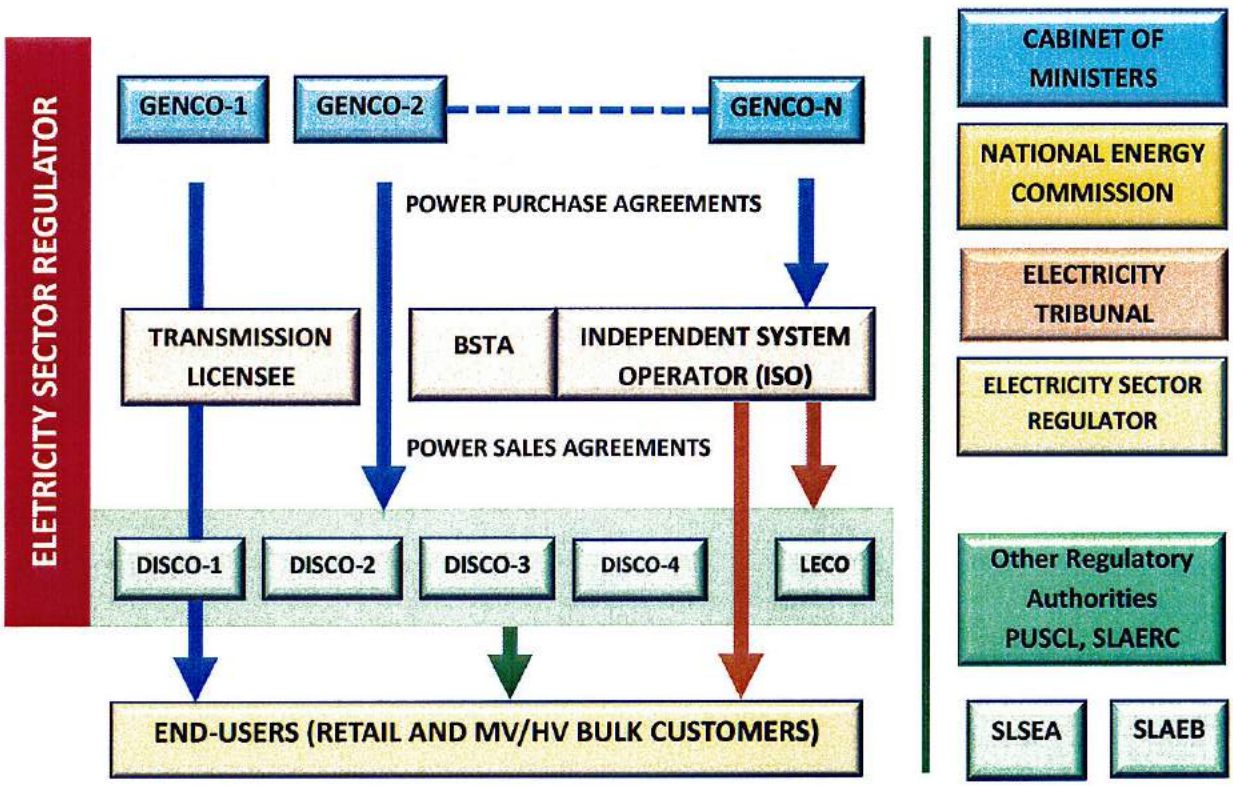


FIGURE 2 – PROPOSED STRUCTURE OF THE ELECTRICITY INDUSTRY

STATUS AND OPERATIONS OF THE BULK SUPPLY TRANSACTION ACCOUNT ("BSTA")

61. Implementing a fully operational BSTA will significantly enhance the financial transparency of the Transmission Licensee.[17] In any event, already the CEB as the Transmission Licensee is required to establish and maintain the BSTA as per the approved Tariff methodology of the PUCSL issued under Section 30 of the SLEA2009.

62. With the implementation of the proposed reforms, the ISO should be legally mandated to operate a BSTA that is subject to independent auditing and heavy penalties based on audit findings. The financial data of the BSTA should fully reflect all direct and indirect costs associated with the purchase and sale of electricity through the BSTA (including payments made under PPAs including those of small power producers).[18]

[17] BSTA will improve the financial discipline of the Transmission Licensee, because in situations of cash shortfalls, its liability will be limited to the funds available in the BSTA.

[18] The BSTA reflects the cash flow situation of the sector dynamically and allow the decision makers to monitor the cash situation in relation to demand at any given time.

63. As an immediate step, a BSTA should be physically established in a recognized licensed commercial bank, to immediately separate the cash flow of CEB's generation, transmission, and distribution licensees, and to allow them to operate independently.[19] Further, along with the establishment of the BSTA, the Additional General Managers in charge of licensees should be permitted to operate their business units independently until the ESRA process is complete and CEB is abolished.

LONG-TERM PLANNING FUNCTION

64. The ISO should be designed to be capable of independently carrying out the long-term investment planning function in close collaboration with the Transmission Licensee and other relevant governmental and non-governmental entities. The ISO will be subject to the oversight of the regulator.

65. Demonstrating that the country has a strong energy demand and supply planning process is critical to give comfort to investors including in renewable energy The Committee recommends entrusting the responsibility of overall national level planning to the National Energy Commission proposed in paragraph 34, in addition to the formulation of the national electricity policy.

TREATMENT OF GENERATION ASSETS

66. The business of CEB's Generation Division should be financially unbundled and taken over by separate corporate entities. It is recommended that the separation be both asset-based (corporate entity per generation unit) and capacity-based (combining generation systems under one corporate entity), best calculated to achieve the key objective of appropriate market competition and ensure transparent costing and pricing.[20]

67. The Committee proposes that Mahaweli Hydropower Complex, Laxapana Hydropower Complex, Samanalawewa, and other hydropower plants, Norochcholai Coal Power Plant, other thermal plants owned by the CEB (Kelanitissa, Sapugaskanda, barge, etc.) and the Mannar Wind Power Plant should be owned and operated by separate and distinct corporate entities functioning as stand-alone companies. Their ownership structures can also be decided based on energy type (e.g., hydropower, thermal, wind, etc.) or on their suitability for public-private partnership (PPP) considering which plants need to be retired.

TREATMENT OF FINANCIAL ASSETS, ACCUMULATED DEBTS AND HUMAN RESOURCES

68. Decisions in asset and liability allocation, valuation (e.g., whether assets should be impaired) and capital structure will impact the go-forward tariff required to support

[19] The "Step 1" suggested by the CEB Management in its submissions to the Committee.

[20] Another option is to retain the ownership of the CEB's generation asset in one entity and vest full operational and management authority in separate corporate entities, with strong safeguards to prevent any interference by the asset owner, in the operations; or the operator expecting the asset owner to invest to develop the asset. In this model, strict separation between the owner and operator could discourage the operator making investments to develop the asset and encourage the operator to lobby the GoSL for fiscal support as a pre-condition for low-cost electricity to meet universal service obligations ("USOs"). Strategic use of economic regulatory strategies by the sector regulator can be successfully used to encourage the operators to invest in the assets and profit mainly through efficiency gains. The NBV of the asset at the point of migration will form a key criterion in making this decision.

different entities. The total debt of the CEB as of August 31, 2022, had soared to approximately LKR 333.5 billion (USD 904 million)[21] comprising payments (in both foreign currency and LKR) owed to suppliers of goods and services and outstanding payments for fuel and energy purchases (coal, CPC, IPPs and renewable-based energy producers) amounting to LKR 196.2 billion (USD 532 million), and outstanding loans (commercial banks and LECO) amounting to LKR 137.3 billion (USD 372 million).

69. These legacy liabilities will have to be dealt with using innovative financial engineering ensuring that they do not stand in the way of the sector attracting investments and achieving financial sustainability moving forward. One of the strategies is to ring-fence and separate the liabilities placing them in a suitable entity to be settled over a period. Dedicating a small part of the tariff, initially through a legal provision, can be a strategy to settle over time the debts so placed in such entity. This mechanism should be recognized in the tariff methodology and reviewed in the subsequent years based on the financials of the entities.

70. With the implementation of the proposed ESRA, the assets of the CEB, including the shares it holds in other entities (e.g., LTL, LECO, LCC) will be transferred to the Treasury, enabling the Treasury to decide on the best method to monetize those assets and use the proceeds for investment in the sector and towards lessening the debt burden. Monetization can be also achieved through the public listing, which will ensure a transparent method to arrive at the best market price. The listing will also bring to the sector the added benefit of the discipline and transparency of the securities regulator. Holding or disposal of shares by the Treasury should not create ownership structures that give rise to conflicts of interest in the unbundled electricity industry.

71. Sector human resources can be transitioned to the successor entities. Sri Lanka has multiple precedents of such transitions. The social security funds (CEB Provident Fund and the non-contributory pension fund) of the CEB can be managed by placing them under legally and financially separate and independent management. Depending on the entities that would be formed, a decision could be taken, strictly in compliance with the labour laws and recognized employee rights, as to how those funds could be managed in the future ensuring that there is no reduction in legally entitled benefits of the current CEB employees consequent to the proposed structural changes.

DECARBONIZING: TAPPING INTO THE GLOBAL FINANCES TO DEVELOP RENEWABLE ENERGY

72. The Committee recommends, in the context of decarbonizing and developing renewable-based electricity, wheeling should be allowed to selected projects to minimize off-taker risk factors of new renewable energy projects. The addition of new renewable capacity is expected to bring down the average generating cost and hence the tariff charged to customers. Sri Lanka needs to move expeditiously towards meeting its climate and carbon footprint reduction commitments, which

[21] At the present exchange rate of USD 1 = LKR 368.9

will enable Sri Lanka to access global climate funds. The country is currently severely challenged tapping into global capital markets. Creating an enabling environment, therefore, is paramount to attracting global capital investments to Sri Lanka's renewable energy sector.

73. For renewable energy to make significant in-roads into the power generation mix of the country, and to address climate change concerns it is necessary to make suitable provisions in the proposed new legislation (i.e. the Electricity Act that will subsequently replace the ESRA) to provide the legal and regulatory changes required to stimulate the contribution of renewable energy in the energy mix. Such regulatory changes may include, for example, requiring the transmission system operator or a distribution company to upgrade its system at a reasonable economic expense to connect renewable-based producers, subject to specifying how the cost of upgrading the system may be shared between the parties.

ELECTRICITY TRIBUNAL

74. Consequent to the proposed reforms, the electricity industry will evolve from the current substantially law-based dynamic to that of a contract-based operational regime. The effectiveness of the sector will be based on the efficiency and efficacy with which contractual and license provisions are implemented and the speed with which disputes are resolved.

75. In an unbundled sector, the continuity of electricity supply from generation to the end-user will depend on each sector entity in the electricity value chain fulfilling its license and contractual obligations, including non-discriminatory access rights. If the sector is to achieve the required dynamism, contractual disputes and enforcement cannot be delayed. Further, the nature of the disputes will be such that the traditional court-based dispute settlement and enforcement mechanism will not be very effective.

76. It is proposed, therefore, that a special tribunal ("Electricity Tribunal") be set up, as a separate section in the ESRA, with powers to adjudicate on operational aspects of the electricity industry and make binding determinations.[22] The Electricity Tribunal will include such number of members who will bring legal, managerial, technical, and judicial perspectives to the dispute settlement process. It can be chaired by a person with judicial experience (including a senior judge on secondment) appointed by the Chief Justice and/or the Judicial Service Commission. Other members could be nominated by the Minister with the approval of the Cabinet and appointed by the President. The law should specify tribunal members' respective qualifications. Before appointment by the President, the nomination may receive no objection from the office of the Chief Justice.

77. The Electricity Tribunal must have determination and enforcement authority, beyond what is currently conferred to the PUCSL. Its determinations should be enforceable by the Magistrate's Court deeming it to be an order of such Court. An appeal should lie to the Court of Appeal on very specific grounds, and granting of any

[22] Section 17(i) of the Public Utilities Commission Act No. 35 of 2002 limits dispute settlement to Mediation only.

interim reliefs should be subject to maintaining the continuity of the electricity supply.

KEY LEGAL PROVISIONS TO BE INCLUDED IN THE PROPOSED ELECTRICITY SECTOR REFORM LEGISLATION

78. The Committee does not wish to present a comprehensive draft Act as the committee is of the view that the new laws must benefit from the institutional learnings of the relevant Departments responsible for legislative drafting. The key provisions which the Committee is of the view should be included in the envisaged legislative acts are listed below.

79. The Committee proposes the enactment of the "Electricity Sector Reforms Act" ("ESRA") to implement, expeditiously, the proposed restructuring proposals as contained in this Report. The ESRA will provide the required legal infrastructure for the immediate transformation of the sector. Provisions of Chapter VI of the Electricity Reforms Act No. 28 of 2002 should form the principal basis for the drafting of ESRA. ESRA should amend Sri Lanka Electricity Act No. 20 of 2009, as necessary to make its provisions well synchronized with the ESRA.

80. It is further proposed that subsequently a new Electricity Act be enacted as a single comprehensive piece of legislation for the sector, instead of continuing with the current multiple legislation. The said act will provide for the formulation of national energy and electricity policy. This Act should be enacted not later than 24 months from the enactment of the ESRA and should replace the ESRA, Sri Lanka Electricity Act No. 20 of 2009, and other sector legislation.

81. The Committee also proposes that the reform process as contained in the ESRA be time and milestone-based, and the Parliament must, in the ESRA, designate a person responsible for the implementation of the ESRA (e.g., Secretary to the Ministry in charge of the subject of Power) and mandate that a report be placed by such person, through the Minister, before the Parliament on the status of the reforms once in every three months, until the reform process is completed. The Committee also recommends that the Minister be empowered by the ESRA to appoint if needed, at his discretion, a Competent Authority for the CEB to ensure smooth implementation of the ESRA within the CEB.

82. The ESRA must include the following legal provisions.

(1) Provisions designating the Secretary to the Ministry of Power as the designated person to oversee the reform process and for the Minister of Power to place before Parliament, once in three months, a status report of the reform process.

(2) Provisions for the preparation and publication of a Scheme for Transition and Reorganization of the Electricity Industry referred to as the "Transition Plan". The legislative provisions, with regard to the Transition Plan, shall include the following:

(i) Transition Plan ("TP"). which shall be published in the Gazette by the Minister in charge of the subject of electricity and placed before Parliament for its

information within a period of not more than six weeks of coming into operations of the ESRA.

(ii) Implementation of the TP, including the formation of successor entities, shall be completed not later than 12 weeks after its publication in the Gazette.

(iii) Treatment of existing human resources of the CEB.

(3) Provisions separating generation, transmission, and distribution of electricity as separate and independent functions in a manner capable of allocating those functions to the successor entities that would be set up to take over and operate independently in the respective functional areas.

(4) Provisions mandating the Minister to set up such number of successor entities in terms of Conversion of Public Corporations or Government Owned Business Undertakings into the Public Corporations Act. No. 23 of 1987. The Minister shall set up these companies not later than 12 weeks after the publication of the TP.

(5) Provisions enabling securities held by CEB in other entities that shall stand transferred to the Secretary to the Treasury in terms of the Public Corporations or Government Owned Business Undertakings into Public Corporations Act. No. 23 of 1987 to be disposed of in a manner that avoids conflict of interests through share ownership and in a manner that is best calculated for the Treasury to receive the maximum benefits and further granting the discretion to the Secretary to the Treasury to utilize whole or part of those proceeds to set off part of the debt currently incurred by the sector.

(6) Provisions enabling the transfer of debts of the CEB to a separate entity, the form of which shall be decided at the discretion of the Secretary to the Treasury.

(7) Provision enabling novation or assignment of PPAs and such similar contracts entered into with the CEB to the relevant successor entity.

(8) Provision enabling the Regulator to issue such number of licenses to the successor entities and for the corresponding existing license given to the CEB to stand terminated on the date the new License becomes operational and to amend §19 of the SLEA2009 as necessary to reflect such.

(9) Provisions mandating the Secretary to the Treasury to take such action including stock market listing to encourage public ownership and actively seeking strategic investors into the sector through the appropriate successor entities to eliminate the dependency of the sector on government subsidies within the shortest possible time.

(10) Provisions enabling the establishment of an Independent Systems Operator ("ISO") as a separate and independent body corporate. The ISO shall be made accountable to the regulator, generators, distributors, and consumers. The ISO's mandate and responsibility should include (i) provision of uninterrupted power; (ii) transparent dispatch; (iii) nondiscriminatory access; and (iv) planning, including long-term

investment planning. The ISO should have the power to formulate the standing operating procedures which shall be enforceable subject to approval by the regulator.

(11) Provision mandating the setting up of a Bulk Supply Transaction Account ("BSTA") to be operated by the ISO to fully reflect all direct and indirect costs associated with the purchase and sale of electricity through the BSTA [including payments made under Power Purchased Agreements (PPAs) and Standardized Power Purchase Agreements (SPPAs)]. The BSTA should be capable of reflecting the cash flow situation of the sector dynamically and the decision-makers being able to monitor the cash situation in relation to demand through the BSTA at any given time. The ESRA must specifically provide for the immediate physical establishment of the BSTA in a recognized licensed commercial bank.

(12) Provisions by which the Ceylon Electricity Board Act No. 17 of 1969 shall stand repealed on the day specified for the completion of the TP, which shall not be later than 18 weeks of coming into operations of the ESRA.

(13) Provisions empowering the Minister to appoint a Competent Authority to exercise all powers as conferred on the General Manager of the CEB in terms of the Ceylon Electricity Board Act No. 17 of 1969, specifically Section 5 of the said Act, in the event the Minister is of the opinion that such appointment is necessary for the immediate implementation of the reforms.

(14) Provisions, in a separate section, requiring the Minister, the Regulator, and the ISO, within a specified time, but not more than six months from the date of enactment of the ESRA, such policies, rules, and regulations that are best calculated, in the opinion of the Minister, the Regulator, and the ISO to meet Sri Lanka's international climate commitments relating to decarbonization.

(15) Provisions for providing electricity trading through a power exchange for establishing a competitive electricity market

(16) Provisions declaring that in the event of an inconsistency between the ESRA and the SLEA2009 provisions of the ESRA shall prevail. Similar provisions are to be included with regard to inconsistencies that may arise between ESRA and the existing sector regulations or license conditions.

(17) Provisions stating that the ESRA shall stand repealed on the enactment of the new Electricity Act.

(18) Provisions to amend the Sri Lanka Electricity Act No. 20 of 2009 ("SLEA2009") to ensure harmonization with proposals as contained in the ESRA, specifically, provisions to amend the following sections of the SLEA2009:

(i) Amend §9 and such other relevant sections of the Act, if any, allowing any entity governed under the Companies Act No. 7 of 2007 to be eligible to apply for a generation, transmission, or distribution license.

(ii) Amend §13 and such other relevant sections of the Act, if any, by deleting the words "with the concurrence of the Minister" so that the licensing decision would be exclusively within the purview of the regulator.

(iii) Amend §16(b) and such other relevant sections of the Act, if any, by deleting the mandatory requirement to sell electricity generated exclusively and only to Transmission licensees.

(iv) Amend Sections 16, 17, 18, 30, 43 and such other provisions of the Electricity Act allowing power wheeling operation, whereby the distribution system and associated facilities of a transmission licensee or distribution licensee, as the case may be, are used by another person for the conveyance of electricity on payment of charges

(v) Amend §17, §24, and §30 and such other relevant sections of the Act, if any, mandating and enabling Transmission Licensee and Independent Service Operator ("ISO") to carry out their respective functions to; (i) develop and maintain an efficient, coordinated, reliable and economical transmission system; (ii) procure and sell electricity; (iii) recover costs of wheeling services; and (iii) ensure that there is sufficient capacity from generation plants to meet reasonable forecast demand for electricity.

(vi) Amend §30 to enable the setting up of and operation of the BSTA.

(vii) Amend Section 25(3) to remove the 50-meter distance requirement making Licensee responsible for supplying the electric line to the boundary of the Owner/Occupier's land

(viii) Amend §39 of the act, to grant such additional authority, as may be necessary for the regulator to provide binding determinations that may arise between contracting entities post reforms proposed under the ESRA.

(ix) Such amendments as are necessary, empowering the PUCSL to determine, after a due process, any loss caused due to non-compliance or partial compliance of directions, decisions of the Regulator, violation of the license conditions, etc., and to recover such determined amount deeming such to be a fine imposed by the Magistrate's court.

(x) Such amendments as may be necessary to enable cross-border electricity trading

(xi) Repeal and replace §43 with suitable and simplified wording to reflect the reforms as proposed by the ESRA.

ACKNOWLEDGEMENTS

83. The Committee Members wish to place on record their appreciation of the opportunity to present their views regarding an issue of great national importance. The Committee acknowledges the support provided by the Hon. Minister of Power & Energy, Ministry officials, multilateral and bilateral development partners who

provided technical input, Chairman, Director General, and other staff of the PUCSL, and Management and Unions of the CEB for their valuable insights.

84. The contents of this report present the joint views of the Committee. Any single or several of the points, ideas or suggestions cannot and should not be attributed to any single member but considered as collective. These recommendations, in keeping with the mandate, are proposed within a short period of 2 months, and they are expected to be advisory and not binding.

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Mr. K. L. R. C. Wijayasinghe
Director, Ministry of Power & Energy & Convenor of the Committee

Annex: List of persons met and submission received by the Committee