ADVANCING ELECTRICITY REFORMS

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Assessment of Strategic Reforms for State-Owned Enterprises in the Energy Sector, UNDP (contract # 10468954)
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Table of Contents

List of Acronyms

CEB- Ceylon Electricity Board

DG- Director General

Disco- Distribution Company

IMF- International Monetary Fund

LECO- Lanka Electricity Company

LTL- Lanka Transformers Limited

NSO- National System Operator

NTNSP- National Transmission Network Services Provider

NWSDB- National Water Supply and Drainage Board

PFMA - Public Financial Management Act, No. 44 of 2024

PPA- Power Purchase Agreement

PPP- Public-Private Partnership

PSA- Power Sales Agreement

PSRS- Power Sector Reforms Secretariat

PUCSL- Public Utilities Commission of Sri Lanka

REM- Retail Electricity Market

SOE - State-Owned Enterprise

Transco - Transmission Company (NTNSP)

1. Executive Summary

Efforts to reform Sri Lanka's electricity industry have been ongoing since the late 1990s, but little progress has been made. In the aftermath of the economic crisis, removal of the distortions affecting the industry and the creation of the conditions for economic growth were seen as necessitating significant reform. There is general agreement that reform is necessary, though not on the nature of the reform. The reform agenda has advanced with the enactment of the Sri Lanka Electricity Act, No. 36 of 2024, and its subsequent amendment introducing a two-stage unbundling pathway.

The report takes the changes made by the Sri Lanka Electricity (Amendment) Act, No. 14 of 2025, as the starting point. Based on an adapted mediation technique, it identifies practical actions that will reduce uncertainty, manage transition risks, maintain reform momentum, and address the overall objectives of an electricity industry that will alleviate present dysfunctions and enable economic growth. It is hoped that the proposed actions will help reduce the frictions affecting the process.

Based on the centrality and the urgency of the need to mobilize investment to address the dysfunctions of the industry and to create the conditions for supply and quality necessary for economic growth, the following actions are among those identified:

- Expanding transmission capacity through the provisions for additional transmission licences to persons other than the 100 percent state-owned National Transmission Network Service Provider (NTNSP), including clarification of the PPP modality;
- Opening up possibilities in distribution by separating distribution and supply and by clarifying opportunities for private investments in the distribution companies that will be created by the Final Transfer Plan;
- Study modalities of attracting investment from superannuation funds; and
- Take appropriate policy and regulatory actions address any constraints to investment caused by the lowered cross-ownership limits.

Actions to address the need to obtain government-guaranteed debt within the limits placed by the Public Financial Management Act, No. 44 of 2024 are proposed. It is suggested that the demarcation of the territories of the distribution companies under the Final Transfer Plan be conducive to benchmark regulation. The importance of establishing the proposed ancillary services markets as soon as possible is highlighted.

It is suggested that the necessary resources for the Committee appointed by Minister under S. 3 of Act be provided and that a schedule of the investment requirements of CEB owned generating plants other than major hydro be prepared. There is value in commissioning studies on a gradual transition to a prosumer model and on energy security. Implementing the extant but non-actioned policy on subsidies.

Clarifications are suggested for:

- The criterion of "security constrained economic dispatch";
- The procedure for appointing directors representing the state to the companies created under the Final Transfer Plan; and
- The status of non transmission assets such as LTL shares held by the NTNSP in Final Transfer Plan.

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2. Introduction

Efforts have been made to reform Sri Lanka's electricity sector since the late 1990s, but little progress has been made. More homes have been provided access, but consistent, reliable power has not, especially outside the main cities. Nationwide blackouts have occurred. Complaints of high prices are common, though there is some evidence that they may not be justified in all categories. There is general agreement that reform is necessary, though not on the nature of the reform.

In the aftermath of the economic crisis, attention was focused on the necessity of fiscal discipline. Non-cost reflective pricing of electricity and fuel was seen as a major contributor to poor fiscal management. Electricity tariffs had not been revised since 2014. Cost-reflective pricing was a prior action for the release of funds from the IMF's Extended Fund Facility. Avoiding these distortions and creating the conditions for economic growth was seen as requiring significant reform.

As a result, the electricity sector reform agenda has advanced with the enactment of the Sri Lanka Electricity Act, No. 36 of 2024, and its 2025 amendment introducing a two-stage unbundling pathway. However, stakeholder alignment is currently constrained by unresolved implementation questions, particularly regarding the design and sequencing of the second stage (horizontal) unbundling, which the legislation leaves largely to the Final Transfer Plan to be prepared after initial (vertical) unbundling. This deferral has created some uncertainty around the eventual industry structure, governance arrangements, and ownership outcomes for successor companies.

At the same time, stakeholders hold divergent risk perceptions and priorities. A key group is concerned that potential privatization of generation and distribution assets could compromise affordability, service quality, and energy security if public control over critical infrastructure is diluted. Another group is concerned that continued full state ownership could constrain future investment and operational modernization, given Sri Lanka's fiscal and debt-related limitations. Additional concerns relate to expanded ministerial discretion and the adequacy of checks and balances to preserve regulatory predictability and investor confidence. These differences may recreate the conditions for policy paralysis prevalent in the past two decades.

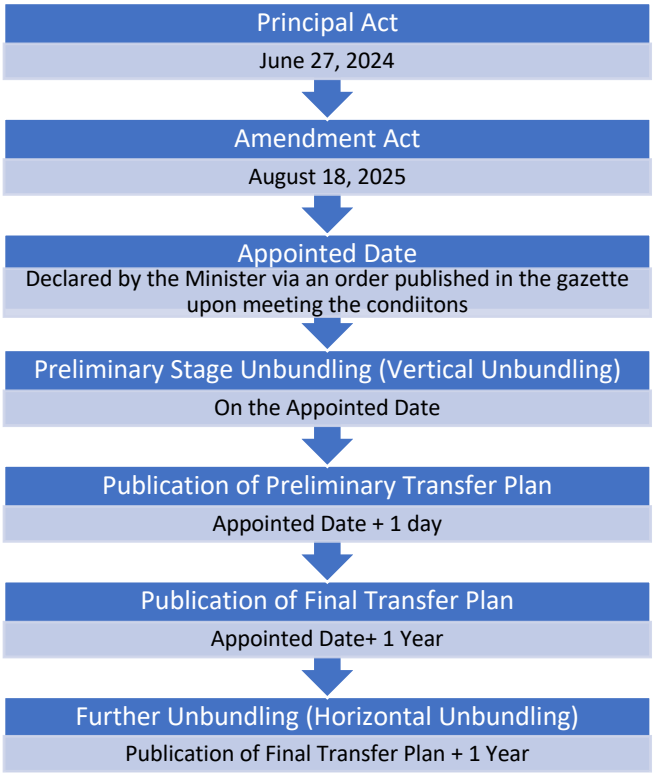
The report takes the changes made by the Sri Lanka Electricity (Amendment) Act, No. 14 of 2025, as the starting point. It focuses on identifying practical "common-ground" commitments and implementation instruments, especially the content and governance of the Final Transfer Plan that can reduce uncertainty, manage transition risks, maintain reform momentum, and address the overall objectives of an electricity industry that will alleviate present dysfunctions and enable economic growth.

3. Legislative design of the current law

Sri Lanka's electricity reform framework is set out in the Sri Lanka Electricity Act, No. 36 of 2024 (Principal Act) and the Sri Lanka Electricity (Amendment) Act, No. 14 of 2025 (Amendment Act), which together establish the legal basis for restructuring the vertically integrated Ceylon Electricity Board (CEB) and transitioning the sector toward a multi-entity industry structure. The legislation provides for a phased approach to restructuring: an initial stage of vertical unbundling, separating CEB's key

functions across the successor companies. This is followed by a second stage of horizontal unbundling intended to introduce multiple entities within the same key function (generation and distribution). As per the Act, until completion of both stages, the successor companies are envisaged to remain under 100 percent state ownership, while the framework also contemplates the potential for private participation, particularly in transmission and also generation and distribution, subject to subsequent decisions and implementation instruments, especially the Final Transfer Plan to be formulated in terms of Section 18 of the Act.

3.1. Timeline of Critical Actions



Appointed Date (Sections 1(2) and 1(6))

The Appointed Date, which brings all provisions of the Act into force, must be declared by the Minister through an order published in gazette once the Minister is satisfied that the conditions outlined in Section 1(2) have been fulfilled. If no Gazette is issued, the relevant provisions of the Act will come into force within four months once the Minister is satisfied that those conditions have been fulfilled.

Preliminary Stage Unbundling (Section 17(2)(a)

On the Appointed Date, the functions of the Ceylon Electricity Board are transferred to the newly created companies established under the preliminary stage of the sector unbundling process. This transfer becomes effective immediately upon activation of the Act.

Publication of the Preliminary Transfer Plan (Section 18(2)(a))

The Preliminary Transfer Plan, approved by the Cabinet and detailing the initial allocation of assets, liabilities, duties, functions and activities of the CEB to successor companies, must be published on the day immediately following the Appointed Date.

Publication of the Final Transfer Plan (Section 18(2)(b))

The Final Transfer Plan, setting out the structure for the full unbundling of the sector, must be published one year from the Appointed Date.

Further Unbundling of Generation and Distribution Companies (Section 17(2)(aa))
Further unbundling, including restructuring of generation and distribution companies in line with the Final Transfer Plan, must occur one year from the publication of the Final Transfer Plan.

3.1. Key institutions/ Players

Minister (Policy Leadership, Reform Sequencing, and State-Shareholder Oversight)

The Minister is the central political executive actor in the institutional framework of the Electricity Act, with responsibilities spanning policymaking, reform sequencing, and state-shareholder oversight of successor entities. Under Section 4, the Minister is positioned as the key authority in relation to national electricity policy, including issuing policy direction that guides the sector's institutional and operational arrangements. The 2025 amendment further reinforces this role by embedding a minister-led mechanism for formulating the draft national electricity policy (as part of the national policy on energy), which is subsequently routed for approval at the level specified by the amendment.

In addition to policy, the Minister plays a decisive role in implementation and institutional control points through powers linked to the commencement and sequencing of reforms. This includes the declaration of 'Appointed Date' and overseeing the publishing of Preliminary and Final Transfer Plans, thereby shaping the timing and order in which unbundling- and market-related provisions take practical effect.

The Minister's influence also extends to governance of successor entities through board appointment and continuity controls. Sections 10 and 17 establish the Minister as the interface to the dominant state-shareholder, Secretary to the Treasury, during the transition period when successor entities remain wholly state-owned, having authority to appoint the board of directors of the companies, and therefore create a critical need for administrative guardrails to prevent ad hoc operational interference while preserving legitimate policy and shareholder control.

Regulator

The Electricity Act designates the Public Utilities Commission of Sri Lanka (PUCSL) as the regulator of the electricity industry. Sections 5, 6 and 7 of the Act establish its mandate and core instruments, responsible for licensing regulated activities across the value chain (generation, transmission, distribution, supply, and system operation as defined in the legal structure). It further sets or approves tariff methodologies and the tariffs, enforces consumer protection and quality of service obligations, ensuring that service standards are maintained irrespective of ownership form. The Regulator also monitors market conduct and enforces non-discriminatory network access particularly important where natural monopoly networks interface with competitive procurement or open access, and applies compliance tools including licence conditions, directives, and penalties.

System Operator

The National System Operator (NSO) is established as the technical and operational core of the electricity sector under the Act. Its statutory mandate is as set out in Section 10 of the Act as amended and includes long-term power system planning, generation scheduling and commitment, system operations, bulk purchasing and sale of electricity, as well as the operation of the national grid. .

The institutional design also connects the NSO to the evolution of the market framework. The 2025 amendment to Section 30 of the Act, strengthens the NSO's role in National Energy Market by aligning the development of market arrangements (including market models and related enabling terms and conditions) with NSO led formulation processes initiated through ministerial direction. This effectively

positions the NSO as the institution responsible for translating the market vision into operational design, subject to the broader governance and regulatory framework.

Power Sector Reforms Secretariat

Section 38 of the Principal Act (2024) sets up a Power Sector Reforms Secretariat (PSRS) to support the Minister in implementing the reform program, including helping drive regulations, successor-company readiness, and preparation of the preliminary and final transfer plans. It is a small expert unit (up to five appointed members plus a Director-General) and is time-bound, initially operating for two years unless extended by Gazette (with Cabinet approval) up to a maximum of five years. These Section 38 provisions were not changed by the 2025 amendment.

National Electricity Advisory Council (2024 Act) and the Minister-Appointed Committee (2025 Amendment)

The 2024 Act establishes a statutory National Electricity Advisory Council to provide structured advice to the Minister on national electricity policy, reform implementation, market development, long-term planning, and tariff-policy-related matters. The Council is intended to act as an expert advisory mechanism within the governance framework, supporting evidence-based policy direction and coordinated reform execution. The 2025 amendment changes this architecture by replacing the statutory Council model with a committee appointed by the Minister, including for purposes linked to formulating the draft national electricity policy under Section 4 as amended.

Cabinet of Ministers

Cabinet of Ministers is embedded as a decisive approval node in the governance chain established by the legislation. The statutory design routes key instruments, particularly those with economy-wide implications such as National Electricity Policy and Long-Term Power System Development Plan through an approval pathway that culminates at Cabinet level, thereby providing political validation and whole-of-government alignment for major sector decisions. Additionally, in executing many of the key roles of the Minister, the act requires approval of the Cabinet of Ministers.

3.2. Changes to the roles of core institution from 2024 to 2025

National Electricity Advisory Council Vs the Committee appointed by the Ministry

Principal Act (2024)	**Amendment (2025)**
National Electricity Advisory Council (Council) - Body corporate with perpetual succession and a common seal - Charged with the responsibility of advising the Minister in formulating the national electricity policy - Members appointed by the minister with the approval of the Cabinet of Ministers - Council shall appoint a Director General with the approval of the Minister - Council shall employ such number of persons to function as the staff of the Council	Replaces the Council with a Committee appointed by the Minister - to formulate the draft national electricity policy as part of the national policy on energy - Members appointed by the Minister with the approval of the Cabinet of Ministers - No permanent staff other than the members of the Committee

The statutory National Electricity Advisory Council (the Council) established under the 2024 Act functioned as a permanent body corporate with a broad technical advisory mandate focused on the electricity sector. In contrast, the 2025 Amendment replaces it with a Minister appointed committee,

which is a temporary, flexible mechanism without corporate status. While the Council provided long-term continuity and institutional memory, the committee structure is more streamlined and aligned with the Government's plan for a broader energy sector policy framework, which was explained by the Director General of Power Sector Reforms Secretariat (PSRS) during the discussions.

Both modalities have distinct advantages and limitations. The Council's strengths lie in its independence, permanence, and capacity for sustained sectoral analysis, but its narrow electricity-only focus risks duplication within a broader energy governance system. The committee approach, while more adaptable and better suited to a transitional period, has negatives such as reduced independence and lack of continuity. Most importantly such a committee, made up of persons with other commitments, will not possess the resources required to develop the national electricity policy in an evidence-based manner, making the support of a dedicated permanent staff or paid consultants essential.

The PSRS has explained that the Council was repealed because a standalone electricity-specific corporate body does not align with the Government's future plans to create a comprehensive advisory institution for the entire energy sector, (which may include electricity, petroleum, gas, biomass, nuclear and hydrogen etc.) under the Energy Transition Act which has been proposed by the government. To ensure this approach delivers its intended benefits, it will be essential to establish the proposed cross-sector Energy Advisory Council through legislation, define clear mandates and safeguards for independence, maintain a strong base of technical expertise, and ensure stakeholder engagement throughout the transition.

Public Utilities Commission of Sri Lanka

The Amendment Act has not introduced substantive changes to Sections 5, 6, and 7 of the principal 2024 Act, which set out the core responsibilities and functions of the Public Utilities Commission of Sri Lanka (PUCSL) as the regulator. These sections remain largely unchanged, preserving PUCSL's regulatory role in overseeing licensing, technical standards, tariff methodologies, and sector monitoring. The only modification is a minor revision in Section 5(3)(l), where the term "least cost economic dispatch" has been replaced with "security constrained economic dispatch." This adjustment reflects a shift toward prioritizing system reliability and operational security in dispatch decisions, rather than focusing solely on least-cost outcomes.

Some stakeholders expressed concern that the new requirement for PUCSL to consult the Ministry of Finance during tariff setting could reduce the Commission's independence. Their view is that involving the Ministry may influence or slow down PUCSL's decision-making process. However, the amendment only requires PUCSL to seek and consider the Ministry's views and it does not obligate the Commission to follow or implement those comments. This approach can offer some advantages, such as ensuring tariff decisions are better aligned with national financial conditions and the government's capacity to support subsidies. At the same time, it may also create the impression that PUCSL's autonomy is somewhat diluted. Overall, the change brings both positive and negative implications, but it does not remove PUCSL's authority to make the final tariff decisions.

Ministerial and Cabinet Powers

The most significant change to ministerial powers introduced by the 2025 Amendment is the replacing of the Council with a committee appointed directly by the Minister, subject only to Cabinet approval. This shifts the policy development function from statutorily constituted body to a committee largely guided by the Minister, strengthening ministerial influence over strategic policy directions and reducing independence in policy formulation.

The Principal Act only provided for the board of directors of the National System Operator (NSO) to be appointed by the Minister and was silent about the board of directors of the other successor companies. Under the Amendment Act, the Minister is empowered to appoint the boards of directors of other successor companies created under preliminary stage unbundling, namely; National Transmission Network Services Provider (NTNSP), Generation Company, Distribution Company and the two residual companies. By centralizing appointments at the ministerial level, the Amendment effectively increases political and administrative control over all the successor companies. It is to be noted that the Amendment Act is also silent on who has the authority of appointing the subset of the board of directors representing the state ownership shares in the generation and distribution companies to be established under second stage unbundling, effectively leaving formal authority with the Secretary to the Treasury or to be specified in the Final Transfer Plan. This is a matter that should be dealt with in the Final Transfer Plan.

3.3. No deviation from conventional Few-Generators-Many-Consumers model

Throughout the world, there is discussion of a model different from the conventional few-generators-many-consumers model of past century. This is one based on many generators who are also consumers, prosumers. The proliferation of rooftop solar is a manifestation of the new model.

Conventional Centralized Generation

The 2024 Electricity Act (original as well as amended) establishes a sector architecture that maintains a strong centralized operational model. Section 10 clearly sets out the functions of the NSO, giving it responsibility for system planning, real-time system operation, dispatch and scheduling of all generation plants, grid code preparation, management of system constraints, and maintenance of overall system security. These functions ensure that the national electricity system remains centrally coordinated. The 2025 Amendment further reinforces this by revising Section 5(3)(l) to replace “least cost economic dispatch” with “security constrained economic dispatch,” which expands the NSO’s discretion in system operation to prioritize stability and security. The Acts also provide for a National Electricity Market under Part IX, reflecting an economic and operational model centered on large-scale generation integrated through a unified transmission network.

New clauses supporting distributed resources

In addition to the existing framework supporting distributed generation (Feed-In Tariff, Private sector participation in generation and competitive procurement), the 2024 Electricity Act introduces several provisions that strengthen the integration of distributed renewable energy within the national grid. Section 13 establishes the framework for non-discriminatory open access, enabling distribution-connected renewable generators to use the transmission and distribution networks on equal terms with larger generators, which is essential for small and embedded renewable systems to participate in the wider electricity market. Further, Section 30(4) permits distribution licensees to enter into Power Purchase Agreements (PPAs) with small scale generation licensees even before the establishment of the wholesale electricity market, with the Minister’s approval (which is also implied in clauses 29 (a), Section 5(3)(l) providing energy procurement by distribution licensees), further supporting the distributed renewable energy.

Extent of Grid Modernization Supported by the Acts

The Acts support elements of grid modernization by strengthening system planning, security and grid-code functions through the NSO. The 2025 Amendment further aligns operational rules with modern reliability and stability requirements by formalizing security-constrained dispatch. However, neither

the 2024 act nor the amendment introduce institutional structures such as distribution system operators, local energy markets, aggregation mechanisms or microgrid governance frameworks. As a result, grid modernization evolves primarily within a centralized operational paradigm. Distributed generation is encouraged, but the broader transition to a decentralized, flexible and consumer-interactive grid is not enabled under the current legal provisions.

4. Unbundling

The following tables summarize the single stage unbundling process proposed by the principal act against the two-stage unbundling process proposed under the Amendment Act.

Entity	**2024 Act (Original Schedule I)**	**2025 Amendment Preliminary Transfer Plan**	**2025 Amendment- Final Transfer Plan**
National System Operator (NSO)	One company, 100% state owned, responsible for system operation and planning.	No change; NSO remains a 100% state owned company.	No change; NSO continues as a single fully state-owned company.
Transmission (NTNSP)	One company with more than 50% state ownership and responsible for the development, maintenance and operation of the physical infrastructure that makes up the national grid.	Replaced with a 100% state owned company, also absorbing other selected CEB assets and currently CEB owned shares of LTL and Sri Lanka Energies.	NTNSP remains a single 100% state owned company; no further unbundling. Unclear what happens to non-transmission assets such as LTL shares.
Generation	Four separate generation companies (hydro, coal & Lanka Coal company, other thermal, wind).	Replaced with one Generation Company, 100% state owned, absorbing all CEB generation assets and Trincomalee Power Company.	Multiple generation companies as specified in the Final Transfer Plan. Company owning hydro plants will continue as a 100% state owned entity. No requirement on state-ownership specified in the Act |\ for other additional generation companies
Distribution	Separate companies for each CEB distribution division.	Consolidated into one Distribution Company, 100% Treasury-owned, including CEB Divisions 1–4 and LECO assets.	Multiple distribution companies under the Final Transfer Plan. No requirement on state-ownership specified in the Act

Residual Companies	Includes one company for remaining CEB functions and one for pension/provident fund responsibilities.	No change; residual companies continue.	No change; residual companies continue.

4.1. Vertical Unbundling Under the 2025 Amendment- Preliminary Transfer Plan

The 2025 Amendment introduces a clear framework for the vertical unbundling of the CEB by replacing several items in Schedule I of the 2024 Act and specifying the creation of six vertically separated successor companies under the Preliminary Transfer Plan. These companies correspond to the main functional segments of the electricity industry value chain and are required to be established on the Appointed Date.

Under the amended Schedule I, the following six companies will be created:

- National System Operator (NSO): a company with 100 percent state ownership, responsible for generation scheduling, commitment, dispatch, and system planning (amended Schedule I item (f)).
- National Transmission and Network Service Provider (NTNSP): a 100 percent state owned entity taking over physical infrastructure of the National Grid, shares of specified subsidiaries including LTL Holdings and Sri Lanka Energies and other selected assets, functions and activities of CEB (amended Schedule I item (e)).
- Generation Company: a single state-owned generation company, consolidating all CEB generation functions including hydropower, the Lakvijaya Coal Power Plant together with Lanka Coal Company, other thermal power plants, the Mannar Thambapavani Wind Power Plant, and Trincomalee Power Company Ltd (amended Schedule I item (a)).
- Distribution Company: a single Treasury-owned distribution company, incorporating the four existing CEB distribution divisions and selected associated assets and currently CEB owned shares of the Lanka Electricity Company (LECO) (amended item (g)).
- Residual Company for Non-Allocated Functions: responsible for any remaining CEB functions not transferred to other successor companies (Schedule I item (h)(i)).
- Pension and Provident Fund Company tasked with managing CEB pension and provident fund liabilities and required to be fully state owned (Schedule I item (h)(ii)).

Together, these six companies represent the vertical unbundling of CEB into distinct operational layers: system operation, transmission, generation, distribution, and residual functions. The Preliminary Transfer Plan executes this restructuring in the first stage of industry reform.

4.2. Horizontal Unbundling Under the 2025 Amendment- Final Transfer Plan

The 2025 Amendment includes provisions for horizontal unbundling to be carried out under the Final Transfer Plan, as specified in the new item (i) inserted into Schedule I.

Under this amendment, the vertically created Generation Company and the Distribution Company may be further split into multiple successor companies. The Act does not specify the number of companies to be created; instead, it leaves it to the Final Transfer Plan prepared under Section 18(2)(b) and implemented through Section 17(2)(aa).

The new horizontal-unbundling provision allows:

- The Generation Company to be divided into multiple generation companies, enabling separation by technology (hydro, thermal, solar, wind), by asset group, or by regional clusters (Schedule I item (i)(i)). As per Section 17 (2)(b) of the Act, the hydro company to be created under Section (i)(i) must continue as a 100% state owned entity.
- The Distribution Company to be divided into multiple distribution companies, permitting restructuring along geographic or operational boundaries consistent with policy objectives for regulation or efficiency (Schedule I item (i)(ii)).

This second stage of restructuring introduces a horizontal unbundling layer, allowing generation and distribution to evolve from single entities into multiple companies. The Final Transfer Plan therefore determines the final market structure of the electricity sector, enabling deeper unbundling beyond the initial vertical split.

4.3. Rationale for Vertical and Horizontal Unbundling

During stakeholder discussions, government representatives indicated that the amended two-stage unbundling approach is intended as a pragmatic transition pathway to progress reform while balancing strongly polarized views on the future ownership of successor companies. They emphasized intent to proceed with restructuring with meaningful employee buy-in which is not yet fully in place, while simultaneously managing divergent stakeholder positions that range from opposition to any privatization to concerns that continued full state ownership could constrain future investment.

Vertical Unbundling Under the Preliminary Transfer Plan

The preliminary unbundling of the CEB separates the core functional layers, system operation, transmission, generation, distribution, and residual functions. This reflects global best practice in utility restructuring. The rationale for this vertical unbundling is to create transparency, improve accountability, and remove conflicts of interest inherent in vertically integrated monopolies. By placing functions such as system operation (NSO) and transmission (NTNSP) into independent, state-owned entities, the reform ensures that network access, dispatch, planning, and system operation are performed impartially and are no longer influenced by generation or distribution interests.

Vertical unbundling also lays the foundation for competitive procurement of generation and ancillary services as required under the 2024 Act (Section 11). The standard structural separation improves regulatory oversight and simplifies tariff-setting. This will also establish the necessary PPAs and Power Sales Agreements (PSAs) within the new companies, which are currently absent between CEB owned entities as well as between CEB and LECO. This initial unbundling is designed to create organizational clarity and a functional baseline from which further competition and market development can evolve.

Rationale for Horizontal Unbundling Under the Final Transfer Plan

While the Preliminary Transfer Plan establishes the vertical layers of the electricity industry, the 2025 Amendment introduces horizontal unbundling under the Final Transfer Plan (Schedule I, new item (i)). The rationale for this second-stage unbundling is to enable market efficiency by dividing the Generation Company and the Distribution Company created at the preliminary stage into multiple successor companies. It will enable benchmark regulation. Also, this second stage unbundling will open up the possibility for private sector investments in distribution as well as in some of the currently CEB owned generation assets (other than major hydro). The staged approach will allow the sector to transition first into a stable, clearly defined structure before moving toward an environment that supports efficiency through benchmark regulation.

Some of the stakeholders questioned the rationale for merging the current four distribution regions of CEB and LECO during the preliminary unbundling. In response, the PSRS representative expressed the wish to create a "more rational" demarcation of the unbundled distribution companies was also stated. The questions of whether alternative demarcations were feasible within the time frame of the Final Transfer Plan and whether they would be conducive to benchmark regulation remain open. For example, having different companies for rural and urban areas would not allow comparison of costs. In addition, complex subsidy mechanisms to support the high-cost discos would have to be established.

The PSRS representative also noted the possibility of separation of physical infrastructure of distribution from supply services in future with demand growth, which will be supported by the Retail Electricity Market to be established in terms of amended section 30 of the Act. Because the investments in supply services will be relatively less than in the distribution network, it may be feasible to periodically bid out supply services as concessions (competition for the market).

4.4. Ancillary Services and Sector Unbundling

The 2024 Electricity Act introduced ancillary services as a distinct component of the electricity industry and establishes the requirement that these services be procured competitively. This statutory requirement represents an important shift from the vertically integrated CEB era, in which ancillary services were bundled within generation and transmission operations. Under the amended Act's unbundled framework, the NSO is responsible for system operation functions under Section 10, including dispatch, scheduling, maintaining system security and preparing the Grid Code. The NSO therefore becomes the principal entity that determines ancillary service requirements, while competitive procurement is intended to introduce efficiency and transparent cost recovery across multiple unbundled entities.

The 2025 Amendment Act further strengthens this provision by explicitly enabling the creation of an Ancillary Services Market. Amendments to the market-related provisions under Section 30, broaden the market scope to include ancillary services as market-based products alongside energy. The Amendment clarifies that the NSO will play a central role in defining, procuring and settling ancillary services within this market environment.

In the context of unbundling, the development of competitive ancillary services is a critical enabling measure. The unbundling of CEB into separate companies means that no single entity is responsible for providing frequency control, spinning reserves, voltage support, black start capability and other essential services by default. Instead, the NSO identifies requirements while licensed generators and other qualified service providers compete to supply those services. This approach creates operational transparency, reduces implicit cross-subsidization and introduces cost-reflective procurement, which aligns with the broader reform objective of transitioning from an integrated monopoly model to a regulated, efficient electricity industry.

Both Acts centralize the procurement of energy storage and ancillary services at NSO level. Distribution licensees are not authorized to procure ancillary services directly from the ancillary services market. Any local storage requirement of a distribution company will need to be developed as a regulated distribution asset or through another investment model.

4.5. Reduction of Cross Ownership Limits

The 2025 Amendment revises Section 20(6) of the 2024 Act by reducing the allowable cross-ownership that a private investor may hold in more than one distribution company or a generation company and a distribution company, from 15% in the Principal Act to 5%. This tightening reinforces the unbundling

framework by limiting the ability of investors to influence both generation and distribution companies or majority distribution companies at the same time, thereby supporting neutrality, avoiding conflicts of interest, and preventing informal re-integration of the sector through minority shareholdings. The Amendment retains the exemption for state-owned companies, which may continue to hold majority ownership across multiple successor entities of CEB. The restriction may, however, have the effect of dampening the interest of private investors.

Some stakeholders raised concerns that a 5% threshold may be too restrictive for Sri Lanka's relatively small capital market, potentially reducing investor interest and limiting access to private capital. Comparisons were also drawn to sectors such as banking, where ownership caps of 20% are the norm, suggesting that effective regulation does not always require very low shareholding limits. Overall, while the reduced limit strengthens governance and unbundling objectives, it also presents challenges for investor participation and capital mobilization that may need to be addressed through complementary regulatory and policy measures.

5. Investment to maintain systems/upgrades to accommodate renewables/improve quality

Even though over 99 percent of households have been provided access to electricity, the functioning of transmission and distribution networks are less than optimal, as evidenced by repeated nationwide blackouts and the inability to accommodate rooftop solar in certain areas. Many of the large solar and wind farms require the grid to be extended to remote locations. Improvements and extensions to the transmission and distribution networks requires significant additional investment that are constrained if seen as sourced only from Transco or Disco resources, from loans taken by the Transco or the Disco under the preliminary transfer plan (given the limits to government guarantees embedded in the Public Financial Management Act (PFMA), No. 44 of 2024, and IMF agreements.

In light of the vertical unbundling that has been completed, the problem may be seen principally in two parts: the transmission network and the distribution network.

5.1. Investment in transmission

There is no intention to unbundle the transmission horizontally (an idea that was unsuccessfully floated in 2022 was for two geographically demarcated transmission networks) or to allow private investment (100 percent ownership by Secretary to Treasury is a key element of the 2025 Amendment). However, the 2025 Amendment does not remove the provision permitting issuance of transmission operator licences to private companies to be developed under PPP Modality in terms of Section 11 (1) (b) of the Act, and consistent with the long-term power system development plan to extend the network. This leaves open the possibility of private investment being brought in to extend the current transmission network. Whether (and how much) such investment will flow in and under what terms, will depend on risk perceptions associated with agreements with the NSO. The question of what constitutes an extension to the transmission network and what does not will depend on interpretation of the provisions regarding consistency with the long-term power development plan.

For example, take the case of large, energy-hungry data center that places value in renewable electricity supply. If it is in an area currently served by a distribution network operated by a Disco and the transmission network, it may be argued that the only option is that of paying wheeling charges to the intermediary networks. If these charges are too high and/or the extremely high uptime requirements (99.995 percent for a Tier IV center; 26.3 minutes of downtime per year) require use of

electricity from two separate operators, the data center may wish to have an additional power source. Will the transmission extension be permitted to enter the territory already served by the Transco and Disco?

5.2. Investment in distribution

To attract investment for distribution networks, there is no obvious pathway similar to that for additional transmission lines in section 20(5). The 2025 Amendment specifies that under the preliminary transfer plan, there shall be one Disco that will be 100 percent owned by the Secretary of Treasury. The questions of how many Discos there should be in the second phase and what percentages of ownership should remain with Secretary of Treasury is left to the Final Transfer Plan. If the government keeps 100 percent of the shares of the newly created discos, the investment required to upgrade the distribution networks to accommodate greater use of rooftop solar and decentralized battery storage and to equip all consumers with modern meters capable of supporting time-of-day tariffs and other elements needed for efficient management of supply will have to come from the internal earnings of the discos and/or loans guaranteed by the government. On the other hand, if private investment is permitted in discos by the Final Transfer Plan, an additional source of investment will be unlocked.

5.3. Investment in ancillary services

The provisions for a competitive Ancillary Services Market that includes frequency control ancillary services, reactive power ancillary services and blackstart support services for the National System Operator that would allow mobilization of private capital remain after the amendment.

5.4. Sources of investment funds

Investment is essential. Without regular infusions of investment, the deterioration of a public utility service is unavoidable. Unfortunately, not enough weight is given to this critical element in Sri Lankan policy debates that are mostly about how stakeholders in the current configuration, especially employees, will be affected by any changes. Investment is counted in rupees, but different kinds of investment carry with them different costs of capital. Because these costs must be paid in the end by consumers through the tariffs charged to them, cost of capital is the most important factor when talking about investment.

The first source of investment capital is what is internally generated. This means earnings in excess of what is required to recover costs. Todays or yesterday's consumers pay for investment that will benefit tomorrow's customers. If the tariff methodology approved by the regulator permits this, it can be a source of investment capital. But the currently approved tariff methodology is cost reflective. In any case, the need to pay off or service accumulated debt makes this unrealistic.

What remains are debt and equity. Generally, government-guaranteed debt taken by a utility with a steady revenue stream is seen as low risk and therefore low cost. These types of investment tend to be favored by superannuation funds. At the present time, the risks have risen, both because the country went into default and because CEB did not honor its contractual obligation during and after the economic crisis. In addition, the PFMA places limits on government guarantees:

17(1) The aggregate stock of outstanding Government guarantees at the end of each financial year shall not exceed 7.5 per centum of the average gross domestic product (hereinafter referred to as the "guarantee limit") of the relevant financial year and preceding two financial years.

The considerable investments necessary for the transmission and distribution networks will have to compete with other SOEs seeking guarantees.

If what can be raised through debt is inadequate, the remaining option is equity. It is clear that private investments are permitted in generation. Major hydro is to be 100 percent state-owned. For the rest, the interpretation of the following badly drafted amended section 17 is crucial: "(b) the Secretary to the Treasury shall be **initially** allotted one hundred per centum of the shares in the successor companies incorporated under this **section other than the companies referred to in** items (a), (e), (f), (g) and (h)(ii) of Schedule I and the company referred to in item (i)(i) of Schedule I relating to the hydropower generation in which the Secretary to the Treasury shall be **permanently allotted one hundred per centum** of the shares. "

Our conclusion is that there is flexibility other than for major hydro in Phase 2. Some of the generating plants have reached or will shortly reach the end of their operational lifespan and may require significant investments in the medium term.

Whether it is debt or equity, the repayments or return on equity must be reflected in the tariff. If the return on investment capital is more favourable to the consumer than debt, that option must be chosen. With debt, the question of what quantum can be obtained with a government guarantee is an open question.

6. Energy security

There are legitimate concerns shared by many, if not most, stakeholders that energy security must be ensured. The outages experienced during Cyclone Ditwah have emphasized the critical importance of reliable and uninterrupted power supplies for the normal functioning of the economy and society. Threats to energy security range from direct attacks on the grid as seen in Ukraine, through cyber-attacks at one end to the inability to maintain electricity generation as was seen in the 2022 economic crisis on the other.

While some cling to a conception of energy security that relies on the location and control of generation and transmission assets within the country and under state ownership, that is not as prevalent as it used to be. The Chair of the Parliamentary oversight subcommittee appears to subscribe to a conception of energy security that sees security in terms of avoiding over-dependence on a single source, suggesting that a link with the Indian grid is essential for energy security. The acceptance of the need for horizontal and vertical unbundling by almost all participants indicates that state ownership of an integrated utility is no longer seen as a critical element of energy security. The extensive outages caused by Cyclone Ditwah bring up the role of the regulator in ensuring energy security from the perspective of the end users.

The Act (section 10) reserves the function of trading electricity across the border to the 100 percent state-owned National System Operator. That provides a safeguard that should comfort those with concerns about giving a foreign entity/government the ability to choke off supplies. The mention of a partially state-owned generating plant on the Kelanitissa site appears to fit the approach of diversifying to minimize risk.

7. Rural and other subsidies

Concerns were raised about how users located in rural and remote areas would fare if the integrated state-owned utility ceased to exist. It was stated that the revenue from these customers would not be seen as adequate to justify the costs of connecting them and maintaining the lines. Given the revenue raised from all low users, not just those located in rural areas, does not cover the costs of supply, the fact is that the Sri Lankan system is rife with cross subsidies. If the discos in the Final Transfer Plan follow the current demarcations, those may continue. If rural areas are assigned to a separate disco or discos, a formal subsidy mechanism will have to be implemented.

The current National Energy Policy and Strategies states:

3.3.4 The government will identify and provide transparently funded subsidies to target groups of energy users in household, industrial and commercial sectors, that deserve special consideration owing to their economic standing and contribution to national economic development priorities.

Though not implemented until now, this appears to be the solution that will work best in an environment where the distribution licensees will place greater weight on efficiency. When the government is fiscally constrained, it may not supply the necessary funds consistently. The discontinuance after some time of payments promised to the NWSDB for school water supplies is indicative of the problem. Creative solutions will have to be devised to ensure consistent funding of subsidies as per the policy.

The regulator will have to play a role by ensuring that the subsidies are not misspent by specifying customer service levels in the licenses and by enforcing them.

8. Summary of suggested actions to advance the reform process

Action	Entity(ies) responsible	Section where elaborated
Provide necessary resources for Committee appointed by Minister under S. 3 of Act; transition to proposed energy advisory council as soon as possible	Minister	3.2
Set out clear procedures for appointing directors representing the state to the companies created under the Final Transfer Plan	PSRS	3.2
Commission a study on what must be done to gradually transition to a prosumer model; consider the recommendations for implementation	Committee appointed by Minister under S. 3 of Act; superseded by Advisory Council appointed under proposed energy advisory council	3.3
Define “security constrained economic dispatch”	NSO	3.3
Clarify what happens to non-transmission assets such as LTL shares held by the NTNSP in Final Transfer Plan	PSRS	4
Reconsider deviation from existing demarcation of the territories of discos or ensure that whatever	PSRS	4.3

Action	Entity(ies) responsible	Section where elaborated
demarcation scheme is adopted is conducive to benchmark regulation		
Consider separation of distribution and supply functions, with supply services being periodically opened to bids (competition for the market), in Final Transfer Plan	PSRS	4.3
Create the conditions for markets in ancillary services as soon as possible	NSO and PSRS	4.4
Study the implication of cross-ownership limits for investor participation and capital mobilization & identify appropriate regulatory and policy measures.	PSRS	4.5
Clarify through explicit policies, how transmission operator licences will be granted to private companies under PPP Modality in terms of Section 11 (1) (b) of the Act	Minister, PSRS, Ministry of Finance (unit responsible for PPP Act)	5.1
In light of the government's interest in promoting data centers, clarify whether transmission extensions will be permitted to enter the territory already served by the Transco and Disco	PSRS	5.1
Commission consultants to study modalities of attracting superannuation fund investment to Discos	PSRS	5.4
Reach agreement with Ministry of Finance about how much government-guaranteed debt may be availed for the Disco and its successors	PSRS and Disco	5.4
Prepare a schedule of the investment requirements of CEB owned generating plants other than major hydro	PSRS	5.4
Commission a study on energy security and take action to implement/make recommendations to government	NSO	6
Implement 3.3.4 of National Energy Policy and Strategies *(The government will identify and provide transparently funded subsidies to target groups of energy users in household, industrial and commercial sectors, that deserve special consideration owing to their economic standing and contribution to national economic development priorities.)*	Minister and Ministry of Finance	7

Annex 1: How the report was compiled

The Amendment Act was not yet enacted at the time the project commenced, leading to a high level of polarization on the issue of how the electricity sector was to be reformed. It was concluded that not much could be achieved by getting all the contending parties into the same room for face-to-face interaction. Indeed, it was not possible to get some of the key actors into such a setting.

However, it was found that key actors were willing to speak on the record when interviewed by a journalist, with others present in the room and joining in the conversation. These videos attracted significant viewership among stakeholders which allowed a series of such interviews to be conducted. Freed from the immediate need to respond, the stakeholders were hearing what others said asynchronously, in a non-confrontational setting. This allowed for the deployment of a variation of a technique used in difficult mediations. The added benefit was that the willingness to have the videos of the interviews be made public.

Once the amendment was enacted, the passions cooled. It is possible that the interview videos also contributed to lowering the temperature. When the final workshop was convened, almost all the stakeholders agreed to participate. The format and the moderation were designed to keep the discourse from excessive polarization and focus all on what practical actions could be taken to achieve the country's objectives with the electricity sector.

The present report is not a verbatim account of what each party said. It is a synthetic document that draws from what was gathered from the interviews and the workshop, and the knowledge and analyses of the authors. A draft was circulated to all who contributed and minor corrections were made based on comments received.

Sources

01	Eng. Isuru Kasthurirathne	Representative- Engineers Union- CEB, Project Engineer, Ceylon Electricity Board
02	Mr. Nandana Udaya Kumara	Vice President, Technological Engineers and Superintendents Union, CEB
03	Mr. Dammika Nanayakkara	Deputy Chief Executive Officer (Operations)LTL Holdings Ltd
04	Eng. Pubudu Niroshan	Director General, Power Sector Reform Secretariat (PSRS)
05	Ajith P. Perera. M.P.	Chairman, Energy Subcommittee
06	Mr. Ravindra Pitigalage	Director, Deputy CEO, LTL Holdings Ltd
07	Eng. Noel Priyantha	Representative- Senior Engineers Union- CEB, Deputy General Manager (Business and Operational Strategy), CEB
08	Dr. Vidura Ralapanawa	Energy Sector Expert
09	Mr. Priyantha Wickramasinghe	President CEB General Workers Union.

In addition, the report benefited from the discussion at a workshop attended by most of the key stakeholders on the 19th of November 2025. The list of attendees is indicated below.

Attendance List – Workshop Held on 19 November 2025

No	Name	Designation and Organization
1.	Eng. Pubudu Niroshan	Director General, Power Sector Reform Secretariat (PSRS)
2.	Mr. Chandana Ranathunga	Director, Electricity Distribution Lanka (Pvt.) Ltd. (DisCo)
3.	Eng. Noel Priyantha	Deputy General Manager (Business and Operational Strategy) CEB
4.	Mr. Ravindra Pitigalage	Director, Deputy CEO, LTL Holdings Ltd
5.	Mr. U.Gamini Sarath	Deputy CEO (Finance), LTL Holdings Ltd.
6.	Mr. Dhananath Fernando	CEO, Advocata
7.	Mr. Dayananda Wijeweera	Chartered Accountant, President, CEB Accountants Union
8.	Eng. Parakrama Jayasinghe	Retired Director Engineering, Haycarb PLC, Past President of Bio Energy Association.
9.	Dr. Lakmal Fernando	Deputy President, National Chamber of Commerce, MD/Deputy CEO Regan Renewables (PVT) Ltd
10.	Mr. Vipula Karunathilaka	Social Commentator
11.	Raveesha Thilakawardhana	Vlogger
12.	Mr. Philip Dissanayaka	Executive Director, Right to Life Human Rights Centre
13.	Mr. K.W.Janaranjana	Senior Journalist, Editor-in-Chief, Anidda Weekly Newspaper
14.	Mr. Deepthi K. Gunarathna	Political Commentator
15.	Mr. Nishantha Kamaladasa	Civil Engineer and Management Consultant
16.	Mr. Jayantha Saram	Electrical engineer
17.	Mr. Saliya Nawarathna	Columnist, Sunday Morning
18.	Mr. Bruno Divakara	Journalist and Podcast host, SLVLOG
19.	Ms. Chamindry Saparamadu	Former Director General, Sustainable Development Authority, Sri Lanka
20.	Dr. Madhawa Dharmadasa	Ministry of Health
21.	Dr.Eng Priyantha Wijesooriya	Founding President Solar Industries Association
22.	Mr. Charith Randika	Engineering Manager, Renewable Energy Div, E B Creasy PLC
23.	Mr. Aruna Wijesinghe	Former General Manager ITN
24.	Mr Dhanushka Parakramasinghe	CEB Engineers Union
25.	Ms. Jalini Suriarachchi	EIA/SIA Specialist, Former Asst Director Ministry of Finance and Planning
26.	Mr. Sithum Kavinda	Manager Engineering and Projects, Vidulanka PLC
27.	Ms. Piyumika Wijesinghe	Assistant Manager Legal, Vidulanka PLC
28.	Ms.Ranushi Ediritilekege	Junior Data Science Researcher, LIRNEasia
29.	Mr. Deepa Tharinda Nissanka	Director, Apeed Engineering (pvt) Ltd
30.	Mr. Saliya Wickramasuriya	Former Chaiman- Ceylon Petroleum Corporation
31.	Mr. Y. T. Samarakoon	Vlogger
32.	Mr S. H. Wijethunga	Electrical Superintendent - CEB
33.	Mr. Aruna Kulathunga	Envision Energy
34.	Mr. Mahesh Sethunga	Solar City
35.	Mr. Kavish	J U Solar

No	Name	Designation and Organization
36.	Prof. Rohan Samarajiva	Moderator
37.	Mr. Sudarshana Gunawardana	Attorney-at-Law, Former Director General Government Information, Convenor of the Workshop
38.	Mr. Harsha Gunasena	Chartered Accountant, Co-Convenor of the workshop
39.	Ms. Punsara Nagasinghe	Energy Specialist
40.	Ms. Chandima Dunuwila	Attorney-at-Law, -Rapporteur
41.	Mr. Ronnie Daniel	Director, United Solar Energy
42.	Mr. Rajitha Uduwela	SL Vlog
	Mr. Ishara Deshan	SL Vlog
43.	Mr. Kalana Sugeeshwara	SL Vlog
44.	Mr. Yasith Wijesinghe	SL Vlog
45.	Mr. Thulakshan Nuwanjith	SL Vlog
46.	Mr. Raveendra Dewaka	SL Vlog
47.	Ms. Uadani Thakshila	SL Vlog
48.	Ms. Chaturya Mithushi	SL Vlog

Annex 2: Profiles of the authors

Rohan Samarajiva has expertise and experience in utility regulation and reform. He served as Director General of Telecommunications in 1998-99; led infrastructure reform work at the Ministry for Economic Reforms, Science and Technology in 2002-04 including the preparation the PUCSL Act, No. 35 of 2002. He prepared a report on water sector reforms for the PUCSL in 2021. He was Visiting Professor of Economics of Infrastructure at the Delft University of Technology and helped design and teach the MBA (infrastructure specialization) at University of Moratuwa. He has directed executive courses on electricity, telecom and infrastructure regulation in several countries. He is an editorial board member of the academic journals, *Utilities Policy* and *Telecommunications Policy*.

Punsara Nagasinghe is an energy sector specialist holding both bachelor's and master's degrees in electrical engineering from the University of Moratuwa, Sri Lanka. She brings a decade of experience from the PUCSL, where she developed expertise in electricity sector regulation, including formulation of regulatory tools, long-term planning, and competitive procurement of new generation. Most recently, she served as a Tariff Analyst and Power System Specialist with the USAID Sri Lanka Energy Program, contributing to Sri Lanka's grid transition through planning and tariff modernization efforts. She is currently working as an independent energy consultant.