Before the Appellate Tribunal for Electricity
(Appellate Jurisdiction)

Appeal No.251 of 2006

Dated the April 4, 2007.

Present: - Hon'ble Mr. H.L. Bajaj – Technical Member
Hon'ble Mrs. Justice Manju Goel, Judicial Member

Reliance Energy Limited
Reliance Energy Center,
Santacruz(East) Mumbai …Appellant

Versus

1. The Maharashtra Electricity Regulatory Commission
Cuffe Parade, Colaba
Mumbai-400005

2. Mumbai Grahak Panchayat
Sant Dnyaneshwar Marg
Vile Parle(W), Mumbai-400056

3. Prayas C/o Amrita Clinic,Athawale Corner
Karve Road, Pune-411004

4. Thane Belapur Industries,
Post Ghansoli, Navi
Mumbai-400071

5. Vidarbha Industries Association
Civil Lines, Nagpur-440001

6. Lata Enterprises
S.V.Road, Borivali(W)
Mumbai-400092

7. Bombay Small Scale Industries Association
Sonewala Cross Road No. 2, Goregaon(E)
Mumbai-400063

8. Vel Induction Hardenings
Waman Tukaram Patil Marg, Deonar
Mumbay-400088 ……Respondents

For the appellants : Mr. J.J.Bhatt, Sr. Advocate
Ms Anjali Chandurkar, Advocate
Mr. Syed Naqvi, Advocate
Ms Smieetaa Inna, Advocate
Mr.D.R.Shukhtankar,Sr.Vice President,
Reliance Energy Ltd.

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For the respondents: Mr. Dipak Bhattacharya, Advocate
Mr. Arijit Maitra, Advocate
Mr. Palaniappan, Consultant
Mr. Rakesh Abrol, President
Mr. Sandeep Ohry, Member
Mr. Navin M. Shetty, Member
Bombay Small Scale Industries
Mr. Mahesh M. Barbhaya, Borivali
M/s Lata Enterprises, Mumbai
Mr. N. Ponrathnam Intervenor,VEL
Mr. Shantanu Dixit for Prayas,Pune
Mr. Neeraj Kumar for Sr.Counsel for Resp.I.
Mr. Balwant Joshi,Consultant, MERC

Judgment

Mr. H.L. Bajaj, Hon'ble Technical Member

This appeal has been preferred by Reliance Energy Ltd. (for short REL) challenging the order dated October 3,2006 (hereinafter referred to as 'the Impugned Order ') passed in case Nos. 25 and 53 of 2005 in the matter of Annual Revenue Requirement (ARR) Petition of REL for Fy 2005-06 and ARR petition for FY 2006-07 by the Maharashtra Electricity Regulatory Commission (MERC), the Ist respondent

2. The appellant, Reliance Energy Ltd. (REL) is a Public Limited Company incorporated under the provisions of the Indian Companies Act, 1913 and registered under the provisions of the Companies Act, 1956. The facts giving rise to the appeal briefly stated are as under:

3. REL filed its Annual Revenue Requirement (ARR) petition for FY 2005-06 on March 1, 2005 based on the Draft Tariff Regulations. The Commission notified the Maharashtra State Electricity Regulatory Commission (MERC Terms and Conditions of Tariff) Regulations, 2005 on August 23, 2005. In compliance with the Commission directions issued vide letter dated October 10, 2005, REL submitted its revised ARR Petition for FY 2005-06 providing break up of ARR of Generation, Transmission and Distribution function on November 22, 2005. Subsequently, REL submitted its ARR and Tariff Petition for 2006-07 on February 24, 2006. After two technical validation sessions the Commission vide its letter dated May 3, 2006 directed REL to submit its revised ARR and Tariff Petition for FY 2006-07 including separate section on truing up of ARR for FY 2005-06. REL submitted its revised ARR and Tariff Petition for FY 2006-07 on May 10, 2006. The Commission admitted the ARR petition of REL for FY 2005-06 (case No. 25 of 2005) and ARR and Tariff Petition of REL for FY 2006-07 (case No. 53 of 2005) on May 18, 2006.

4. The Commission in exercise of power vested in it under Sections 61 and 62 of The Electricity Act, 2003 and all other powers enabling it in this behalf and after taking into consideration of the submissions made by REL, all the objectors

response of REL, issues raised during public hearing and all other relevant material issued the Impugned Order on the ARR Petition of REL for FY 2005-06 and ARR and Tariff Petition of REL for FY 2006-07.

5. Aggrieved by Impugned Order in respect of the following REL has filed the appeal before this Tribunal.

A. Disallowance of expenses in their entirety claimed by REL while truing up ARR for FY 2004-05 for FY 2005-06 in respect of :

(a) Employee Expenses

(b) Administration and General Expenses; and

(c) Income Tax

B. ARR for FY 2006-07:

(1) MERC not having approved the total expenses incurred by REL under the following heads in respect of Generation, Transmission and Distribution of electricity :

(I) repair and Maintenance Expenses

(II) Transmission and Distribution Losses

(III) Administration and General Expenses

(IV) Employee Expenses

(2) MERC having approved a lesser distribution loss than contained in REL's petition.

(3) "Reversal of Treatment on Rebate given by REL" to its consumers of an amount of Rs. 350.01 crore on account of the judgment and order passed by this Tribunal dated May 22, 2006 by inclusion thereof in the Aggregate Revenue Requirement of REL as a distribution licensee by MERC in the manner set out in paragraph 7.16 and 7.17 of the Impugned Order.

6. REL has sought the following reliefs:

(i) Expenses as per the following table may be allowed:

(Rs. Crores)

Particulars of Expenses	**FY 2004-05**	**FY 2005-06**	**FY 2006-07**
Employee cost	207	207	283
Repair and maintenance Expenses			127
Administration and General Expenses	102	102	105
Income Tax	101	74	

(ii) Set aside reduction of distribution loss approved by MERC of 0.5% and approve the distribution loss at 12.1% for FY 2006-07.

(iii) (a) Set aside the directions contained in paragraphs 7.16 and 7.17 of the Impugned Order dated October 3, 2006, to the extent that the reversal of treatment on rebate given by REL on account of Appellate Tribunal for Electricity order of Rs. 350.01 crore is included in the aggregate Revenue Requirement of REL as a distribution licensee for the FY 2006-07.

(b) Permit REL to treat the said amount of Rs. 350.01 crore as a regulatory asset to be amortized with carrying cost as provided under the clause 8.2.2 of Tariff Policy dated January 6, 2006 as under:

(i) to residential and Agricultural consumers their share over a period of 3 years

(ii) all other consumers their shares over a period of 18 months.

(iia) In the alternative to prayer (i) in so far as it relates to employee costs and administration and general expenses, the distribution surplus aggregation to Rs. 150 crores (inclusive of interest) be treated in the manner provided for in Schedule VI of the Electricity (Supply) Act, 1948.

(iib) The contingency reserve of Rs. 75.45 crores be treated in accordance with Regulation 76.9.2 of the MERC (Terms and Conditions of Tariff) Regulations 2005 and not adjusted against the ARR for 2006-07.

(iic) MERC be directed to consider the norms for heat rate, auxiliary consumption and secondary oil consumption as prescribed by MERC in Regulation 33 of Tariff Regulations, 2005.

7. We have heard the learned counsel for the REL, Ist Respondent Commission and various representatives appearing for the respondent Association and Prayas. We now proceed to examine each one of the issues one by one arising in the matter:

8. DISALLOWING OF EXPENSES IN THEIR ENTIRETY CLAIMED BY REL WHILE TRUING UP OF ARR FOR FY 2004-05 AND ARR FOR FY 2005-06 IN RESPECT OF (i) EMPLOYEES EXPENSES (ii) ADMINISTRATION AND GENERAL EXPENSES AND (iii) INCOME TAX.

9. **Employee Expenses of ARR for FY 2004-05.** Learned counsel appearing for the appellant stated that in its ARR for FY 2004-05 REL had proposed expenses of Rs. 187 crores but the Commission allowed total employee costs of only Rs. 136.2 crores. However, the actual employee costs incurred by REL during the aforesaid period was Rs. 207.34 crores as certified by REL Auditors. MERC has allowed only a sum of Rs. 161.85 crores as against the amount of Rs. 207.34 crores claimed and incurred by REL as given in the table.

	Fy 2004-05			**FY 2005-06**		
Particulars	Tariff Order	Actuals	Allowed after truing up	Petition	Actuals	Allowed after truing up
Salaries (Basic)	50.78	56.70	56.70	59.72	63.18	62.26
Dearness allowance	16.53	21.21	21.21	23.86	26.23	23.30
Other allowance/Bonus/ Benefits etc.	48.62	99.19	73.66	113.50	101.01	80.89
Gross employee cost	115.93	177.10	151.58	197.09	190.42	166.45
Provision for VRS	10.00	0.00	0.00	0.00	0.00	0.00
Contribution to PF,Pension and Gratuity	10.27	30.24	10.27	26.73	16.84	16.31
Total employee cost	136.20	207.34	161.85	223.82	207.26	182.76

10. Learned counsel highlighted that as was evident from the above table MERC has permitted actual amount incurred by REL in respect of Salaries (Basic) and Dearness Allowance but had disallowed Rs. 25.53 crores in respect of other allowances, Bonus/other benefits etc. REL has claimed the actual amount spent by it of Rs. 99.19 crores in this regard. However, Rs. 73.66 crores was allowed on truing up for FY 2004-05.

11. MERC arguments in this regard are that it has conducted a detailed analysis of the employee expenses. Gravamen of REL is that whereas the actual expenditure incurred by REL on Salaries and Dearness Allowance has been allowed, in respect of the very same employees, MERC has not allowed the entire amount of actual expenditure aggregating to Rs. 99.19 crores purportedly after applying "prudent norms".

12. In this regard when we requested the Consultant Mr. Palaniappan appearing for the Commission to explain the prudent norms, he stated that so far as the claim towards other allowances/Bonus/benefits etc. is concerned the Commission has given whatever claim towards Bonus and other benefits like LTC, Housing and 50% OTA, other allowances and several welfare expenses. It was stated that these are being disallowed by applying prudent norms and disallowed figure comes to Rs. 24.50 crores. No norms or principle or formula for conducting 50% could be explained by the Consultant.

13. As far as the payment of Rs. 24.43 to LIC towards terminal benefits of employees under the Gratuity Scheme is concerned, Mr. Arijit Maitra, learned counsel for MERC stated that the same shall be considered subject to actual payment by REL and verification of the same.

14. The appellant also tried to justify the increased employee cost on account of employing additional skilled staff after MERC has notified several Regulations in the exercise of its powers under Section 181 of The Electricity Act, 2003. In particular MERC has notified MERC (Consumer Grievance Redressal Forum and Ombudsman) Regulations, 2003; MERC (Supply Code and other Conditions of Service) Regulations, 2005 and MERC (Standards of Performance of Distribution Licensees, Period of Giving Supply and Determination of Compensation) Regulations, 2005. It was submitted that REL necessarily required to deploy additional skilled staff. Even in the case of preparation of the Annual Revenue Requirement for the purpose of determination of tariff under the MERC (Terms and Conditions of Tariff) Regulation, 2005, REL was required to deploy skilled staff proficient in their respective fields. Even in Consumer Related Department in order to improve the consumer services, skilled staff was necessary. For example, REL has introduced fully IT enabled consumer services, 24 hours call centers for addressing consumer complaints, state of art billing system, geographic information system etc including billing in various languages at the request of the consumers including BRAIL. It was submitted that MERC had not at all considered the aforesaid

while disallowing the additional expenditure actually and properly incurred by REL in FY 2004-05. REL is entitled to such expenses as have been fully and properly incurred by REL towards its employees

15. As apparent from the table hereinabove REL had incurred an actual expenditure towards contribution to Provident Fund, Pension and Gratuities aggregating to Rs. 30.24 crores either based on a demand made by the Life Insurance Corporation towards REL's contribution under the Gratuity Scheme on the basis of an Acturial Certificate issued on acturial valuation by LIC or on the basis of acturial valuation done by REL towards leave encashment which is required to be provided by REL as per Accounting Standard AS 15. Out of the said amount of Rs. 30.24 crores REL has paid an amount of Rs. 20.43 crores to LIC as Gratuity for the past period on account of revision of salaries from FY 2003-04 which was determined and informed to REL in March, 2005. The balance amount of Rs. 9.81 crores has been actually paid toward Provident Fund. However, once again purportedly on the basis of "prudent norms" without considering that REL has actually incurred the entire expenditure of Rs. 30.20 crores towards providing terminal benefits of its employees (as stated hereinabove deployment of some of the employees was necessitated to comply with various Regulations framed by MERC which were skilled employees). Thus MERC has arbitrarily fixed the amount of Rs. 10.27 crores as against the actual expenditure properly incurred by REL of Rs. 30.40 crores.

16. Other respondents including Prayas stated that it is the duty of the MERC to protect the interest of consumers, ensure that tariff reflects adequate and increasing levels of efficiency and that tariff would encourage the efficiency , economic use of resources, good performance and optimum investments. Commission should allow only those costs to be recovered from consumers which are prudent and justifiable. Merely incurring of expenditure by the licensee cannot be the grounds passing on costs to the consumers.

17. Employee Expenses of ARR for FY 2005-06:

Appellant has expressed dissatisfaction against MERC not allowing the actual expenditure of Rs. 207.26 crores claimed by it while truing up of ARR for FY 2005-06. The Commission has permitted only an expenditure of Rs. 182.76 crores towards employee cost. Once again whereas MERC has permitted the actual expenditure incurred on Salaries and Dearness Allowance but has allowed only a sum of Rs. 80.89 crores as against Rs. 101.01 crores towards other allowances/ bonus/benefits of the very same employees. It was submitted by the counsel that the purported basis on which the Commission has allowed expenses towards employee cost for FY 2005-06 is by considering increase of around 9.8% over the allowed level of expenses for FY 2004-05 (after truing up, based on the increase in the Basic Salary over the last 5 years). The counsel asserted that disallowing of expenditure by MERC under the head “Other Allowances/Bonus/Benefits” are in respect of the very same employees whose Salaries and Dearness Allowance has been allowed. Even in so far as the terminal benefits are concerned the

Commission has merely allowed 9.8% increase over the allowable level of allowances for FY 2004-05 after truing up but has not considered the actual expenditure properly incurred in this regard. It was clarified by the counsel that out of actual expenditure of Rs. 16.84 crores, the sum of Rs. 3.00 crores was paid towards Gratuity to LIC as per demand made by LIC (demand was after adjustment of Rs. 20.43 crores for the preceding year) and a sum of Rs. 13.84 crores was towards Provident Fund. It is not even MERC's case that REL is over staffed in as much as the entire amount paid towards Basic Salary is allowed on the basis of actuals.

18. The appellant placed before us a table on record showing that the per employee per lac consumers of REL are the least as compared to several other companies in the same business. It is observed that whereas some of the comparison of the SEBs where the consumers density is much lower is of no relevance (As also pointed out by some of the respondents). In case of denser consumer population cities, the table reveals that REL is in fact the lowest in terms of employee per lac consumers. Concedingly, the Commission has allowed employee expenses for FY 2005-06 by considering increase of around 9.8% over the allowed level of expenses for FY 2004-05 (after truing up, based on the increase in the Basic Salary over the last 5 years).

19. We observe that as per the Sixth Schedule titled Financial Principle and their Application of the Electricity(Supply) Act, 1948, expenditure incurred properly by the licensee has to be allowed. Once the actual expenditure on the Salaries and

Dearness Allowance of the employees has been allowed, there is no reason or rationale for not allowing the actual expenses in respect of *the very same employees*.

20. In view of the aforesaid discussion, taking into consideration the provisions of Sixth Schedule to The Electricity (Supply) Act, 1948 which is being used for determination of ARR and truing up and the fact that the MERC is allowing the Basic Salaries and Dearness Allowance of the employees and that there are no prudent norms prescribed by MERC in this regard, we allow the appeal in this respect and MERC should allow the actual expenditure of employees for the years 2004-05 and 2005-06 after verification of the same.

21. Administration and General Expenses for FY 2004-05 and FY 2005-06:

Counsel for the appellant stated that whereas the appellant had incurred the Administration and General Expenses (A&G) expenses of Rs. 102.02 crores for FY 2004-05, MERC has permitted a sum of Rs. 74.05 crores only after truing up. The purported reason for not permitting the actual expenditure incurred by REL is that the expenses are significantly higher " which is abnormal" and that no reasons have been given for the alleged "abnormal" increase in the A&G expenses. Counsel submitted that the increase in A&G expenses were by reasons of various Regulations framed by MERC which required REL to employ additional skilled staff. The normative increase of 3.3% for FY 1998-99 to FY 2003-04 applied by MERC is once again without any basis. Apparently the said normative increase is based on Compounded Aggregate Growth Rate (CAGR) . It was argued that this CAGR of 3.3% should not

be applied in isolation without considering the quantum increase in the services provided by REL. It was submitted that merely because the actual expenditure was 46% higher than the projected and allowed amounts does not per se make the same unreasonable. The expenditure was need based and necessitated by enhanced statutory compliances which are for the benefit of the consumers. On the same grounds MERC ought to have permitted expenditure of Rs. 101.64 crores towards A&G expenses as against Rs. 77.48 crores allowed by MERC for FY 2005-06.

22. It was submitted that " any expenditure properly incurred" on distribution and sale of energy by a licensee is permitted to be taken into account under the Sixth Schedule, Clause XVII of The Electricity (Supply) Act, 1948 for the purpose of arriving at a Clear Profit and that truing up exercise for the FY 2004-05 and 2005-06 would be in accordance with the provision of the Electricity (Supply) Act, 1948 and The Electricity Regulatory Commission Act, 1998 as per the proviso to Section 61 of The Electricity Act, 2003 till the MERC (Terms and Conditions of Tariff) Regulations, 2005 (which were notified on August 24, 2005 and were made effective from FY 2007 as per MERC Order dated April 13,2006) comes into force. MERC (Terms and Conditions of Tariff) Regulations, 2004 which were superceded by the aforesaid 2005 Regulations had no provision with regard to treatment of expenses. Even in the said Tariff Regulations, 2005, no norms have been prescribed for employees costs or A&G expenses. All reasonable and justifiable operation and maintenance expenses are permitted to be recovered even by the Tariff Regulations, 2005. It was pleaded

that such expenditure has been properly and actually incurred and, therefore, ought to be permitted.

23. Per contra the Commission reiterates that the appellant has claimed significantly higher expenses for FY 2004-05 under this head which is abnormal and no reasons have been given for the abnormal increase in A&G expenses. The Commission is of the opinion that these expenses should be controlled and hence it allowed A&G expenses for Fy 2004-05 and 2005-06 based on the normative increase of 3.3% over the period Fy 1998-99 to FY 2003-04 and that this is consistent with the approach followed by the Commission for all utilities in the State.

24. Respondent 3, Prayas suggests that the Commission can allow only those costs to be recovered from the consumers, which are prudent and justifiable. According to Prayas, prudent and justifiable costs are those costs which reflect progressively increasing efficiency and those which are essential, lowest costs required to deliver electricity services to the consumers.

25. Concedingly, under the Sixth Schedule, Clause XVII of the Electricity(Supply) Act, 1948 “ any expenditure properly incurred” on the distribution and sale of energy by the licensee is to be permitted. In the absence of any norms specified by the Commission, merely allowing 3.3% (being the CAGR) is not correct as this does not factor inflation which has to be necessarily taken into account and cannot be ignored.

We are inclined to accept the contentions of the appellant and, therefore, allow the appeal in respect of A&G expenses for FY 2004-05 and FY 2005-06.

26. Income Tax:

Learned counsel for the appellant has drawn our attention to the following para 15.9 of the order dated July 1, 2004 in case No. 18 of 2003 passed by MERC while determining ARR of REL for FY 2003-04 and FY 2004-05.

"15.9 Income Tax":

BSES has estimated the provision for tax of Rs. 125 crores and Rs. 156 crores for F 2003-04 and FY 2004-05, respectively, at existing tariff levels. BSES has estimated Corporate Income Tax as per the prevailing Income Tax rates (including surcharge) of 35.875% and provisions of the Income Tax Act, by considering the Income Tax payable by the Company and adjusting the same for income and expenses not relating to License Area operations.

The Commission has projected Income Tax applicable to profit before tax computed for the License Area operations. The Commission has adopted the methodology in line with its earlier order for TPC for computation of Corporate Income Tax and has accordingly computed the Income Tax for FY 2003-04 and FY 2004-05 based on the Commission's estimate of revenue and expenditure. The Commission has also considered the tax benefit available to DTPS under Section 80 1A *of the Income Tax Act based on the submissions of BSES in this regard. The total provision for tax estimated by REL and*

provision for tax allowed by the Commission in FY 2003-04 and FY 2004-05 is presented in the following table:

Table: Provision of Tax for FY 2003-04 and FY 2004-05. *(Rs.Cr.)*

Particulars	*FY 2003-04*		*FY 2004-05*	
	ARR Petition	*MERC approval*	*ARR petition*	*MERC approval*
Total provision for tax	*125*	*121*	*156*	*169*

Note: at existing tariff. The Income Tax payable based on income from revised tariff is Rs. 95 crores.

27. Counsel submitted that MERC had permitted income tax on the basis of licensed business and had not taken into consideration the other businesses of the Company in such computation. REL has various non licensee businesses such as EPC Division, Generating Stations, Elastimold Division and Treasury operation. REL, as required under the Accounting Standards, has always shown the accounts of licensee business separately in its accounts. As required under the law REL has been filing its tax returns putting income tax for its various businesses as one corporate entity. Thus the income tax is not separately paid for revenue earned from the Mumbai licensee business. DTPS generation business of REL is entitled to tax benefits under Section 80 1A of the Income Tax Act.

28. Our attention has also been drawn to the Sixth Schedule of Electricity (Supply) Act, 1948 paragraph XVII, sub-para 2(b)(iii) and (c)(ii) (which is applicable in the present case) as reproduced below:

> *" 2) "Clear Profit" means the difference between the amount of income and the sum of expenditure plus specific appropriations made up in each case as following:-*
>
> *a) Income derived from…….*
>
> *b) Expenditure properly incurred on-*
>
> *(i) ……………..*
>
> *(ii) ……………*
>
> *(iii) rents, rates, and taxes, other than all taxed on income and profits;*
>
> *(c) Special appropriation sufficient to cover-*
>
> *(i) ……………*
>
> *(ii) all taxes on income and profits"*

29. Appellant asserts that it has made special appropriation sufficient to cover income tax as required by the above noted stipulation of the Sixth Schedule. This was accepted by MERC vide its order as is evident from para 15.9 of its order dated July 1, 2004 reproduced above. However, in the Impugned Order MERC has held that REL is leveraging its Balance sheet of its licensed business for investment in other businesses. This finding of MERC is without any basis, incorrect and therefore, challenged in this appeal. Counsel alleged that the benefit of the tax

shelter available to REL's other businesses has been considered while truing up the tax payable on the revenue earned by REL from its licensed (distribution) business.

30. Appellant's complaint is that on an incorrect presumption and basis, MERC has allocated expenses and revenue between REL's licensed business and other businesses as if the other businesses contribute 70% of gross profit and REL's distribution business contribute 30% of gross profit and therefore 30% of the actual income tax paid by REL has been apportioned on a notional basis to REL's licensed business in Mumbai area. It was submitted that such a treatment on a notional basis is contrary to the provisions of the Sixth Schedule and in view of the fact that the Sixth Schedule provides for "specific appropriations", there is no question of REL providing documentary evidence that actual income tax paid by REL for its distribution business is higher than the income tax considered by MERC and that MERC would be considering such amount for truing up in the following year.

31. REL submitted that the purported reliance on the MERC (Terms & conditions of Tariff) Regulation, 2005 by counsel for MERC in the course of hearing is misplaced since the said Regulations are not at all applicable as the present issue relates to truing up for the years 2004-05 and 2005-06 for which years the provisions of Sixth Schedule are applicable.

32. We see force in the arguments put forth by the counsel for the appellant as truing up for the years 2004-05 and 2005-06 has to be carried out only as per the

Sixth Schedule. The consumers in the licensee's area must be kept in a water tight compartment from the risks of other business of the licensee and the Income Tax payable thereon. Under no circumstance, consumers of the licensee should be made to bear the Income Tax accrued in other businesses of the licensee. Income Tax assessment has to be made on stand alone basis for the licensed business so that consumers are fully insulated and protected from the Income Tax payable from other businesses. We, therefore, allow the appeal in this respect.

33. <u>ARR for FY 2006-07 -Reparis & Maintenance</u>

MERC has dealt ARR for the period 2006-07 in three parts i.e. Generation, Transmission and Distribution.

34. Repairs and Maintenance: (Generation):

The appellant contends that MERC has allowed only Rs. 25.69 crores against their petition for Rs. 33.58 crores in respect of repairs and maintenance (generation). MERC has taken into consideration the fact that DTPS is operating at a Plant Load Factor (PLF) much above normative PLF provided in the Tariff Regulations. MERC also took note of the fact that the plant is more than 10 years old and has been operating at high PLF which has implication on the overall R&M cost. MERC has also noted that a mandatory overhaul and boiler license renewal related works for FY 2006-07 would be carried out by REL to sustain high liability and PLF. The Impugned Order requires an availability of 95.48% as against REL Petition of 94.25%. The PLF is also approved at 95.48% as against the petitioned figure of 94.25%. Learned counsel for the appellant contended that if MERC was approving

a higher PLF, it ought to permit the expenditure claimed by REL towards repair and maintenance on this account alone.

35. Repairs and Maintenance (Transmission):

It is contended by the appellant that MERC has approved only Rs. 2.6 crores as against Rs. 3.78 crores required by REL as per its Tariff Petition. The disallowance of expenses is without any basis and in fact less than the earlier years approved proportionate R&M expenses of Rs. 2.90 crores.

36. Repairs and Maintenance (Distribution).

MERC has approved expenditure of Rs. 69.95 crores towards R&M expenses for FY 2006-07 as against the petitioned amount of Rs. 89.41 crores by REL. Appellant's contention is that the amount approved by MERC towards R&M expenses in distribution business for FY 2006-07 is even less than the amount approved for FY 2005-06 as is evident from the fact that REL was permitted an expenditure of Rs. 130 crores out of which the amount of Rs. 42.00 crores was attributed towards the payment of extraordinary expenditure thereby leaving Rs. 88.00 crores for the FY 2005-06. Appellant further contended that there has been an increase in the material cost as per the price list issued by the Indian Electrical and Electronic Manufacturers Association in this regard which fact has not been disputed by MERC.

37. Per contra the respondent Commission contends that the Commission has projected the overall R&M expenses by considering a 3.5% increase in the total R&M expenses, after deducting the extraordinary expenses incurred for FY 2005-06 due to cable damage on account of road widening by MMRDA. The Commission allocated the projected overall R&M expenses to each business in proportion to expenses incurred by the appellant in its ARR and Tariff Petition for FY 2006-07. The Commission contended that it is debatable whether there is a direct relationship between the higher PLF and R&M expenses being allowed and even if it is so assumed whether 1.25% increase in the PLF will result in 3.1% increase in R&M expenses, from Rs. 25.69 crores allowed by the Commission to Rs. 33.58 crores sought by the appellant. .

38. Commission clarified that all these amounts in respect of Repairs and Maintenance for Generation, Transmission and Distribution are only projections and the actual expenses could be higher or lower than these projections, which will be considered at the time of truing up of the expenses, subject to prudence of the expenditure.

39. We do not find anything wrong in this approach of the respondent Commission. However, we would like to comment in the passing that continuous operation of the generating units at such high PLF at 95% against the norms of 80% could be detrimental to the overall life of the generator. Flogging and fatiguing rotating machinery without giving time for proper overhaul and maintenance may

result in forced outages during the coming years and impair life of the plant. It would be prudent to leave to the generator to fully follow the maintenance instructions of the equipment manufacturers. It is also recognized that for any marginal improvement of PLF over high levels of 90% and above requires much more efforts and maintenance which is much more expensive. Generator has to keep the large inventory of spare parts, assemblies and sub-assemblies and line up technical experts for meeting any emergencies.

40. Transmission and Distribution Loss:

Appellant submitted that actual distribution loss level achieved by REL during FY 2004-05 and FY 2005-06 is 12.1% and 12.02% respectively against the approved distribution loss level of 12.5% during FY 2004-05. MERC has directed further reduction of Rs. 0.5% by REL during FY 2006-07 at a level of 11.52% for the FY 2006-07.

41. Appellant drew our attention to the Impugned Order wherein at page 110 paragraph 7.9 MERC has held as under:-

> " *…. The actual loss level achieved during FY 2004-05 and FY 2005-06 is 12.1% and 12.02% respectively. The Commission observed that REL in its proposals submitted for approval of Capital Expenditure schemes has indicated a loss reduction of around 109 MU in FY 2004-05 and 34 MU in FY 2005-06, thus aggregating to total loss reduction of around 1.5% over the*

actual loss level of FY 2003-04. However, in the ARR petition, REL has not considered any loss reduction during FY 2006-07. Considering the actual loss reduction achieved during FY 2004-05 and FY 2005-06 and loss reduction indicated by REL along with Capital Expenditure Schemes, the Commission approves the target of 0.5% distribution loss reduction to be achieved during FY 2006-07. The distribution loss level approved by the Commission for FY 2006-07 is 11.52%"

42. Appellant submitted that the table below demonstrates the proposed distribution loss reduction based on various Detailed Project Reports (DPRS) for FY 2004-05 submitted to MERC. MERC Approvals/Disapproval in respect thereof and the consequence of Disapproval is non-achievement of loss reduction.

Sl. No.	DPR Head	Amount proposed by REL, Rs.Cr.	Amount approved by MERC. Rs.Cr.	MU Loss reduction on account of approval	Amount disapproved withheld by MERC	Loss reduction on account.1 Amount disapproval withheld
1	Receiving Station Schemes (15 Nos)	11235	11235	19.01	0.00	0.00
2	DTPS Absorption (13 schemes)	75.75	75.75	9.93	0.00	0.00
3	Replacement of 11 kV Old Cables, Replacement of 11 kV Obsolete Switchgears and Augmentation of 220kV Transmission Network	77.01	77.01	3.51	0.00	0.00

4	SCADA-DMS	151.41	77.88	0	73.53	1.58
5	Metering & Instruments	111.52	74.25	29.12	37.27	25.85
6	11KV Mains & Distribution	179.85	132.47	10.64	47.38	1.82
7	Corporate Office Customer Care Centres etc.	180.89	135.64	0	45.25	0.00
8	Information Technology (GIS/KM/Networkin g/Computers etc.)	42.35	42.35	0	0.00	0.00
9	220 kV GIS Chembur	332.83	0	0	332.83	7.72
10	Total DPR for FY 2004-05	1263.96	727.7	72.21	536.26	36.97

43. The table above clearly indicates that although DPR's were submitted which would target loss reduction of 109 MU (with regard to proposed scheme year) MERC has approved only part of the DPR's which would result in achieving only a distribution loss of 72.21 MU. Part approval and disapproval of some of the DPRs in their entirety has resulted in REL not being able to achieve a loss reduction of balance 36.97 MU as proposed. The Scheme in respect of which DPRs were approved have already been taken up by REL. However, while considering the loss reduction for FY 2006-07, MERC has taken into consideration loss reduction of 109 MU for FY 2004-05 (though it approved Capital Expenditure (CAPEX) Schemes projected at reducing loss by only 72.21 MU) and 34 MU for FY 2005-06 (projected on the basis of approval of CAPEX Schemes for reducing such loss being granted) while approval is yet not given. In fact, a perusal of Item 5 above, would show that in respect of Metering and Instruments, MERC has disallowed a substantial expenditure. MERC has disallowed replacement of meters before completion of 15

years of their installation. However, while arriving at the distribution loss reduction, MERC has considered units corresponding to replacement of meters as proposed.

44. Appellant further stated that similarly REL, has submitted DPRs for the FY 2005-06, which are pending with MERC. The schemes proposed are intended to reduce losses by 34 MU once implemented in toto. The total loss reduction on the basis of approved DPRs for FY 2004-05 and FY 2005-06 works out to 106 MU (i.e. 72.21 MU on the basis of approvals for FY 2004-05 plus 34 MU for FY 2005-06 (as proposed). It is an admitted position that the load on REL's distribution system is growing and if necessary capital expenditure is not incurred such increased growth would increase distribution losses. This factor has also not been taken into consideration by MERC.

45. Appellant submitted that had REL not incurred increased capital expenditure (CAPEX) during the years 2004-2005 and FY 2005-06, the total loss on account of the same system being required to carry additional load would have been 13.01% and 12.20% as against 12.10% and 12.02% respectively as per table below:

Sr.No.	Year	Unit purchased MU	Unit sold MU	% Distribution on loss	Actual loss MU	MU Loss units without Investment	Actual loss units reduction done		% Actual loss reduction achieved.
							MU	%	
1	2004-05	7356	6466	12.10%	890	967	77	13.01	0.91%
2	2005-06	7821	6881	12.02%	940	956	16	12.20	0.18%
3	2006-07	8370*	7357*	12.10%	1013	1125	112	13.26	1.16%

* Projection proposed by REL in ARR 2005-06 and 2006-07

46. Appellant submitted that approval of CAPEX and execution of works under the DPRs is imperative to reduce losses as technical losses are a major component of REL's T&D losses. For example in FY 2003-04 REL has brought out in its ARR the technical losses at 9.92% against the system loss of 12.8% (# 8.8 Table 110 of ARR). With the proposed Capex schemes and enforcement measures to control commercial losses, REL submitted that the loss level achievable would be realistically maintained at 12.1%. Appellant urged that to achieve the T&D loss as per the impugned order, all proposed expenditures (DPR) ought to be approved and additional expenditure would have to be incurred (i.e. to achieve a loss reduction of ½%).

47. The appellant highlighted the effect of Load Growth on losses in the following manner:

(1) There is a rapid growth in the system demand over last two years. Especially certain pockets in REL's area of supply are developing at much higher growth rate than the average growth rate. This has necessitated intensive use of the existing infrastructure. The increase in sale over last three years has been 4%, 5.7% and 6.4% during the years 2003-04, 2004-05 and 2005-06 respectively. If the infrastructure is not upgraded to meet the load growth, the losses will increase in proportion to the square of increased loads. Moreover, from the last data it is observed that there is shift in sale from HT category to LT category. The losses at HT level are less in comparison to LT level. The sale in respect of LT consumers is increasing, which means that the load growth is more on LT network than HT

network. As the losses are proportional to square of the load, the losses are increasing in LT network.

(2) The quantum of LT network in the system also affects the losses and also limits further reduction of losses. As on 31st March, 2006, REL Mumbai distribution network has 3124 Kms of LT main line cables and 2538 Kms of Streetlight Cables. With such high quantum of LT network, further reduction of losses can be only achieved by replacing most of LT distribution system (main line) with HV distribution system, which is highly capital intensive.

(3) In absence of any new outlets at 22/33 kV close to REL load centers from TPC and the increased demand of REL's distribution system the energy is drawn at 220 kV through tie line. REL has to step down it to 33 kV and lay the longer lengths of feeders to transmit energy to take to load centers which results in additional technical losses at 13 MU (0.17% of total purchase of REL – base year2005-06). This loss is expected to increase with the increasing trend of load growth in REL supply area.

48. Appellant stated that in any event, and without prejudice to the aforesaid, submitted there are no norms whatsoever nor any Regulations with regard to reduction in transmission and distribution losses by a licensee.

49. It is well recognized that in a growing electrical distribution system the technical losses will increase with the load growth if the system is not augmented in

line with the growth pattern. Admittedly the load growth is more on the LT category which will give rise to additional losses. Augmentation of the system has to be planned well ahead of the expected load growth. The licensee is expected to carry out periodic system studies and plan for augmentation projects well in advance. In the instant appeal it has been brought out by the appellant that all the DPRs submitted for system augmentation for reduction of losses and meeting the additional load growth were not approved by the Commission. It has been held by this Tribunal in appeal No. 84 of 2006 in the case of Karnataka Power Transmission Corporation Ltd. V/s Karnataka Electricity Regulatory Commission and Ors. as under:-

> *"21. The Commission overlooked the fact that the appellant being transmission utility transmitting power through out the State for the bulk supply as well as distribution as an obligation to maintain the supply as well as quality supply and when the demand increase, either at the level of distribution or at the level of bulk supply it is the transmission licensee who should provide for the supply. This obviously means that the transmission utility has to plan in advance and should be in a position to supply power as demanded from time to time. Section 42, 43 of The Electricity Act, 2003 also should not be lost sight of. To meet the ever increasing demand consequent to development and improvement in the status of the consumer public, industrialization computerization, heavy industries and requirement increases by geometric proportion, it is for the transmission utility or such other utility to estimate the future demands as well, besides improving the quality and standard of maintenance. This is possible only if the utilities have the freedom to plan with respect to their investment, standardization, upgrading of the system. For such a course it is within the domain of those utilities to undertake to plan, invest and execute the projects or schemes of transmission etc. If the view of the Commission is to be sustained as already pointed out, the same would*

mean for each and every investment an approval has to be sought by the utility in advance which is not the objective of The Act.

22. The consumer interest also do not arise at this stage for consideration nor they could be an objector in respect of proposal or plan or investment by utility as the liability of the consumers, if any, arise or there could be a passing by way of return on equity or interest etc. as such contingency arises only when the Regulatory Commission subject to its prudent check allows such expenditure, while fixing the annual revenue requirement and determining the tariff. Till then, the consumers have no say and there could be no objection from their side. When the consumers complain poor service or failure to maintain supply, to face such a situation the utility has to plan in advance, invest in advance, execute the project or scheme for better performance and maintain.

23 The Karnataka Electricity Regulatory Commission has not acted reasonably or fairly in interfering with the internal, commercial management and domain of the transmission utility with respect to its commercial plan and proposal to invest a substantial sum. We have made ourselves clear and in the future years to come the Commission will take this into consideration and will act accordingly. The point "A" is answered in the above terms."

50. In view of the aforesaid facts and the discussion, we agree with the contention of the appellant and allow the appeal in this regard. In future, if the Commission expects the licensee to curtail losses to the extent it requires, it ought to agree to the Schemes proposed by the licensee to meet the increasing load and reduce losses.

51. Norms for Heat Rate, Auxiliary Consumption and Secondary Oil Consumption.

Learned counsel for the appellant submitted that MERC while determining tariff and ARR of Generation Function for FY 2006-07 has failed to follow its own Regulations i.e. Regulation 26.2 read with Regulation 33 of MERC (Terms and Conditions of Tariff) Regulations, 2005 as elaborated hereunder:

(i) MERC has approved a purported revised norm of heat rate for DTPS as 2350 K Cal/Kwh as against the heat rate of 2500 K Cal/Kwh proposed by REL.

(ii) MERC has approved the Auxiliary Consumption for REL's DTPS as 7.80% as against REL's projection

(iii) MERC has approved a purported revised norm of Secondary Oil Consumption of 0.80 ml/kwh as against REL's projection of 2.0 ml/kwh in accordance with the norms stipulated in the Tariff Regulations.

52. Counsel pleaded that a deviation from the norms is without any basis or reason. REL would be deprived from sharing the gains on account of such controllable factors to which it is entitled under Regulation 19 of MERC (Terms & Conditions of Tariff) Regulations, 2005.

53. The Commission has drawn our attention to the following provisos to the Regulation 26.2 which reads as under:-

" Provided that the Commission may deviate from the norms contained in this part or specify alternative norms for particular cases, where it so deems appropriate, having regard to the circumstances of the case.

Provided that the reasons for such deviation shall be recorded in writing:

Provided further that in case of an existing generation station, the Commission shall determine the tariffs having regard to the historical performance of such generating station and reasonable opportunities for improvement in performance, if any"

"4………..

54. The Commission stated that in view of the foregoing provisos to Regulation 26.2 of the MERC, the Commission had analysed that the station heat rate, Auxiliary Consumption and Secondary Oil Consumption parameters as achieved by DTPS for the past 7 years are much better than the norms provided in its Regulation 33: norms for operation. MERC submitted that some of the stakeholders during public hearing had represented that in case the actual performance is better than the operational norms stipulated in the Regulations, the operational parameters should be allowed at actual levels achieved during the previous years. In accordance with the provisos to the Regulation, there was a need to specify the operational norms for existing DTPS based on historical performance of the generating station. The Commission was of the opinion that if historical performance is considered in toto, then there will be no room to motivate the Utility to improve further, as REL's

historical performance has been better than the norms stipulated in the Regulations. At the same time, the historical performance needs to be considered, while stipulating the norms. Therefore, the Commission had considered revised operational norms for REL, keeping in view the past performance, while at the same time retaining some incentive for the Utility to encourage for sustained efficient operation.

55. Norms for operation for power stations are determined for the industry based on the technology, industry performance and in order to ensure optimum utilization of machines with efficient and economic operation. Black's Law Dictionary defines norms as : "An actual or set standard determined by the typical or most frequent behaviour of a group". We are quite intrigued: once the Commission has specified "norms" how the same can be changed for a particular generator merely because it has consistently performed better. One can understand if the entire industry performs at better operational levels, then observing the consistent industry average improve, norms for all can be upgraded. It is against natural justice that an individual station, instead of being rewarded for better performance, is made to meet higher targets of performance and exposed to the risk of not achieving it. Achieving exceptionally high levels of efficiencies requires great deal of effort and expertise and must be incentivised. If Commission wishes to revise norms upward, it may also do so but such a revision has to be applied to all players after watching the industry performance over a period of time.

56. The Proviso to Regulation 26.2 of MERC does provide leeway to MERC to deviate from the norms where it so deems appropriate having regard to the circumstances of the case. It can be understood if it makes a departure from the norm if a station has met an accident or has inherent deficiencies in design or workmanship and unless the norms are so moderated generator will have no incentive to generate and may have to wind up if the station continually operates at below norms. We are not convinced that MERC can upgrade norms for individual generator even if it performed better year after year. If the entire industry operates at better operating parameters for sufficient number of years, then MERC may consider to revise the norms for all.

57. In view of the foregoing discussions, we do not agree with the reasoning of MERC and, therefore, allow the appeal with regard to the operating norms.

58. Rebate:

Learned counsel for the appellant stated that in an appeal filed by REL challenging the orders dated February 20, 2004 of MERC, this Tribunal vide judgment dated May 22,2006 had held that grant of rebate by REL was not illegal or violative of the provisions of statute then in force. MERC in the Impugned Order dated October 3,2006 decided that the revenue gap of Rs. 350.01 crores on account of rebate will have to be recovered through levy of additional energy charge of Rs.0.97 per kwh for a period of six months during October 1,2006 to March 31,2007. While computing ARR the said amount of Rs. 350.01 crores has been taken into

account which as per Impugned Order would result in an energy tariff increase of 25% of all categories including residential consumers.

59. It was stated that treatment of rebate by way of additional energy charge in the manner provided in the Impugned Order results in tariff shock which is contrary to the tariff philosophy adopted by MERC. The treatment of the amount of Rs. 350.01 crores on account of rebate as a part of REL's ARR has arisen in exceptional circumstances. Counsel for REL urged that the same ought to have been treated as a Regulatory Asset. REL ought to have been permitted to recover the same within a period not exceeding 3 years from residential and agricultural consumers their share and within a period not exceeding 18 months from other consumers of their share. REL also claims the carrying cost. If the said facilities were to be granted this would not be repetitive.

60. The 3rd respondent (M/s Prayas Energy Group) submitted that as an appeal has been filed in the Hon'ble Supreme Court of India against this Tribunal order in the matter of recovery of rebate granted by REL, no order should be passed in this matter. In case this Tribunal also decides this matter, it was submitted that the quantum of rebate of Rs. 350.01 crores should be recovered from those consumers who are benefited from the rebate (large industrial and commercial consumers) and not from small residential and other consumers. Vide this Tribunal order dated November 2, 2006 in the instant appeal following order has been passed:-

> " *The learned senior counsel appearing for the appellant made a statement to the effect that the appellant has already informed The Maharashtra Electricity*

Regulatory Commission of its proposal not to implement the consequential recovery to off set the sum of Rs. 350.01 crores allowed as per directions in the earlier appeal.

The learned counsel also further stated that by a public notice, the appellant has announced that it is not going to increase the tariff as a result of addition of Rs. 350.01 crores in the ARR. The appellant seeks for amortization of sum of Rs. 350.01 crores for a longer duration, which would enable the appellant to recover the said sum without causing hardship to its consumers. This above statement is recorded.

In the light of the said statement, in our view it is not necessary to stay that portion of the tariff order, while at the same time we make it clear that first respondent, Commission, shall not initiate any coercive action for non compliance of that portion of its tariff order, appealed against".

61. In view of the matter regarding rebate being pending in the Hon'ble Supreme Court of India and the above order dated November 2, 2006 of this Tribunal we order the status quo in respect of rebate to be maintained.

62. In conclusion we decide that the appeal is partly allowed as concluded herein above at paras 20,25,32, 50 and 57 in respect of Employee Expenses, Administrative and General Expenses, Income Tax, T&D Loss and Operating Norms respectively. In respect of Repairs & Maintenance Expenses, the Commission has clarified that actual expenses will be considered at the time of truing up subject to

prudence of expenditure. In view of this we have decided at para 39 not to interfere. As far as 'Rebate' issue is concerned we have decided at para 61 above that status quo be maintained.

(Mrs. Justice Manju Goel) (H.L. Bajaj)

Judicial Member Technical Member