Before the Appellate Tribunal for Electricity

(Appellate Jurisdiction)

Appeal No.158 of 2010

Dated : 17th January, 2012

Coram; HON'BLE MR. RAKESH NATH, TECHNICAL MEMBER

HON'BLE MR. JUSTICE P.S. DATTA, JUDICIAL MEMBER

In the matter of:

Kerala State Electricity Board
Vyduthi Bhavanam,
Thiruvananthapuram- 695 004 ….Appellant

VERSUS

Kerala State Electricity Regulatory Commission
KPFC Bgavanam, CV Raman Pillai Road,
Vellayambalam, Thiruvananthapuram- 695 010 … Respondent

JUDGEMENT

HON'BLE MR. JUSTICE P.S. DATTA, JUDICIAL MEMBER

1. Being aggrieved by the order dated 14th May,2010 passed by the Kerala State Electricity Regulatory Commission , the sole respondent herein whereby it decided upon the true up petition of the appellant for the FY 2006-07 the appellant, the Kerala State Electricity Board preferred this appeal on the grounds that the total claims of the appellant on the following points have not been admitted, namely : a)Revenue Gap,, b)Return on Equity, c)Depreciation, d)Interest and finance charges, e)Provision for bad and doubtful debts, f)Other debits, g)Employees Cost,h)Administration& General Expenses with Electricity Duty, i)Transmission and Distribution loss Levels, j)Assumption of revenue from Tariff.

2.According to the appellant, as per section 181(2) (zd) of the Electricity Act,2003 the State Commission is required to notify the 'Terms and Conditions of Tariff 'under section 61 of the Act which should form the basis for filing the ARR application and an application for truing up of the accounts, and the State Commission is yet to notify any Regulations under the said section 61 of the Act and within the framework of the National Tariff Policy notified by the Central Government on 6th of January,2006.In the absence of any Regulations for preparing the

regulatory accounts and for truing up process and revenue requirements the appellant has been following the Electricity (Supply)Annual Accounting Rules,1985 which the State Commission has not been following and instead has been adopting different approach and thereby disallowing many valid expenses.

3. Before the enactment of the Act,2003 the appellant has been claiming 3% return on equity on the net fixed assets. This continued till the year 2004-05., but the State Government has not been extending any subsidy to the appellant who in the circumstance had to find out adequate internal resources to meet its capital investments. The appellant thus claimed 14% return on Government equity of Rs.1553.00 crore as per the Government Order dated 14.9.1998.The State Commission changed its earlier stand and purportedly relied upon the remark of the Comptroller & Auditor General to the effect that the Government of Kerala has not followed the procedural formality of conversion on equity and it has been deemed that the State Government has no equity in the appellant. Further, during the period from 2003-04 to 2008-09 the appellant has made additional capital investment of Rs. 3346.06 crore through internal resources. The Board during these years availed itself of loan of Rs.3113.66 crore. The internal resources used for funding of capital assets are required to be considered as equity contribution .

4.The Commission did not allow Rs. 175.31 crore towards depreciation claimed by the appellant for the FY2006-07 as per the audited accounts of the appellant but approved the depreciation as per the norms contained in the Tariff Regulations of the CERC. It is the case of the appellant during the three financial years preceding the FY 2006-07 the appellant was allowed depreciation as claimed by the appellant as per the audited accounts at the rates notified by the Ministry of Power but during the FY 2006-07 the Commission allowed depreciation as per the CERC rate despite the State Government's letter dated 16.12.2006 directing depreciation to be allowed at the rates notified by the Government of India.

5. As per the Kerala Electricity Supply Code,2005 , notified by the State Commission , interest on security deposit has to be paid by the appellant. In the audited accounts of 2006-07 the appellant had provided an amount of Rs. 37.44 crore for interest on security deposit being the interest on the total outstanding security deposit at the prevalent bank rate as on 1.04.2006 but the Commission did not allow the entire amount on the ground that the actual payment of interest on security deposit for the FY 2006-07 was only Rs.22.85 crore.

6. As per the audited accounts the appellant made a provision for bad and doubtful debts at Rs. 281.32 crore , but the Commission allowed only

Rs.49.00 crore as was approved in the original tariff order for the FY 2006-07 ignoring the audit observations on the accounts of the appellant.

7. The Commission did not allow a sum of Rs. 401.84 crore as other debts The net dues from the Government to the appellant was Rs. 2002.30 crore . It was the recommendation of the Committee constituted by the Government of Kerala the sum of Rs. 2002.30 crore should be written off by the appellant in five years starting from the FY 2006-07 @400 crore each year. The State Government by the order dated 09.10.2002 decided to net off the dues between the appellant and itself .The State Commission was constituted on 14.11.2002. As per the audited accounts of the appellant the net dues as on 31.03.2003, ie, prior to the Commission started issuing orders on tariff and truing up was Rs. 2196. 01 crore.

8. The Commission ignored the fact that the appellant had 25117 employees and the average medical expense per annum as per the audited accounts is Rs. 1210 per employee.

9. The Commission approved the T & D loss reduction target of 2.5% for the FY 2006-07 against the target of 1.76% proposed by the appellant. The appellant could be able to reduce the loss by 1.49%.There was, according to the Commission, underachievement of 1.01% representing 182 MU .

10. As directed by the State Government the Commission by its order dated 5.1.2006 ordered to extend 20 paise rebate to all domestic and commercial consumers with effect from 01.01.2006. This continued till the State Commission revised the tariff vide the tariff revision order dated 26.11.2007. The Commission directed the State Government to release the revenue shortfall as subsidy as per section 65 of the 2003 Act.

11 The Commission did not consider Rs. 71.78 crore as part of the A & G Expense.

12. The respondent Commission in its reply contended that the ARR & ERC for 2006-07 which was approved by the Commission by the order dated 30.03.2006 which is the basis of the true up order has not been challenged .Hence , the raising of the contentions that the regulations have not been notified under section 61 of the Act at this stage is not maintainable. The Tribunal in Appeal No.94 of 2008 on true up for FY 2003-04 and FY 2004-05 observed that the projections for these two years have not been challenged. The respondent duly issued the KSERC(Tariff)Regulations,2003 and the appellant has been filing its ARR & ERC and true up applications in terms of the Regulations. The respondent has already disposed of the appellant's petition for notifying the norms under section 61 of the Act. Further, the Electricity (Supply) Annual Accounting Rules is not a substitute for the Regulations framed

under section 61 of the Act. The mismatch between the approved expenses and the actual is due to the fact that the appellant failed to follow the ARR & ERC order and due to the serious accounting discrepancies the C& AG made observations which could not be ignored.

13.With regard to the return on equity it is contended that though the respondent had allowed 14% return on equity of Rs.1553 core in line with the CERC (Terms and Conditions of Tariff)Regulations in the earlier orders on true up as well as ARR & ERC, the Comptroller and Auditor general of India based on the order of the Government of Kerala made serious observations which appeared in the audit report to the effect that the equity capital accounted was against the provisions of Electricity (Supply)Act,1948 and is in contravention of the State Governments' order dated 09.10.2002 and does not show the fair view of the accounts of the appellant. The matter of the fact is that the State Government through another order dated 09.10.2002 modified its earlier order and converted loan and interest as grant . This amount of Rs.1553.00 crore existed as loan on the capital side in October,2002. The C & AG reported that the important legal requirement for conversion of equity under section 12A of the Electricity (Supply) Act,1948 was not fulfilled by the Government because the concept of equity shall be applicable only when the State Government issues notification under section 12A(1) of the Electricity (Supply)Act,1948 directing the Board to be a body

corporate with a capital not exceeding Rs.10 crore. In the absence of equity in the balance sheet the respondent is not in a position to ascertain a return on equity of 14%.

14. As regards depreciation it is contended that the decision of this Tribunal in Appeal No.5 of 2009 is decisive as it held that the policy direction under section 108 of the Act is not binding upon the Commission.

15. As regards interest and finance charges it is contended that the respondent disallowed only the excess provision of interest which is more than what has been paid to the consumers.The respondent has made it clear that in case the appellant pays the arrear interest due to any customer(s) the same may be accounted through prior period expenses and allowed in the year in which it is paid.

16.In respect on the provision for bad and doubtful debts it is contended that the reasoning of the Board is highly inconsistent and is against the provisions of Annual Accounting Rules and much higher than what is generally provided . The appellant made a provision of 22.73% compared to less than 2% in the previous years.

17. On the point of other debts the respondent has submitted that this has

already been decided in the Appeal No.5 of 2009 by this Tribunal.

18.On employees cost the respondent allowed all full expenses of employees cost except medical expenses which was limited to the approved level of Rs.2.74 crore against the actual of Rs.3.04 , the reason being that the Board could not show that the expenses were beyond its reasonable control. Of the total amount of Rs.898.09 crore the amount of disallowance amounts to only Rs.0.3 crore.

19. On T & D loss the appellant failed to achieve the loss reduction on account of its failure to implement the capital expenditure as proposed by the appellant itself. This Tribunal also held in the Appeal no 94 of 2008 that for non achievement of loss targets it is reasonable to disallow the cost incurred for purchase of additional power. The respondent disallowed only the average power purchase cost as given in Appeal No.100 of 2007.

20. On assumption of revenue the appellant has made serious violation of section 65 of the Act.

21. On the aforesaid pleadings the following points arise for consideration:-

Whether the State Commission was justified in its treatment on

a) Revenue Gap.

b) Return on equity.

c) Depreciation

d) Interest and finance charges

e) Provision for bad and doubtful debts

f) Other debits

g) Employee cost

h) Administration and General expenses with Electricity Duty

i) Transmission & Distribution Loss Levels

j) Assumption of Revenue from tariff

22. On the issue no. a) it does not appear that the Appellant has any case at all. The matter of the fact is that that ARR and ERC for the FY 2006-07 was approved by the Board on 30th March, 2006 and this has not been challenged. The True Up proceeding is based upon the approved ARR and ERC of the same Financial Year. Secondly, the Respondent has been filing ARR and ERC Applications and applications for True Up consistent with the KSERC (Tariff Regulation 2003). The Respondent also issued KSERC (Terms and conditions for retail sale of electricity) Regulations 2006 and MYT Regulations 2006. These Regulations are in force. It was the Appellant who earlier filed the petition praying for notifying the norms under Section 61 of the Act and that petition was disposed of by the Commission by an order dated 1st December, 2010. Thirdly, in PTC India Vs. CERC (2010 4 SCC 603) the Hon'ble Supreme Court held that Regulations are not preconditions for exercising the powers conferred under the provisions of the Act. Fourthly, the contentions of the Appellant that in the absence of the

Regulations the Electricity (supply) Annual Accounting Rules 1985 would apply is not correct because the said Rules and the provisions of Section 61 of the Act operate in different fields.

23. It has been brought to our notice that the True Up proceeding was based on the ARR and ERC order but the Appellant did not follow the said order and because of serious accounting discrepancies there has occurred the mis match between the approved expenses and the actuals.

24.On return on equity the appellant had been allowed 14% return on equity in accordance with the CERC Regulations. The Govt. of Kerala by an order dated 14.9.1998 converted the Govt. loan and the interest accrued thereon to the tune of Rs. 1553.00 Crores as equity but the same Govt. by a subsequent order on 9.10.2002 modified its earlier order and converted the loan and interest as grant. By considering these two orders C&AG in its audit report for the year 2005-06 reported that no notification as was required under Section 12A of the Electricity (Supply) Act 1948 was issued directing the Board to be a Body Corporate with capital not exceeding Rs. 10 crore. The Audit Report said that the Equity Capital accounted for by the Appellant in its Books of Account is against the provisions of the Act 1948. It is argued by the learned counsel of the Commission that during the proceedings of True-Up for 2006-07 the Respondent required clarifications from the Appellant which could not

produce any evidence to overcome the observation of the Audit Report. The Govt. also did not issue any order amending its earlier order. It has been argued that in the absence of Equity in the Balance Sheet the Commission could not consider in favour of the Board a return of 14% on equity. It is the case of the Respondent that it is still open for the Appellant to provide adequate details upon which return on equity might be allowed. Now, Mr. Ramachandran argued on behalf of the Appellant that in view of Section 66 of the Supply Act 1948 no notification under Section 12A of the said Act 1948.

25. The controversy as to whether in spite of what is contained in Section 66 A of the Supply Act 1948 a notification is required under Section 12A of the Act. It has come to our notice through a copy of the order dated 13th December 2010 passed by the Govt. of Kerala wherein there is a reference to the order dated 14.9.1998 and 9.10.2002 and in the said third order dated 13.12.2010 the Govt. of Kerala reviewed the matter on the request of the State Electricity Board and ordered that the equity of Rs. 1553 crore ordered in G.O. (Ms) No. 27/98/PD dated 14.09.1998 will continue to be treated as Government's capital in KSEB . The Commission had no difficulty in following the Notification dated 14.09.1998 But it was not in a position to grant 14% return on Equity as by the subsequent order dated 9.10.2002 the Govt. converted the loan and interest as grant. Now that the Govt. reverted back to the position as

was obtaining on 14.09.1998 and specifically observed that the order dated 14.9.1098 will continue to operate. In view of this Government's order the Commission may now upon examination of the matter review the position and pass appropriate order.

26. On the issue of depreciation it is the argument of the Appellant that the accounts prepared by the Appellant under Annual Accounting Rules 1985 that provide for the rate of the depreciation should not have been rejected. It is the case of the Appellant that it was allowed depreciation as per the Govt. of India's notification dated 29.03.1994 and though the State Govt. requested the Commission to allow depreciation in terms of Govt. of India Notification dated 29.03.1994 it did not follow the Govt.'s letter. The Respondent argued, to our mind not unjustifiably, that the letter of the Govt. is not binding upon the Commission and this Tribunal made such observations in Appeal NO.5/2009 holding that the policy direction under Section 108 is not binding upon the Commission. This Tribunal held that *"when the direction regarding the depreciation is to be applied, it can only be under Section 65 of the Act. In that event, the difference between the depreciation calculated on the basis of the Government direction and the amount determined by the State Commission shall be paid in advance by the state Government".* This decides the issue.

27. On interest and finance charges we do not think that the Commission committed any illegality. According to the Appellant, it was preparing the accounts as per the accrual basis i.e. recording the income and expenditure in which each item is reported as earned or incurred without regard to when actual payments are received or earned. The Commission found that the Appellant had made a provision of interest on security deposits based on the total security deposits as per Books and if portion of interest is not passed on to the consumers they are not liable to pay such amount. The Commission rightly disallowed the excess provision of interest which was more than what was paid to the consumers. In Appeal No. 177/2009 this Tribunal observed as follows:-

> *"Regarding dis-allowance of interest and finance charges, the only item disallowed is the interest on security deposit. The State Commission has allowed interest on security deposit to the extent of actual disbursement for the year 2005-2006. As such this finding is also perfectly justified."*

28. On bad and doubtful debt the Commission observed that the Appellant proposed to write off Rs. 281.32 crore which is about 8% of the revenue from sale of power. This means that the Appellant did not collect the amount due from the consumers, and according to the Commission the burden of arrears of non paying consumers will fall on

the promptly paying consumers. The Board found that the treatment of the appellant was against the provisions of Annual Accounting Rules. The Commission approved only Rs. 49 crore against Rs. 281.32 crore. We do not find that the Commission's approach was unreasonable. In Appeal No 177/2009 the Tribunal held *"regarding bad and doubtful debts, the Commission has observed that the Appellant has provided unusually high provisions without*

any explanation for such high provisions. The State Commission has also correctly held that interest on belated payment of electricity duty cannot be passed on to the consumers. It is also held that another amount of Rs. 28.73 crores towards interest payable on security deposit as on 1.4.2004 cannot be allowed as the interest is payable effective."

29. On other debits this Tribunal's order in Appeal No. 5/2009 is decisive. We may reproduce the observation of this Tribunal in that case. ***"According to the Learned Counsel for the Appellant, the State Commission has disallowed an amount of Rs. 402 crores for the FY 2008-09 against other debit proposed to be written off by the Appellant. The dues from the Government to the Appellant are on account of unpaid subsidy commitment. The proposal of the Committee constituted by the Government is to write off the dues from the Government as against the surplus without affecting the***

tariff determination. If the writing off leads to any revenue deficit in any of the written off period, the same will be covered by the Government through cash subsidy.The Additional Secretary of the Power Department of the State of Kerala, who was present before the State Commission, had admitted before the

State Commission that the issue of writing off dues has not been yet decided and is still under the consideration of the Government.No operative order has yet been issued by the State Government. The concurrence of CAG has also not been obtained. In these circumstances, the writing off has no legal status. In view of the said situation, the State Commission is right in not allowing the writing off. Under section 65 of the Act, if the Government require grant of subsidy to any consumer category, the Government has to provide the monetary compensation to the licensee concerned in advance. The proposed write off of the dues from the Government to the Appellant involves approximately Rs. 400 crores per annum which becomes a component of ARR. This huge sum cannot be allowed to be passed on from certain consumer category to the entire consumer base of the Appellant. Therefore, disallowance of the other debits is perfectly justified. ”

30. On employees cost the Commission disallowed only an amount of Rs. 0.3 crore. According to the Appellant, the exact medical expenses could not be

anticipated as being not controllable expense. We are of the opinion that this differential amount, being actual, of Rs. 0.3 crore may be allowed.

31. On T&D loss the Commission targeted 2.50% but the Board achieved 1.01% less than the approval of the Board. According to the Appellant the Board was able to reduce T&D loss by 9.29% over five years since 2001-02. Though the State Commission has to fix a multi year trajectory for loss reduction as per the National Electricity Policy notified by the Central Govt. it did not fix the loss reduction trajectory. It appears the Commission directed the Board to provide segregation of voltage wise/technical/commercial losses in all the orders in the ARR & ERC from 2005-06 onwards but the Respondent could not provide loss reduction trajectory in the absence of authentic studies from the Appellant. In Appeal No 5/2009 this Tribunal made observations regarding non compliance with the directives from the Respondent in these words.

> "*32. Let us now take the next issue relating to the Fixation of Transmission and Distribution losses. According to the Learned Counsel for the Appellant, the State Commission does not employ any mathematical mechanism to assess the target at which transmission and distribution losses is to be fixed and therefore, the Tribunal has to devise a mechanism by which to assess the target for fixing the transmission*

and distribution losses and the State Commission should not be allowed to fix the same at its whims and fancies. 33. One of the key areas of performance improvement required for any utility seeking to operate according to commercial principles is in the area of transmission & distribution losses.The Kerala State Electricity Regulatory Commission (Terms & Conditions of Tariff for Retail Sale of Electricity) Regulations, 2006 dated 23.03.2006 set out the manner in which losses will be regulated, as under:

"9. Distribution Loss – ***(1) The licensee shall carry out proper loss estimation studies as required by the Commission, to set a realistic base line of loss estimates at different voltage levels and in relation to different consumer categories.***

(2) The Commission shall approve a loss target for the year under consideration based on the opening loss levels, licensee's filings, submissions and objections raised by the stakeholders. This approved loss target shall be used for computing power purchases/sale of power to consumers for that year.

(3) `The licensee shall have to share with the consumers part of the financial gains arising from achieving higher loss reduction vis-à-vis the target. ***Losses on account of underachievement of loss reduction target shall be entirely borne by licensee.***

34. The State Commission has, on numerous occasions, directed KSEB to conduct relevant baseline studies and submit the results to the Commission for its consideration. However, the Board has consistently refused to comply with these directives. Hence the Commission has, as per section 9(2) of the relevant regulations, set loss targets for the Appellant.

35. The State Commission has accepted the loss reduction target suggested by the Appellant as 1.63%. The difference in the requirement of power is due to the method of calculation. The State Commission has taken previous year's figure as estimated whereas the Board has taken the actual figure without achieving the loss reduction target for the previous figure. The loss reduction target fixed by the Commission is based upon the proposal of the Appellant itself. Even now the Appellant has not initiated detailed study of estimate on technical and commercial loss in the system, even after repeated directions by the Commission. In the absence of proper study and estimates projected by the Appellant, the Commission was constrained to rely upon the data submitted by the Appellant. The Aggregate Revenue Requirement and Expected Revenue from Charges proceedings are meant to assess the financial requirement of the utility as realistic as possible and fix the tariff accordingly. The figures are on the basis of projections. The actual figures are available at the time of truing up proceedings. Unless the projections decided by the

State Commission are substantially wrong, which can result in change of tariff, the order impugned can not be interfered with. According to Regulation 2006 dated 23.03.2006, the licensee shall carry out proper loss estimation study as required by the State Commission. As such, it cannot be said that the State Commission has fixed the transmission and distribution losses on its whims and fancies. In view of the above there is no merit in this claim. Hence there is no merit in this claim."

32. On administrative & General Expenses it was the contention of the appellant that the State Commission wrongly relied upon section 3 (3) of the Kerla Electricity Duty Act to justify its decision. But in this respect this Tribunal held on 12.11.2009 in Appeal No.94 of 2008 as follows:-

"*29) Mr. Ramachandran submits that in a cost plus method of tariff fixation, we cannot burden the distribution licensee with any expenditure lawfully incurred. According to him electricity duty payable under section 3 of the KED Act should be part of the general expenses as has been done in the past. Mr. Sibal submits that if it is so done, the burden of the duty will eventually fall on the consumer and would not be permissible as per the proviso quoted above. We entirely agree with Mr. Sibal's contentions. The provision of the legislation cannot be frustrated by such manipulation. Even if in some year/years the duty in question has been included in the A&G expenses, the same cannot be adopted as a*

practice. There can be no estoppel against statute. Hence the Commission's view in this regard needs to be upheld".

Further, in Appeal No. 5 of 2009 decided on 13.1.2011 this Tribunal held as follows:

"42. According to the Appellant, the Electricity Duty payable to the Government of Kerala is Rs. 76.45 crores which forms a significant portion of the A&G expenses for the FY 2008-09. It is also the case of the Appellant that the total A&G expenses proposed by the Appellant for the FY 2008-09 are Rs. 140.06 crores and despite the increase in the above expenditure over the years, the percentage of the total revenue expenditure is more or less the same. As a matter of fact, the State Commission has disapproved the Electricity Duty payable to the State Government on the ground that according to section 3 of the Kerala Electricity Duty Act, the duty payable by the licensee to the Government will be on account of licensee and the same should be borne by the licensee alone and shall not be passed on to the consumers. Therefore, the State Commission has approved only Rs. 61.99 crores towards A&G expenses. As indicated above, this issue has already been decided as against the Appellant in Appeal No. 94 of 2008 dated 12.1.2009. As such there is no merit in this issue.

33. On the question of assumption of revenue from tariff it is the case of the appellant the Board can not withdraw rebate granted by the Commission . It was upto the Commission to withdraw rebate once the Government declined subsidy for such reduction in tariff by the order dated 16.12.2006. The Commission observes that the appellant made serious violation of section of 65 of Act. In the order date 5.1.2006 the Commission observed as follows:

> *"The attention of KSEB/ Government is drawn to the provision under section 65 of the Electricity Act 2003, which reads as follows to deal with the non payment of subsidy "Provided that no such direction of the State Government shall be operative if the payment is not made in accordance with provisions contained in this section and the tariff fixed by the State Commission shall be applicable from the date of issue of orders by the Commission in this regards."*

34. The appellant without receiving advance amount from the Government allowed rebate for 24 months. The total amount was passed on to the consumers was to the tune of Rs. 122.23 crore for the year 2006-07. Since the consumers are not responsible for the violation of the orders of the Commission and provisions of Act by the appellant, it was rightly not fair to pass on the burden to the consumers. Hence, the respondent treated the short fall in revenue due to non- payment of subsidy as part of the revenue from tariff and directed the Appellant to take necessary steps to realize to the

amount from the Government as subsidy. This issue stands decided against the appellant.

35. In the result the appeal succeeds only in part on the issue of return on equity in view of the Government's modified order dated 13.12.2010 and employees cost relating to medical expenses of Rs.0.30crore over which the Commission will pass appropriate order. No Cost

(Justice P.S.Datta) (Rakesh Nath)

Judicial Member Technical Member

Reportable/Non-reportable

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