Appellate Tribunal for Electricity
(Appellate Jurisdiction)

Appeal No. 102 of 2011

Dated: 18th April, 2012

Present: HON'BLE MR. JUSTICE P S DATTA, JUDICIAL MEMBER
HON'BLE MR. V J TALWAR, TECHNICAL MEMBER,

Haryana Vidyut Prasaran Nigam Limited.
Shakti Bhawan, Sector 6
Panchkula -134112

...Appellant

Versus

1 Haryana Electricity Regulatory Commission
Bays 33-36, Sector 4
Punchkula-134112

2 Uttar Haryana Bijli Vitran Nigam Limited
Vidyut Sadan, C-16 Sector 6
Panchkula – 134112

3 Dakshin Haryana Bijli Vitran Nigam Limited
Vidyut Nagar
Hissar - 125005

…Respondent(s)

Counsel for the Appellant : Mr Neeraj Kumar Jain Sr. Adv
Mr Umang Shankar
Mr Paratham Kant

Counsel for the Respondent : Ms Shikha Ohri for R-1
Ms Surbhi Sharma for R-2&3

JUDGMENT

PER V J TALWAR TECHNICAL MEMBER

1 Haryana Vidyut Prasaran Nigam Limited is the Appellant. The Haryana Electricity Regulatory Commission (Commission) is the 1st Respondent herein. 2nd & 3rd Respondents are the distribution licensees in Northern and Southern Parts of Haryana respectively.

2 The Appellant, Haryana Vidyut Prasaran Nigam Limited is a Transmission Licensee and State Transmission Utility in the State of Haryana. The Appellant is fully owned by the Government of Haryana. The Commission had passed an order dated 16.4.2010 determining the Annual Fixed Charges recoverable by the Appellant from its transmission system users including the 2nd & 3rd Respondents.

3 The Appellant filed a review petition before the Commission seeking review of the order dated 16.4.2010 in respect of certain issues. The Commission passed the impugned order on 30.10.2010 affording relief on some of the issues and rejected the remaining one raised by the Appellant in review petition. Aggrieved by the Commission's impugned orders dated 16.4.2010 and 31.10.2010, the Appellant has filed this Appeal.

4 The Appellant has raised the following issues in the present Appeal for our consideration:

i. Depreciation;
ii. Debt redemption obligation and other interest cost;
iii. Financial Impact of the judgment of this Tribunal in Appeal No. 27 of 2007;
iv. Interest on working capital;
v. Rate of Return on Equity;
vi. Interest on Capital Works;
vii. Income from Short term Open Access Customers;
viii. Depreciation on BBMB and IP Station assets;
ix. Incentive

5 Before proceeding further we would like to mention that the Appellant, in this Appeal has claimed certain reliefs in accordance with the Tariff Regulations 2009 framed by the Central Commission and the learned Counsel for the Appellant has stated that the Commission ought to have followed the guidelines laid down by the Central Electricity Regulatory Commission and the principles laid down by the Tariff Policy issued by the Government of India in accordance with Section 3 of the 2003 Act. He further states that under Section 61(d) of 2003 Act requires of the State Commissions, while fixing tariff, to be guided by the principle under which recovery of cost of electricity is ensured in a reasonable manner. Further, Section 61(i) of the Act mandates the State Commission to be guided by the National Electricity Policy and the Tariff Policy. The State Commission has neither followed the principles and methodology specified by the Central Commission nor followed the provisions of Tariff Policy and National Electricity Policy. In this context it would be desirable to refer to Section 61 of the Act which read as under:

> ***61. Tariff Regulations.***—*The Appropriate Commission shall, subject to the provisions of this Act, specify the terms and*

conditions for the determination of tariff, and in doing so, shall be guided by the following, namely:—

(a) the principles and methodologies specified by the Central Commission for determination of the tariff applicable to generating companies and transmission licensees;

(b) the generation, transmission, distribution and supply of electricity are conducted on commercial principles;

(c) the factors which would encourage competition, efficiency, economical use of the resources, good performance and optimum investments;

(d) safeguarding of consumers' interest and at the same time, recovery of the cost of electricity in a reasonable manner;

(e) the principles rewarding efficiency in performance;

(f) multi-year tariff principles;

(g)…;

(h)…;

(i) the National Electricity Policy and tariff policy:

Provided that the terms and conditions for determination of tariff under the Electricity (Supply) Act, 1948 (54 of 1948), the Electricity Regulatory Commissions Act, 1998 (14 of 1998) and the enactments specified in the Schedule as they stood immediately before the appointed date, shall continue to apply for a period of one year or until the terms and conditions for tariff are specified under this section, whichever is earlier.

6 Bare reading of Section 61 would elucidate that the State Commissions have been mandated to frame Regulations for fixing tariff under Section 62 of the Act and while doing so i.e. while framing such Regulations, State Commissions are required to be guided by the principles laid down by the Central Commission, National

Electricity Policy and Tariff Policy etc. It also provide that while framing Regulations the State Commissions shall ensure that generation, transmission and distribution are conducted on commercial principles; factors which would encourage competition and safe guard consumer's interest. Once the State Commission has framed and notified the requisite Regulations after meeting the requirement of prior publication under Section 181(3), it is bound by such Regulations while fixing Tariff under Section 62 of the Act and the Central Commission's Regulations have no relevance in such cases. However, the State Commission may follow the Central Commission's Regulations on certain aspects which had not been addressed to in the State Commission's own Regulations. The Haryana Electricity Regulatory Commission has framed HERC (Terms and Conditions for determination of Tariff for Transmission) Regulations (here in after referred as Tariff Regulations 2008) in the year 2008 effective from 19th December, 2008. The State Commission is required to fix tariff as per these Regulations. Perusal of the Commission's Tariff Regulations 2008 would reveal an important feature in as much as it does not vest with the Commission any power to relax any of the Regulations. Thus, the Commission has to follow these Regulations strictly and no deviation is permissible under these Regulations.

7 Keeping in view the above observations, let us deal with each of the above issues raised in the Appeal one by one: First issue before us for consideration is **Depreciation**

8 The Appellant had projected an amount of Rs 1518.7 Millions towards depreciation in its ARR filing for the FY 2009-10. However, the Commission in its impugned order dated 16.4.2010 had allowed depreciation of Rs. 877.80 millions considering the rate of depreciation of 3.07% in accordance with the provisions of Commission’s Tariff Regulations, 2008. The Appellant in its review petition before the Commission had claimed review of depreciation allowance on the basis of the CERC (Terms and Conditions for Determination of Transmission Tariff) Regulations, 2009 which worked out to be Rs 1407.25 Millions at a rate of 4.83% on the Gross Fixed Assets (GFA) of Rs 30082.67 Millions at the beginning of the year.

9 The Commission in its impugned order dated 31.10.2010 accepted the contention of the Appellant and agreed to approve depreciation as per the CERC Tariff Regulations, 2009 and recalculated the allowable depreciation at higher rate of 4.83% on GFA of Rs 30082.67 Million amounting to Rs 1407.25 Millions. However, the Commission directed the appellant to adjust the difference of Rs. 529.60 millions (Rs. 1407.25 millions less Rs. 877.80 millions) from the Advance against Depreciation (AAD) allowed by the Commission in its previous orders.

10 Before dealing with the rival contentions raised by the learned Counsels of Appellant and the Respondents, it would be desirable to examine the findings of the Commission in the impugned order dated 31.10.2008. Relevant portion of Commission’s finding relating to the issue reads as under:

"2. Depreciation:

HVPNL has submitted that depreciation at the rates as per CERC notification applicable for FY 2009-10 to FY 2013-14 were sought but the Commission allowed depreciation as per rates provided in HERC Terms and Conditions for Determination of Transmission Tariff, Regulations, 2008 (Tariff Regulations, 2008) issued in 2008. The rates of depreciation specified in HERC Tariff Regulations, 2008 are based on CERC depreciation rates as per notification issued in 2004 which were applicable till FY 2009. CERC has amended the rates of depreciation vide its notification for 2009 which are applicable for the period starting from FY 2009-10 to FY 2013-14. The new CERC rates are higher as compared to the earlier rates as adopted by HERC, as a result the provision for advance against depreciation has been done away with. The licensee has prayed that the revised rates as per CERC latest notification may be allowed or else advance against depreciation amounting to Rs.529.60 million may be allowed in addition to the depreciation already allowed to them.

The Commission takes note of the argument advanced by the licensee. The rates of depreciation as per the HERC Tariff Regulations, 2008 for transmission business are in line with the depreciation rates notified by CERC in 2004 in accordance with the National Tariff Policy. The new Regulations notified by CERC in 2009 have also done away with the need for advance against depreciation. The Commission is of the opinion that advance against depreciation front loads the tariff and burdens the consumers of the existing transmission network. It is better to have loan repayments that are commensurate with the life of the transmission system in which case they would dovetail with the depreciation normally generated. Advance against depreciation (AAD) also leads to a negative tax implication for the utility. ***The Commission, therefore, allows the licensee to claim depreciation for FY 2010-11 on the basis of revised CERC rates.***

For CERC determined tariff, the new rates of depreciation are applicable only to projects to be Commissioned after 1.4.2009, but for HVPNL the higher rates of depreciation will be applicable to all transmission assets and not restricted to

> ***new additions after 1.4.2009 and therefore would be beneficial for it; enabling it to generate higher internal resources from existing projects also.*** *Therefore, the Commission is of the opinion that there is no requirement for AAD. The Commission had allowed HVPNL to recover certain amounts as advance against depreciation in its earlier ARRs with a direction to show the amount separately in its financial accounts by creating a separate and distinct reserve which would be available for adjustment in future.*
>
> *However, the Commission finds that the licensee has not shown the AAD amounts separately, nor has it created any fund to clearly demarcate the funds it has collected on this account. Therefore it appears that the funds generated through the AAD have been merged by HVPNL in its profit. The consumers have paid the amount of AAD for the specific purpose of generating funds for the transmission network system and for future adjustment against depreciation and therefore such merging of these funds with general profits is highly undesirable. Therefore the Commission allows HVPNL to charge depreciation on assets during FY 2010-11 at revised rates as notified by CERC in 2009 and directs it to adjust the difference between the amount allowed in the order dated 16.4.2010 and the amount so calculated now from the AAD allowed by the Commission in its earlier orders till date. Difference in the amounts, if any, shall be taken care of in the next ARR. This treatment of existing AAD would be in line with the Commission's decision allowing higher depreciation on all assets and not just assets being commissioned after 1.4.2009."* ***{Emphasis Added}***

11 Perusal of the above findings of the Commission in the impugned order would indicate that the Commission has adopted higher rate for depreciation provided in the CERC Regulation 2009 solely on the ground that the Commission's 2008 Tariff Regulations notified in December 2008 were based on CERC Tariff Regulations 2004 and since the Central Commission had revised the rate of depreciation in its 2009 Regulations, the Commission has adopted the same. While doing so, the Commission has not only adopted the CERC

Regulations 2009 but relaxed it further and made it applicable to all the assets of Appellant.

12 As pointed out earlier in Para 5 & 6 above, once the State Commission have notified its Regulations in accordance with the provisions of the Act, the Central Commission's Regulations would have no relevance in the matter and the State Commission would have to follow its own Tariff Regulations for determination of tariff for licensees and generating companies. In this case the Commission has notified Haryana Electricity Regulatory Commission (Terms and Conditions for Determination of Transmission Tariff) Regulations, 2008 on 19th December 2008. The Commission is mandated to determine transmission tariff in accordance with the provisions of these Regulations only.

13 Section 181 (2)(zd) of the Act gives powers to the State Commissions to frame Regulations specifying Terms and Conditions for determination of tariff under section 61 of the Act. Similarly, Section 178 (s) of the Act gives powers to the Central Commission to frame Regulations specifying Terms and Conditions for determination of tariff under section 61 of the Act. The powers of Central Commission under section 179 and powers of State Commissions under section 181 are independent of each other. Section 61 of the Act requires of the appropriate Commission to specify terms and conditions for determination of tariff and while doing so it shall be, interalia, guided by the principles and methodologies specified by the Central Commission. The rational for incorporating this provision is to ascertain uniformity, to the extent possible, in the Regulations framed

by various State Commissions. If the intention of the legislature was that the State Commission would adopt the provisions of the Regulations framed by the Central Commission, the legislature would have used the term ‘shall follow’ rather than the term ‘shall be guided by’ in section 61(a) of the Act.

14 The crux of the above discussions is that the State Commissions are independent statutory bodies having full powers to frame its own Regulations specifying terms and conditions for determination of tariff and once such Regulations are notified, the State Commission is bound by these Regulations.

15 Further, scrutiny of 2008 Tariff Regulations of the Commission would disclose that the Commission does not possess power to relax any of the provisions of these Regulations. In the present case, the State Commission has not only adopted the rate of depreciation specified by the CERC Regulations but also relaxed it further to apply it on the assets of the licensee exerting the powers to relax which it did not posses.

16 Further, while adopting the rate of depreciation specified by the Central Commission, the Commission has failed to appreciate that the process of determining the transmission tariff by the Central Commission is completely different from the one adopted by the Commission. The Central Commission determines the tariff for each project of the licensee separately. Thus, accounting for higher depreciation rate for first 12 years from Commercial Operation Date (COD) of the project and remaining depreciation to be spanned over

balance period of useful life of the asset could be carried out without any complications. However, the Commission provides depreciation on opening value of Gross Fix Asset (GFA) at a certain rate without considering the period the asset has already served. GFA would contain many assets which had already served its useful life and its book value is reduced to the salvage value (10%). These assets would not earn any depreciation if the accounting is done for each asset separately. However, in case the depreciation is provided on opening value of GFA, the assets which have been fully depreciated (up to 90%) would also earn depreciation as their salvage value is also reflected in the GFA.

17 Above discussions would make it amply clear that the Commission has erred in adopting the rate of depreciation specified by the Central Commission in its 2009 Regulations and relaxing it further to all the assets including the existing ones. The Commission is directed to recalculate amount of depreciation permissible to the Appellant as per the provisions of its own Tariff Regulations 2008 including provision for Advance against Depreciation.

18 Next question for our consideration is related to **Debt redemption obligation and other interest cost**. This issue relates to profit earned by the Appellant through sale of a piece of land in Hissar which was purchased by the Appellant at Rs 185.30 Millions and sold to HPGNL, a state owned generating company, at Rs 791.20 Millions there by earning a profit of Rs 605.90 Millions. The Commission in its impugned order directed the Appellant to adjust this amount against the outstanding liability of pension and PF bonds.

19 The Learned Senior Counsel for the Appellant would submit the following contentions:

(a) The appellant had to purchase land of various locations for setting up sub-stations. This amount is not being funded by the financer and to be provided by the Commission in the tariff as no deprecation is applicable on the cost of the land.

(b) During 2008-09, Rs. 791.20 millions was received against land sold to HPGCL at Khedar, Hisar. The land was acquired by the licensee by raising Short Term Loan amounting to Rs. 185.30 millions. The holding cost of the land upto 30th Sept., 2007, works out to Rs. 333.30 millions as per Govt. of Haryana decision dated 24-8-2007.The actual payment of the land cost was made by the HPGCL in parts and further holding cost work out Rs. 86.10 millions due to delay in payment.

(c) Thus, the total cost of licensee for this land work out to Rs. 604.70 millions and as such the profit on the sale of land as such works out to Rs. 186.50 millions. The profit of Rs. 605.96 millions on sale of land is only a book profit from the accounting point of view.

(d) Further, as against the profit of Rs. 186.50 millions, the licensee has already spent the amount of Rs. 221.20 Millions towards purchase of land during FY-2008-09 and Rs. 326.35 Millions during FY 2009-10. Thus the income earned amounting to Rs. 605.96 millions from sale of land by the Appellant to HPGCL cannot be adjusted against pension bonds and the appellant is

also entitled for the differential amount of interest on pension bonds amounting Rs. 60.60 millions.

20 The learned Counsel for the Commission reiterated the view points of the Commission adopted in the impugned order. Let us examine the findings of the commission in the impugned order which read as given below:

"HVPNL has sought review against the Commission's order adjusting profit from sale of fixed assets amounting to Rs.605.969 million against the outstanding liability of pension and PF bonds. The licensee has stated that the profit shown as part of Audited Accounts is incorrect as it has incurred an expenditure of Rs.333.30 million on holding cost upto 30.9.2007. Further, the actual payment of the land cost was made by HPGCL in parts for which additional holding costs works out to Rs.86.10 million. Therefore, as stated by HVPNL, the profit on sale of land works out to Rs.186.50 million and it has already spent Rs.221.20 million towards purchase of land during 2008-09 and Rs.80.73 million during 2009-10 out of the total proceeds.

The Commission has heard the submissions of the licensee and it is found that the cost of land that has been sold is Rs. 185.3 million (as per the books of licensee). As per information provided by the licensee at annexure "D" of its petition, Haryana Power Generation Corporation Limited (HPGCL) has already paid Rs. 250 million prior to 15.7.2008. HVPNL needs to appreciate that the holding cost, if any, is to be calculated only on the payments which have been incurred by it. There can be no holding cost on the profit component of the transaction. It may also be noted by the licensee that the profit is not being adjusted as on 30.9.2007 i.e. the period from which the holding cost has been calculated by HVPNL. The profit is being adjusted only during FY 2010-11 when the full amount has been received. Therefore the contention of the licensee regarding holding cost on profit is not tenable. Further the licensee has stated that they have spent Rs. 221.20 million

towards purchase of land during 2008-09 and Rs.80.73 million during 2009-10. The licensee was directed by the Commission to provide information whether cost of any land has been kept out of transmission ARR in any year till date along with reasons for the same. The Commission is of the opinion that normally all capital costs including land would be a part of planned capital expenditure included in the ARR. The licensee has not addressed this issue in its reply dated 9.7.2010 and 2.10.2010. The Commission in the absence of suitable reply/appropriate justification rejects the review sought by the petitioner on this issue."

21 Having examined the rival contentions of the parties we are of the view that the Commission has correctly held that all the capital costs including the cost of land would be the part of the planned capital expenditure included in the ARR. As a prudent utility, the Appellant ought to have included the cost of land (including the land which was procured in the year 1998 and sold to HPGNL in year 2007) and also the land the Appellant is claiming to have purchased out of the proceeds from the sale of the said land in its ARR filings for various years. To a specific query to the Appellant asking to submit documentary proof to show that the land acquired for Rs 221.20 Million out of the profit has not been included in the ARRs filed by the Appellant before the Commission, the Appellant simply submitted that earlier the cost of land was not an issue for the licensee as it was provided by the Gram Panchayat free of cost and as such in the earlier ARRs the cost of land was not claimed in the Capital Expenditure. Subsequently after amendment in Village Common Land Act by the Govt. of Haryana the licensee is required to pay the compensation to the Gram Panchayat for acquisition of land as per provisions of the legislation.

22 Clearly the Appellant could not substantiate its claim that it had purchased land from the sale proceeds of the land it had sold to HPGNL and did not include such land in its ARRs.

23 We also agree with the Commission's decision with regard to Appellant's claim on "carrying cost" of the land. As prudent utility the Appellant ought to have taken into account the cost of land and its carrying cost in the ARRs filed before the Commission and would have obtained Annual Fix Charges against the same. Thus this plea of the Appellant is not acceptable and is liable to be rejected.

24 As an alternative argument, the Learned Senior Counsel for the Appellant submitted that the land on which the appellant has earned a book profit of Rs. 605.96 millions on its sale was a Generation assets and not a part of Transmission assets. The appellant had always classified the same under Assets of Generation business in its ARR. The Respondent Commission in its impugned order dated 30th Nov., 2010 while giving its decision on Depreciation on BBMB and IP station assets had held that the ARR for Transmission and SLDC business is not concerned with the Generation business and transactions thereon can have no bearing on the transmission charges. Therefore, the direction of the Commission to utilise the profit on sale of land which was held by the appellant for its Generation Business towards redemption of its pension Bonds contravened the view taken in the same order.

25 This contention of the Appellant is misconceived and misdirected. It cannot claim that since the land was shown as generation business

and has been sold to a generation company, the profit earned from sale of such land is to be treated as profit from its generation business. Possession of land without a generation station cannot be treated as generation business. Land would remain land unless a generating station is put up on it and start generating power. Activities carried out after establishment of generating station would qualify as generation business. To further clarify this let us consider an example. If a person sells his land for farming purpose, the profit earned from such sale cannot be said to be income from agriculture business and thus exempted from income tax. Income Tax department would consider such sale as capital gains and tax accordingly. Therefore, sale of land to a generating company cannot be held as a profit from generation business.

26 One very important aspect is related to consumer's interest. The Commission is mandated to safeguard the consumer's interest. The Appellant has sold the land to a generating company at a profit of about Rs 605 Million. The cost at which the generating company have acquired the said land ought to have been included in the ARR of the generating company and reflected in its tariff. Thus, the ultimate consumer would be paying for the profit the Appellant has earned by sale of the land to generating company. If the Appellant Transmission licensee is allowed to pocket the profit, it would be at the cost of consumer. The Commission's decision has rendered the transaction as "tariff neutral" and we fully endorse it.

27 Accordingly the issue is answered against the Appellant.

28 Next issue requiring our delibiration is related to **<u>Financial Impact of the judgment of this Tribunal in Appeal No. 27 of 2007</u>**.

29 The Commission had passed Tariff orders for the FY 2004-05 and FY 2005-06 disallowing some of the claims made by the Appellant in its ARR filings for the Year 2004-05 and 2005-06. Aggrieved by the order of the Commission, the Appellant had filed appeals before this tribunal being Appeal No. 33 of 2005 and Appeal No. 74 of 2005. This Tribunal disposed of these appeals by a common judgment dated 7.7.2006 allowing few of the claims of the Appellant including depreciation on BBMB and IP assets. The Commission sought some clarification from Government of Haryana on depreciation on BBMB and IP assets. The Appellant filed another Appeal No. 27 of 2007 before this Tribunal seeking compliance and execution of the Tribunal's judgment in Appeal no. 33 of 2005 and 74 of 2005. The issues before the Tribunal in Appeal no. 27 of 2007 were related to depreciation on BBMB/IP assets and accumulated losses sustained by the Appellant.

30 The Tribunal in its judgment dated 4.10.2007 in Appeal no. 27 of 2007 remanded the matter to the Commission for computing denovo the amount required to be recovered by the appellant by taking into consideration the actual accumulated losses suffered by the appellant and while calculating the amount the Commission would also take into account the contingent liability of the appellant. The Tribunal also directed the Commission to act in consonance with the earlier directions of this Tribunal in appeal nos. 33 of 2005 and 74 of 2005

dated July 7, 2006, whereby the depreciation on BBMB/IP station assets was allowed as claimed by the appellant.

31 While dealing with issue related to financial impact of the judgment of this Tribunal in Appeal No. 27 of 2007 the Commission made the following observations in its impugned order dated 16.4.2010;

> ***"2.14.2 Commission order on the financial impact of the order of the Hon'ble Appellate Tribunal for Electricity in case no 27 of 2007***
>
> *The Commission, vide its order dated 18.3.2010 has also decided to allow the licensee to recover the benefit of the order of the Hon'ble Appellate Tribunal for Electricity in case no 27 of 2007 in three equal instalments w.e.f. FY 2010-11. Therefore the financial impact amounting to 1/3 of Rs. 1915 million i.e. Rs. 638.33 million along with holding cost of Rs. 102.13 million on the balance amount is allowed to be recovered in the ARR for FY 2010-11.* ***As the Commission had already allowed the accumulated losses as per the audited accounts as on 31.3.2006 in its order dated 1.12.2006,*** *the additional amount now allowed may therefore be utilized by the licensee to redeem its pension bonds in accordance with the Commission's order on the ARR of HVPNL for FY 2008-09."*

32 Aggrieved by the direction of the Commission to utilize the amount to redeem its pension bonds, the Appellant filed a review petition before the Commission. The Commission disposed of the review petition by the impugned order dated 31.11.2010. The observations of the Commission related to the issue are as under:

> ***4. Financial Impact of the order of the Hon'ble Appellate Tribunal for Electricity in Case No. 27 of 2007:***
>
> *HVPNL has sought review against the order of the Commission directing them to utilize the recovery on account of the order of*

the Hon'ble Appellate Tribunal for Electricity in Case No. 27 of 2007 the towards additional redemption of pension bonds on the following grounds:

a) HVPNL has pointed out its financial constraints due to non-liquidation of other receivables and receivables against wheeling charges by UHBVNL.

b) The said order of the Hon'ble Appellate Tribunal does not provide any stipulation/condition that the relief to be allowed to HVPNL is to be utilized towards redemption of any type of liability by HVPNL.

c) HVPNL has to purchase land at various places for which the fund shall be required.

d) HVPNL's investment in subsidiary companies UHBVNL and DHBVNL is not earning any return thus leading to additional financial burden on HVPNL.

The licensee has claimed that it has borrowed substantial amounts from Financial institution to tide over the short fall arising on account of expenditures towards which the Hon'ble Appellate Tribunal had provided relief.

The Commission, in order to evaluate the grounds put forth by the licensee, had directed the petitioner to provide details of loans which had been incurred for funding of the above mentioned expenditure. The petitioner has provided the following additional information on borrowing during each year and closing balance of loans:

year	*Loan drawn*	*Closing Balance*
2002-03	*50*	*47.11*
2003-04	*100*	*76.45*
2004-05	*455*	*445.03*
2005-06	*319*	*574.92*
2006-07	*200*	*529.81*
2007-08	*100*	*387.18*
2008-09	*241*	*475.37*
2009-10	*301*	*661.35*

A perusal of the audited balance sheet of licensee indicates that as against the above borrowing, the licensee has outstanding receivables amounting to Rs. 218 crores on account of wheeling charges on which interest has already been provided by way of interest on working capital and penal interest on overdue amount; Rs 10 crore as advance payment of FBT for which commission has allowed interest in the ARR and Rs. 367 crore as other advances recoverable including advance recoverable from UHBVNL. The licensee in its review petition has stated that this amount is payable by UHBVNL alongwith interest. This implies that borrowing to the extent of Rs. 595 crore being the sum total of these three amounts is already funded by interest which is either allowed in the ARR or to be recovered from some other debtor. The Commission, therefore, is of the opinion that where the interest cost on certain sums is already allowed to the licensee, it cannot be allowed to recover the same again through the ARR. It may be observed that the Commission had allowed additional funds for redemption of PF and pension bonds through ARR only because the licensee had no additional sources of funds for redemption of these bonds and its investments in its subsidiary companies UHBVNL and DHBVNL was not earning any returns.

This is an additional and avoidable burden on the consumers of Haryana who already bear all the expenses of the licensee. Payment of capital costs has no place in the current tariff regime of annual revenue requirement (ARR) calculations. Therefore the Commission and the Licensee are duty bound to minimize the impact of redemption of these bonds. Seeking additional justification for allowing funds for redemption of PF and pension bonds, the licensee was directed to quote rules, Regulations or orders of Appellate Tribunal where in such capital payments formed part of Annual Revenue Requirement. The licensee has not been able to quote any such precedents/judgments in its support in its reply dated 9.7.2010 and 2.10.2010 or during the public hearing.

Hence it is justifiable that any additional funds that accrue to the licensee are utilized to defray the cost of these bonds. This will, therefore, provide some relief to the consumers by reducing part of the liabilities for which bonds were issued. The contention of the licensee that it has utilized these funds for purchase of land is not tenable in view of the Commission observations in para 3 above.

33 The Appellant has sought our intervention on same grounds as it raised in the review petition before the Commission. The Commission has addressed all the grounds in its impugned order dated 31.11.2010. We do not find any reason to interfere with the reasoning and the decision of the Commission.

34 Next issue requiring our consideration is related to **Interest on Working Capital**.

35 The Commission in its Tariff order dated 16.4.2010 had allowed interest on working capital amounting to one month receivables i.e. an amount equal to one twelfth of ARR of the Appellant. The Appellant has requested for interest on working capital as two months' receivable as per the Commission's Tariff Regulations, 2008. While disallowing the claim of the Appellant for an amount equivalent to two months receivables, the Commission had cited better financial position of the Appellant. The findings of the Commission in its Tariff order dated 16.4.2010 are as under:

"Interest on working capital borrowings

In line with the orders of the Hon'ble Appellate Tribunal for Electricity, the Commission had been allowing working capital borrowings equivalent to 2 months ARR for the Transmission

business till FY 2008-09. As per directions of the Hon'ble Appellate Tribunal for Electricity in case no. 24 of 2006 Para 29, this was to be done till the financial position of the licensee improved. Further, in accordance with the payment terms, HVPNL charges penal interest on payments delayed beyond one month of billing. ***Therefore, keeping in view the improved financial position and payment terms and the fact that HVPNL is required to fund O&M expenses for one month from its internal sources; the Commission allows interest on working capital amounting to one month of ARR. The estimate is considered adequate in view of the fact that the ARR includes non cash expenses like depreciation also which are not required to be funded****. The Commission's order on the review petition filed by HVPNL against the ARR order for FY 2009-10, also further clarifies the position. Interest @ 12.25 % (being the prime lending rate of SBI as against 9% proposed by the licensee) on the allowed borrowings works out to Rs. 101.68 millions as against Rs. 156.10 million proposed by the licensee for the Transmission business. Similarly, the allowed interest on working capital for the SLDC business works out to Rs. 1.16 million as against Rs. 1.76 million proposed by the licensee."*

36 The Appellant filed a review petition before the Commission with a prayer for interest on working capital of two months' receivables may be allowed. The Commission rejected the review on the same ground of better financial position of the Appellant. The findings of the Commission in the impugned order dated 31.11.2010 read as under:

Interest on Working Capital Borrowings:

HVPNL has sought review against the Commission's order allowing them interest on working capital restricted to one month's ARR as against its petition for two month ARR. This issue has been dealt by the Commission in the past also and

the Commission believes that the underlying principle is in line with the Hon'ble Appellate Tribunal's order on the issue of working capital. In its order dated 19.2.2010 on the review petition filed by HVPNL on the Tariff order for FY 2009-10 the Commission had stated that: "The Commission perused the audited accounts of HVPNL and observes that the licensee has not shown revenue on account of additional recovery ordered by the Commission relating to the review orders separately. The licensee has, in its review application, also stated that it has accumulated losses of Rs.825 million as on 31.3.2008. However as against these losses, Commission has already ordered recoveries amounting to Rs 2430 million (Rs. 3630 million less Rs. 1200 million recovered in FY 2007-08). Therefore, the past losses appearing in the accounts of HVPNL stand wiped off. In the light of above the Commission is of the considered view that the financial position of the licensee has improved. Additionally, the licensee is recovering interest on transmission charges remaining unpaid after one month of billing. Thus in case working capital is allowed for more than one month the consumers shall be doubly burdened once by way of interest on additional one month of working charges and then again on interest paid on delayed payment by the distribution companies". Consequently, the Commission rejected the review sought on this issue. As the current review is also sought on similar grounds and no fresh facts and arguments are brought out by HVPNL, the Commission maintains its view and the review is not maintainable."

37 It is observed from the above findings of the Commission that the Commission has considered the financial position of the Appellant and that it would be getting penal interest on delayed payments. Accordingly, the Commission concluded that the interest on working capital equivalent to one month receivables would be adequate. While doing so, the Commission has ignored the provisions of its own Tariff Regulations 2008 which provide for an amount equal to two

months' receivables. Regulation 20 dealing with interest on working capital is reproduced below:

> *20.* ***Interest on Working Capital. –*** *(1) The rate of interest shall be equal to short-term Prime Lending Rate of State Bank of India as applicable on 1st April of the year in which the project or a unit thereof is declared under commercial operation. The interest on working capital shall be payable on normative basis notwithstanding that the transmission licensee has not taken working capital loan from any outside agency.*
>
> *(2) The norms for determination of working capital shall be as specified below.*
>
> *(a) Operation and Maintenance expenses for 1 month.*
>
> *(b) Maintenance spares @ 1% of the gross fixed assets of the transmission licensee as on 1.4.2008 or the date of commercial operation, whichever is later; and escalated @ 4% per annum or as allowed by the Commission.*
>
> *(c) Receivables equivalent to 2 months of transmission charges calculated on "target availability".*

38 We have already made it clear in para 5 & 6 above that the Commission is obliged to follow its own Tariff Regulations while determining the ARR and tariff for the licensees. Again, the Tariff Regulations, 2008 framed by the Commission do not give power to the Commission to relax any of the Regulations. Moreover, the Commission did not give any reason in the Tariff order dated 16.4.2010 and in the impugned order dated 31.11.2010 for deviation from these Regulations. In fact, the Commission did not refer to these Regulations while disallowing the working capital as per the Regulation 20 of Tariff Regulation 2008.

39 In the light of above, we direct the Commission to provide Interest on Working Capital as per the provisions of its Tariff Regulations 2008. The issue is accordingly answered in favour of the Appellant .

40 Next issue requiring is related to **<u>Return on Equity.</u>**

41 The Commission had allowed return on equity @ 10% to the appellant as against its claim of return on equity @ 15.5% as per CERC Regulations 2009 with the following observation in Tariff order dated 16.4.2010:

> *"The entire equity of HVPNL is contributed by the State Government; any ROE allowed has cascading effect on the distribution companies who are not being allowed any return. Also, while consumer's appetite for any increases in already low, retail tariff is very high. Besides burdening the retail consumers, the ROE allowed increases the tax liability of HVPNL while the Distribution companies who bear the burden of transmission / SLDC charges are in deep financial distress as they are unable to absorb or pass on any additional financial burden. Consequently, in view of the above facts as well as the massive financial impact of FSA during the current year, the Commission restricts the return on equity to 10% during FY 2010-11."*

42 The appellant in its review petition before the Commission prayed for the return on equity @ 15.5 % as per CERC Tariff Regulations 2009. The Commission has rejected the prayer of the appellant for allowing return on equity @ 15.5% along with the income tax thereon as against the return equity @ 10% allowed by the Commission holding that *"the return on equity to the transmission licensee has been restricted as the Commission was mindful to the fact that the return*

on equity would only add to the financial burden of the distribution licensee which are already carrying huge losses. The Commission had also brought out the fact that the Power Utilities in Haryana are State owned and the equity portion of the Capital Expenditure was funded by the State Govt. through its Annual Plan Expenditure."

43 The learned Counsel for the Appellant argued that HERC Regulations issued in Dec., 2008 called HERC (Terms & Conditions for Determination of Transmission Tariff) Regulation, 2008 provides that return on equity shall be computed @ 14% p.a. The above Regulations of the Commission were based on the CERC Regulations on Determination of Transmission tariff issued in the year 2004 which were applicable for the period 1.4.2004 to 31.3.2009. However, the Central Commission has issued revised Regulations on Terms & Conditions for Determinations of Transmission Tariff in the year 2009 which are applicable for the period 1.4.2009 to 31.3.2014, which provides return on equity @ 15.5% p.a. Accordingly, the appellant has claimed return on equity @ 15.5% p.a. in its ARR for the FY 2010-11, which is a legitimate claim of the appellant.

44 The Learned Counsel for the 2nd and 3rd Respondents supported the view taken by the Commission and made following contentions;

i) the Appellant had been claiming ROE @ 8% in the previous ARR filings. In terms of the Regulation 17 of the HERC (Terms and conditions for determination of transmission tariff) Regulations, 2008, the return on equity shall be computed on the equity base determined in accordance with Regulation 14

@ 14% per annum or as determined by the Commission from time to time. The ROE is payable to the Equity Share Holders to cover the following :-

a. Interest on the equity amount to be paid as dividend
b. Premium for risk in respect of capital involved

ii) The Appellant is not paying any dividend to the Govt. of Haryana from the return of equity earned by it. It is further submitted that in case of the Appellant, there is no risk involved for equity shares as all the expenses are passed through items and both the Discoms are bound to pay all the expenses under the orders of the HERC. Thus there is no risk to equity portion of transmission business**.** Considering the present interest rate and the previous claim of the Appellant @ 8% as well as the enabling provision, the ROE allowed by the State Commission is in order. As such, the entire equity of the company is contributed by the State Government and thus, allowing a higher return on equity will only add to the financial burden on the consumers of power.

45 The learned Counsel for the Commission reiterated the view of the Commission taken in the impugned order and further added that the Commission has determined Return on Equity at 10% as per Regulation 17 of Tariff Regulations 2008 which provides for Return on Equity @ 14% or as determined by the Commission from time to time. Regulation 17 of Tariff Regulations 2008 read as under:

> *"17. **Return on Equity**. – (1) Return on equity shall be computed on the equity base determined in accordance with Regulation 14 @ 14% per annum or as determined by the Commission from time to time.*
>
> *Provided that equity invested in foreign currency shall be allowed a return up to the prescribed limit in the same currency and the payment on this account shall be made in Indian Rupees based on the exchange rate prevailing on the due date of billing.*
>
> *(2) The premium raised by the transmission licensee while issuing share capital and investment of internal resources created out of free reserve of the transmission licensee, if any, for the funding of the project, shall also be reckoned as paid up capital for the purpose of computing return on equity, provided such premium amount and internal resources are actually utilised for meeting the capital expenditure of the project and forms part of the approved financial package."*

46 In this Case the Commission's decision to allow RoE @ 10% lacks transparency. In case the Commission had decided to allow RoE at less/higher rate than 14%, it should have declared before hand and sought comments on the same. In this case the Commission's decision to allow ROE @ 10% is contrary to the Regulations, and we must direct the Commission to allow Return on Equity @ 14% in accordance with Tariff regulations 2008. Once the Regulations have been framed the Commission has to act in accordance therewith.

47 The sixth issue before us is related to **Interest on Capital works.** The issue is related to capital works in progress (CWIP) which were likely to be commissioned during the current financial year i.e. 2010-11. The Appellant has alleged that the Commission did not allow interest on these works on the assumption that these works would

have deemed to be commissioned on the last day of the year i.e. on 31st March 2011. The Appellant has submitted that it is entitled to interest on CWIP for six months. In other words, the Appellant has made a claim for interest on average of opening balance and closing balance of the loan component of Gross Fixed Asset. This proposition can be better understood by the following example:

48 It is an admitted fact that the interest liability on the licensee would accrue from the day it has taken loan. Interest liabilities accrued during the construction phase of the project (IDC) is included in the capital cost of such project and once the project is declared under commercial operation, interest accrued thereon is considered in the ARR of the licensee. The capital cost of the Project including IDC is added to the GFA of the licensee.

49 In real practice some of the loans are returned in instalments and some fresh loans are taken against new projects during the financial year. Thus, while calculating interest payable during the year for the purpose of determining ARR of the licensee, both the deduction and additions in the loan liabilities have to be taken into account. Ideally, each element of the transmission system should be treated separately and interest liability is worked out accordingly. However, in most of the states, where transmission charges are determined for the whole network, the practice is to adopt the average of the loan at the beginning of the year and at the end of the year.

50 With this background let us examine the findings of the Commission in the impugned order dated 16.4.2010 related to interest costs which read as under:

2.6 Interest on Loans

2.6.1 Interest on borrowings for capital works

The Commission has restricted the additional investment on Capital works for FY 2010-11 to Rs. 17000 million based on the revised filings made by HVPNL. The licensee has also revised the Capital investment plan for FY 2009-10 from Rs. 19000 million (approved by the Commission) to Rs. 13874.41 millions against which the Commission estimates a probable expenditure of Rs. 11785.28 million. Keeping in view the capital expenditure approved by the Commission, the borrowings are estimated to Rs. 9697.18 million for FY 2009-10 and Rs11773.50 million for FY 2010-11 respectively and interest is calculated accordingly.

The interest on borrowings related to generation business of IP Station and BBMB (Rs. 20.91 million) and SLDC business (Rs. 20.78 million) are excluded from interest for transmission business. The Commission has already allowed funds for repayment of market committee loans in FY 2008-09 and therefore interest (Rs. 44.97 million) on these borrowings is also excluded. In case the licensee is able to get the interest accrued on this loan waived off as claimed by it in the public hearing, the same will be adjusted in the relevant ARR. The licensee is directed to keep the Commission informed of the latest status on this issue.

*The total interest cost for transmission business is further reduced by amount of interest capitalized i.e. Rs. 1732.51 million as against Rs.1455.74 million projected by HVPNL**. On the new capital works started during 2010-11, interest is capitalized for a period of six months only as the loans are assumed to be received evenly during the entire year.** The Commission allows Rs. 768.17 million as interest on borrowings for capital works for FY 2010-11 as worked out accordingly.*

…

2.6.3 Other interest costs: For calculation of interest on pension bonds, the Commission has taken into account the profit on sale of land as shown in the audited balance sheet for FY 2008-09 in accordance with our order on the ARR for FY 2009-10. Consequently, the interest on pension bonds is allowed as Rs. 612.40 million as against Rs. 673 million proposed by HVPNL. Interest on PF bonds is allowed as proposed by HVPNL. The computations of interest expenses are presented in table 2.3 & 2.4 below.

Particulars	***HVPNL Proposal***	***HERC Approval***
Interest on Loans for Capital Expenditure		
Total interest on Borrowings for CAPEX	*3147.33*	*3147.33*
Less interest on loan from market committee		*44.97*
Less interest on borrowings related to generation		*20.91*
Less interest on borrowings for disallowed capital works for FY 2009-10		*234.41*
Less interest on borrowings for disallowed capital works for FY 2010-11		*346.36*
Gross Interest for Transmission works	***3147.33***	***2500.68***
Less interest capitalized		*1732.51*
Interest cost net of capitalization(1)		***768.17***
Interest on loan for working capital (2)	***156.10***	***101.68***
Interest on Pension bonds (3)	*673.00*	*612.40*
PF Bonds (4)	*168.40*	*168.40*

51 Perusal of the above would disclose that the Commission has approved the interest as claimed by the Appellant after disallowing certain interests. With regard to FY 2009-10 and FY 2010-11, the Commission has deducted interest on borrowings for disallowed capital works. Since works itself had not been allowed, interest on such works cannot be permitted.

52 Thus the Commission has allowed the interest for six months of CWIP and had approved the interest as demanded by the Appellant after carrying out some deductions. The Appellant has not challenged

these deductions. Therefore, we do not find any basis for the claim made by the Appellant. The issue is accordingly decided against the Appellant.

53 Next issue before us is related to **Income from Short term Open Access Customers.** The issue is related to treatment of revenue earned from short term open access customers during FY 2008-09. The Commission in its Tariff order dated 23.04.2008 approving ARR and transmission tariff for FY 2008-09 determined an amount of Rs 101.13 Million as revenue earned from short term open access customers allowed the appellant to retain 25% of the said amount to meet any extra cost including monitoring and control cost that the appellant may incur. However, the Commission in its impugned order dated 16.4.2010 did not allow the Appellant to retain any portion of the revenue earned from the short term open access customers during FY 2008-09 and deducted such revenue from the ARR payable by long term open access customers.

54 The Appellant has alleged that this is contrary to the Commission's own order dated 23.04.2008 and had prayed that the Appellant may be allowed to retain 25% of the revenue it had earned during FY 2008-09 from short term open access customers as per the Commission' order dated 24.4.2008.

55 The learned counsel for the 2nd & 3rd Respondents submitted that the revenue earned by them from the short term open access customers is being treated as income from other businesses and is being deducted from their ARR. Likewise, the revenue earned by the

Appellant from its short term open access customers should also be treated at income from other business and the Commission has rightly deducted it from Annual Revenue Requirements of the Appellant for the year 2010-11.

56 As brought out in para 5 above, the Commission had framed Haryana Electricity Regulatory Commission (Terms and Conditions for Determination of Transmission Tariff) Regulations, 2008 and these Regulations had become effective from 19th December 2008. Regulation 28 of these Regulations provides for recovery of transmission charges from beneficiaries of the Appellant's transmission system and is quoted below:

> *"27.* ***Payment of Transmission Charges. -*** *(1) Annual transmission charges shall be fully recoverable at 98% target availability. Payment of transmission charges below 98% shall be on pro-rata basis. The transmission licensee may recover its annual revenue requirement by way of a fixed charge based on transformation capacity, contracted capacity, a charge based on energy transmitted, connectivity charge, reactive energy charge or a combination of these charges. The transmission charges shall be calculated on a monthly basis. In case of more than one beneficiaries of the transmission system, including the distribution licensees and long term open access customers, the monthly transmission charges leviable on each beneficiary shall be computed as per the following formula unless amended by the Commission.*
>
> $$\text{Transmission Charges} = \frac{\mathbf{ATC}}{\mathbf{12}} \times \frac{\mathbf{CA}}{\mathbf{CS}}$$
>
> *Where, ATC = Annual Transmission Charges payable by the beneficiaries,* ***after deducting total transmission charges paid by the short term open access customers;*** *other*

income, as decided by the Commission, to be passed on to the beneficiaries; reactive energy charges and transmission charges received from the CTUs .

...”

57 Bare reading of the Regulation 27 reproduced above would disclose that the revenue earned from short term open access customers is required to be deducted from the total Annual Revenue Requirement of the Appellant. The Commission has, therefore, correctly deducted the revenue earned by the Appellant from short term open access customers during FY 2008-09. The issue is answered against the Appellant.

58 Next Issue for our consideration is regarding **<u>Depreciation on</u> <u>BBMB and IP Station assets</u>**.

59 The Appellant is a transmission licensee under the 2003 Act. it has claimed depreciation against BBMB and IP Stations assets which are generation assets. The natural question arises as to how a transmission licensee is claiming some interest in generation assets. In order to fully appreciate the issue it would be desirable to get into the background of the power sector reforms in the State of Haryana which is narrated below:

(i) The erstwhile Haryana State Electricity Board (HSEB) was unbundled on 14-8-1998 vide Haryana Government Notification dated 14.8.1998 into two entities namely, Haryana Vidyut Prasaran Nigam Limited (the Appellant) for carrying on Transmission & Bulk Supply business as well as for Distribution

& Retail Supply Business and Haryana Power Generation Corporation Limited (HPGCL) for carrying on the Generation Business in the State of Haryana.

(ii) In the notification dated 14.8.1998 of Haryana Government, the assets of BBMB & IP Station were retained in the books of the Appellant thus giving the Appellant ownership interest in BBMB & IP Station projects. Thus, the Appellant has an ownership interest in inter-state projects viz. BBMB & IP Station inherited from erstwhile HSEB.

(iii) In the year 1997, the Government of Haryana enacted Haryana Electricity Reforms Act, 1997 and Haryana Electricity Regulatory Commission was established under Section 3 of Haryana Electricity Reforms Act on 17th August 1998.

(iv) The Commission vide its order dated 4th February, 1999 issued two licences to Appellant for operation in State of Haryana; a licence for Transmission & Bulk Supply Business and a licence for Distribution & Retail Supply business .

(v) The Commission vide its order dated 4.11.2004 withdrew the licence granted to the Appellant for Distribution and Retail Supply Business and issued separate licences for Distribution and Retail Supply Business to Dakshin Haryana Bijli Vitran Nigam Limited (DHBVNL) and Uttar Haryana Bijli Vitran Nigam Limited (UHBVNL) for operation in their respective area of supply in the State of Haryana.

vi) Since the Electricity Act, 2003 prohibits the State Transmission Utility to engage in business of trading in electricity the Haryana Government vide its notification no. 1/6/2005-1 dated 9th June, 2005 transferred the rights relating to procurement and Bulk Supply of electricity or trading of electricity from the Appellant to Haryana Power Generation Corporation Limited (HPGCL) with effect from 10th June, 2005. The assets & liabilities relating to Trading of electricity which stood in the books of the Appellant as on 31st march, 2005 was transferred and vested with the Transferee Company and also the result of trading operations performed by the Appellant for the period from 1st April, 2005 to 9th June, 2005 was also transferred and vested to Transferee company. The assets of BBMB & IP Station were kept in the books of the Appellant. Thus ownership interest in BBMB & IP station projects remained with the Appellant and only the capacities in the inter-state projects (viz. IP Station of IPGCL, Delhi and BBMB) to the extent of shares owned by the Appellant was allocated to the Transferee Company HPGCL w.e.f. 10th June, 2005.

(vii) The Commission passed Tariff orders for FY 2004-05 and FY 2005-06 on 3.7.2005 and 10.5.2005 respectively approving ARR and Bulk Supply tariff for the Appellant for its Transmission and Bulk Supply Business. In this order the Commission rejected the claim of the Appellant related to depreciation on BBMB and IP assets.

(ix) The Appellant filed an appeal before this Tribunal against

these orders of the Commission dated March 7, 2005 and order dated 10th May, 2005. The Appellant had raised the issue of denying the appellant the depreciation in BBMB and IP Station assets as one of the issues in the appeal.

(x) This Tribunal vide its order dated 7th July, 2006 allowed the depreciation on BBMB & IP Station assets to the appellant.

(xi) The Haryana Government thereafter transferred the rights relating to procurement and Bulk Supply of electricity or trading of electricity from the Appellant and the HPGCL to DHBVNL and UHBVNL with effect from 1st April, 2008.

60 Perusal of the above background would disclose the following aspects

a. The Appellant was granted two licences by the Commission on 4.2.1999, one for Transmission and Bulk Supply and the other for Distribution and Retail Supply under Haryana Reforms Act 1999.

b. On 4.11.2004 the Licence for Distribution and Retail supply was withdrawn from the Appellant and was given to two distribution licensee. Thus the Appellant remained Transmission and Bulk Supply Licensee in the state of Haryana.

c. The Commission passed Tariff order for FY 2004-05 on 7.3.2005 approving ARR and Bulk Supply tariff for the Appellant for its Transmission and Bulk Supply business. The Commission passed Tariff order for FY 2005-06 on10.5.2005

approving ARR and Bulk Supply tariff for the Appellant for its Transmission and Bulk Supply business.

d. The Appellant challenged both these orders before this Tribunal and this Tribunal allowed depreciation on BBMB and IP Assets through its judgment dated 7.7.2006.

e. The Bulk Supply business was also transferred from the Appellant to the Distribution licensees on 1.4.2008. Thus the Appellant became only a Transmission Licensee with effect from 1.4.2008.

61 Now let us examine the findings of this Tribunal in Appeal no. 27 of 2005 allowing depreciation on BBMB and IP Assets to the Appellant in its judgment dated 7.7.2006 which is quoted below:

> "13: **Whether the appellant is entitled to depreciation in BBMB/IP station assets?**
>
> 13.1 *The appellant contended that the respondent Commission disallowed the diminution in value of investments in BBMB and IP Station amounting to Rs. 107.04 millions on the ground that the asset on which the diminution in the value of investments are claimed by appellant are not part of its licensed business and* ***hence this cost cannot form part of the ARR and the Transmission and Bulk Supply Business.*** *The appellant pleaded that it has ownership interest in BBMB and IP Stations, therefore, the generation assets of these projects need to be depreciated like any other generation projects. Learned Counsel for the appellant further pleaded that as per the Electricity Act, 2003, the business relating to generation of power is any way not a licensed activity and therefore the appellant does not need any separate generation license for these projects. The Commission is allowing all the expenses except depreciation incurred for generation of power relating to*

these projects therefore there is no rationale for disallowing depreciation of these projects. Appellant contended that depreciation is an integral part for generation cost of any power station. The Commission is allowing such cost to Haryana Power Generation Ltd. and in case BBMB/IP Stations were owned by HPVNL it would any way have allowed depreciation. The appellant contended that how the depreciation could be disallowed merely by change of ownership from one person to the other. Appellant pleaded that it has inherited these projects from erstwhile Haryana State Electricity Board and these have not been acquired at a later stage.

13.2 Per contra on behalf of respondent Commission it is contended that the appellant claimed diminution in the value of BBMB generation assets which is neither reflected in the cost, nor incurred by the appellant nor claimed by BBMB and is also not actually paid by the participating states. Thus there is no documentation/supporting data before the Commission to consider. The Commission further held that as far as having a replenishment fund at the time of redeeming of BBMB projects by way of depreciation reserve is concerned, is not tenable. In future the participating states may not even have the need for replacing BBMB stations thus there is no commitment even today, the capital cost from year to year is borne by Government of Haryana and not from revenue of the appellant. ***The appellant is only paying operational and maintenance expenses, which the Commission allows them to recover by way of per unit net rate for the BBMB power supply.***

13.3 The Commission took the stand that while regulating public utility funds for capital projects are separately provided either by the Government by way of grant or equity contribution or by the Commission by allowing the required amount of borrowing and interest expenses on the same, depreciation amount is utilized for loan repayment/refurbishment, thereby reducing the burden of interest on the consumers. Thus, the depreciation for capital replacement does not exist in the cost plus regulatory regime.

13.4 Finally the BBMB projects were built with public fund and

the Parliament, in its wisdom while enacting, The Punjab Reorganisation Act, 1966 had provided that in return for the power supply to the participating states they will be required to pay only the full cost of maintenance incurred by the BBMB. It is therefore, not the intention of the Parliament to charge any profit, return etc. over and above the maintenance and capital cost, on the power supply from BBMB. To allow any other charge as sought by the appellant would also be at variance of the provisions of The Punjab Reorganisation Act, 1966.

13.5 The appellant contended that it is incorrect for the Commission to hold that cost of BBMB and IP Stations assets have not been incurred by the appellant. This cost has been incurred by the appellant and as such these are appearing in its Balance Sheet. Appellant is also providing depreciation/ diminution on these assets on year to year basis in its accounts. The cost of generation of power of any station includes the depreciation components and therefore there is no rationale for non inclusion of the same in the cost of generation. Appellant pointed out that no generating station pays for depreciation to anyone else but the same is used for replenishment or refurbishment of the assets as and when the need arises. Appellant argued that had the project been built with the public funds, then the cost of these assets would not have appeared in its Balance Sheets. Appellant also stated that the Regulatory Commission of Punjab and Rajasthan have allowed the depreciation on BBMB projects as part of the cost of generation of power of BBMB in the ARR and Tariff of PSEB and RRVPN.

13.6 After hearing both sides we are persuaded to hold that in view of the fact that generation does not require any license, value of BBMB/IP stations assets appear in the Balance Sheet of HVPNL and ***that replacement will be required after useful life of assets,*** *the depreciation on BBMB/IP station assets deserves to be allowed as claimed by the appellant. Hence this point is answered in favour of the appellant.****{emphasis added}***

62 The above judgment was delivered against the Commission's orders dated 7.3.2005 and 10.5.2005 approving ARR and Bulk Supply tariff

for the Transmission and Bulk Supply Business of the Appellant. At that time the Appellant was responsible for procurement of power from all sources including from BBMB and IP Station and supply in bulk to two distribution licensees for distribution and retail supply in their respective areas. The impugned orders in the present case are related only to transmission business of the Appellant. Therefore, the facts of the present case are different from the one the Appellant has heavily relied on and ratio of that case would not be applicable to this case.

63 Further, while dealing with the issue of depreciation on Grants this Tribunal in Appeal no 134 of 2008 of has held that in practice, depreciation is utilized to meet loan repayment liability of the utility arisen out of creation of an asset. When such an asset is required to be replaced after expiry of its useful life, fresh financial arrangements are made. The relevant portion of this judgment of this Tribunal in Appeal No. 134 of 2009 is quoted below:

> *"27. On a perusal of the above definitions, it is clear that there is an almost unanimity of opinion on the nature of depreciation, the differences are more semantic than conceptual. In short the term Depreciation can be viewed as signifying the process by which the difference between the cost of a depreciable asset (or some other appropriate measure of its value) and its estimated residual value is written-off in a systematic and rational manner over the useful life of the asset by means of periodic charge against revenue.*
>
> *28 Depreciation is defined as the measure of wearing out, consumption or other reduction in the useful economic life of an asset, whether arising from use, passage of time or obsolescence through technological or market changes. Depreciation accounting is the recovery of the original cost of*

assets and not the economic, market or any other non-original cost measures of value. The original cost of assets can be taken as its historic cost, which represents the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition.

29 Generally the cost of asset is allocated, as depreciation expense, during the useful life of the asset. Depreciation is however a non-cash expense as the expense is not actually incurred. Such expense is recognized by businesses for financial reporting and tax purposes. Rate of depreciation varies for different assets classes depending of useful life of the assets and method of depreciation utilized. Methods may be specified in accounting and/or tax rules in a country. Several standard methods of computing depreciation expense may be used, including fixed percentage, straight line, and declining balance methods. Depreciation expense generally begins when the asset is placed in service.

30 However, under the regulatory framework, only regulated returns are allowed to the utility. Appropriate Commission is expected to determine the Annual Revenue Requirement (ARR) and tariffs for the regulated utility in such a manner so as to allow it to recover all its legitimate & genuine costs that are assignable to the business. This would ensure that the utility has sufficient funds at any point of time to meet its liabilities. Thus interest for meeting the interest payment liability of the utility on the loan raised is allowed.

31 Similarly Return on Equity (RoE) for providing Equity for creating an asset is also allowed. However, no allowance is made for repayment of principle amount of loan. Depreciation is thus linked to principle repayment liability of the utility. Since the life span of asset created (in power sector generally 25 years or more) is higher than term of loan raised to create the asset (around 10 years), the depreciation allowed on straight line method would be less than principle loan repayment liability of the utility. So as to allow the utility to have sufficient funds to repay its interest and principle repayment liability, the concept of Advance Against Depreciation (AAD) had been introduced by various Electricity Regulatory Commissions in the country.

Under this concept in addition to allowable depreciation, the distribution licensee is allowed to claim an advance against depreciation (AAD).

32 In this regard it would be pertinent to mention that Central Commission and some of the State Commissions have notified new Tariff Regulations. Under these Regulations, in line with Tariff Policy, the provision of advance against depreciation has been done away with and rates for depreciation have been reworked in such a manner so as to take care of repayment of debt obligations. In other words higher rate of depreciation have been provided for first 10 years to take care the loan repayment liability. After initial period of 10 years, remaining depreciation would be spread over the balance useful life to keep the tariff reasonable.

33 Thus in practice, depreciation is utilized to meet loan repayment liability of the utility arisen out of creation of an asset. When such an asset is required to be replaced after expiry of its useful life, fresh financial arrangements are made. POWERGRID, the Appellant, in its pleadings before the Central Commission has also accepted that it is utilizing depreciation amount to meet loan repayment liability."

64 In the present case before us the Appellant has claimed depreciation on higher rate specified by the Central Commission to meet its loan liabilities. The Appellant also submitted that in the alternative it should be allowed Advance Against Depreciation. At one side the Appellant demanded higher depreciation to meet its loan liabilities; on the other side it has claimed depreciation on BBMB and IP assets for replacement after serving useful life. It would be pertinent to mention that if the depreciation is used for asset replacement than the Appellant must surrender the amount it has received as depreciation against IP station as this asset has been shut down permanently. We are not passing any direction to recover the said amount as we are

aware that in Indian Power Sector the depreciation is normally utilised for meeting the loan liabilities and not for replacement of asset.

65 The learned counsel for the Appellant contended that the Appellant has an ownership interest in BBMB & IP Station Generation projects and Generation does not require any licence. The supply of its own power generated to the distribution licensees by charging the cost comprising of O&M charges besides interest and depreciation in value of investments as already decided by this Tribunal does not amount to Trading in Electricity as the trading of electricity means purchase of electricity for resale.

66 This contention of the Appellant is misplaced. It is agreed that generation is unlicensed activity under the 2003 Act and it is also agreed that selling power by generator to a distribution licensee is not trading. The Appellant is forgetting that it is a transmission licensee under the Act and his business in regulated by the Commission through the Transmission Licence granted by the Commission. The impugned orders dated 16.4.2010 and 31.11.2010 are also related to its transmission business only. Any expenditure against the unlicensed ‘generation business’ cannot form part of ARR for licensed transmission business. The Appellant is at liberty to file a separate ARR for its ‘generation business’ and for determination of tariff thereof before the Commission.

67 In the light of above discussions the issue is decided against the Appellant

68 The last issue for our consideration is related to **Incentive for better Performance.**

69 The learned Counsel for the Appellant submitted that the Tariff Regulations, 2008 provide Availability based Incentive for the Transmission Licensee. According to Regulation 27 of these Regulations the annual transmission charges shall be fully recoverable at 98% target availability. Payment of transmission charges below 98% shall be on pro-rata basis. Regulation 28 provides that the transmission licensee shall be entitled to incentive on achieving annual availability beyond the target of 98% provided no incentive shall be payable above the availability of 99.75%. Regulation 28 also gives formula for calculating incentive. Thus the Tariff Regulations provide both the incentive for better performance and disincentive for non-performance. However, the Commission has rejected its claim for incentive in both the impugned orders.

70 Admittedly the transmission system comprises of large number of elements viz., transmission lines at various voltages having different loading capacities, Transformers of different capacity, line reactors and shunt capacitors etc. A detailed procedure specifying weightage of each element of transmission system is essentially required to evaluate overall transmission availability and to implement the availability linked incentive scheme. The claims of the Appellant in regard to availability of each element of its system would require to be verified and certified by an independent agency to be nominated by the Commission. The Commission has taken note of this pre-

requirement and has made the following observations in the impugned order dated 31.11.2010;

> *"The Commission has considered the review sought and is of the view that, so far, the Commission has not specified any formula or methodology to assess transmission system availability. The CERC benchmark/formula for inter-state transmission system may not be appropriate for intra-state transmission system of comparatively lower ratings and connected to the distribution system which is vulnerable to interruption/ outages. The Commission is in an advance stage of finalizing the relevant regulations and it is not inclined to accept the plea of the petitioner. Hence the Commission rejects the review sought on the issue of availability based incentive.*
>
> *As the financial impact of the review order of the Commission is of a small magnitude, the Commission shall take the same into account while calculating the ARR for the transmission business for FY 2011-12."*

71 In the light of above discussions and the Commission's specific observations that it is in advance stage of finalising the relevant Regulations and the 'Availability linked Incentive Scheme' would be implemented during FY 2011-12, we do not intend to interfere with the decision of the Commission at this stage.

72 The issue is decided accordingly.

73 Summary of our findings:

74 Our findings on various issues raised in this Appeal is summarized in the Table given below:

Issue	Our findings
Rate of Depreciation	To allow depreciation and AAD as per Commission’s Tariff Regulations 2008.
Debt redemption obligation and other interest cost	Against the Appellant
Financial Impact of the judgment of this Tribunal in Appeal No. 27 of 2007	Against the Appellant
Interest on working capital	In favour of the Appellant
Rate of Return on Equity	In favour of the Appellant
Interest on Capital Works	Against the Appellant
Income from Short term Open Access Customers	Against the Appellant
Depreciation on BBMB and IP Station assets	Against the Appellant
Incentives	Commission is in the process of finalising the relevant Regulations and availability based Incentive scheme to be implemented from next financial year.

75 The Appeal is accordingly partly allowed to the extent mentioned above. However, there is no order as to costs.

(V J Talwar)
Technical Member

(Justice P S Datta)
Judicial Member

Dated: 18th April, 2012

REPORTABLE/NOT REPORTABLE