

**Before the Appellate Tribunal for Electricity  
(Appellate Jurisdiction)**

**Appeal No. 186 of 2009 & IA No. 328 of 2009**

**Dated 11<sup>th</sup> July, 2011**

**Present: Hon'ble Mr. Rakesh Nath, Technical Member  
Hon'ble Mr. Justice P.S. Datta, Judicial Member**

**In the matter of:**

Himachal Pradesh State Electricity Board,  
Vidyut Bhawan, Shimla-171004

...Appellant

Versus

1. Himachal Pradesh Electricity Regulatory Commission,  
Keonthal Commercial Complex, Khalini,  
Shimla-171 002
2. Sh. Gautam Nath Thakur,  
President, Manali Hotelier Association,  
The Mall, Manali-175131,  
Distt. Kullu Himachal Pradesh
3. Sh. Jagannathh Sharma, President,  
The Kullu Hotels & Guest Houses Association,  
Hotel Naman, Akhara Bazar,  
Kullu, HP-175 101
4. Sh. Rakesh Kumar Sharma,  
GACL Colony, Unit Himachal,  
PO Darlaghat, Tehsil Arki,  
Distt. Solan, HP-171 102.
5. Sh. Satish Mehta,  
M/s. Auro Spinning Mills,  
P.B. No. 7, Sai Road, Baddi,  
Nalagarh Distt. Solan, HP-174 103

6. Sh. Ashok Singla,  
Director, H.M. Steel Ltd.,  
Kala Amb, Distt. Sirmour, HP-174 104.
  7. M/s. Sri Rama Steel Ltd.,  
Barptowala, Distt. Solan, HP-174 103
  8. M/s. J.B. Steel Rolling Mills,  
Distt. Sirmour, HP-173 001.
  9. Sh. S.K. Kala,  
Manager, Electrical & Instrumentation,  
ACC Gaggal Cement Works,  
PO Barmana, Distt. Bilaspur, HP-174 103.
  10. Sh. Rakesh Bansal,  
(for CII, PIA, BBNIA, KACCI),  
Opposite Office of Industries Department,  
Sector-1, Parwanoo, Distt. Solan, HP-173 220.
  11. Sh. D.C. Katoch,  
President, Hotel Association Chamunda Devi,  
C/o Hotel Sadar, Kangra Valley,  
Distt. Kangra, HP-176 202
  12. Sh. P.N. Bhardwaj,  
Consumer Representative,  
PO Dharampur,  
Distt. Solan, HP-173 209
- ... Respondents

Counsel for Appellant(s) :

Mr. Anand K. Ganesan  
Ms. Swapna Seshadri  
Ms. Sneha Venkataramani

Counsel for the Respondent(s):

Mr. Sanjay Sen, Mr. Sunil Sharma  
Mr. Achintya Dwivedi  
Ms. Surbhi Sharma  
Ms. Shikha Ohri

## **JUDGMENT**

### **HON'BLE MR. RAKESH NATH, TEHNICAL MEMBER**

This appeal has been filed by Himachal Pradesh State Electricity Board against the order dated 24.8.2009 passed by Himachal Pradesh Electricity Regulatory Commission regarding the Annual Performance Review for MYT period from FY 2008-09 to FY 2010-11 and determination of Tariff for FY 2009-10 of the appellant.

2. The appellant is a deemed licensee for electricity transmission, distribution and trading in the State of Himachal Pradesh. It also undertakes generation of electricity. The State Government on 15.6.2009 has issued a notification for reorganization of the Electricity Board under the 2003 Act. The State

Commission is the first respondent. The respondents 2 to 12 are the consumers/consumer associations.

3. The brief facts of the case are as under:

3.1. On 28.11.2008, the appellant filed an application being Petition no. 250 of 2008 before the State Commission for true up of financials of the FY 08 and Annual Revenue Requirement and Tariff for period FY 10 to FY 11. The State Commission after following the due process under the law, passed the order dated 24.8.2009 and determined ARR and tariff in respect of Appellant's activities, viz., transmission, distribution and retail supply of electricity.

3.2. Earlier to the above order dated 24.8.2009, the State Commission had passed an order for truing up the financials of the appellant for FY 2007-08 in true

up petition filed by the appellant alongwith the petition for ARR and tariff for FY 2009-10 and FY 2010-11.

3.3. Aggrieved by the various aspects of the order dated 24.8.2009 passed by the State Commission, the appellant has filed this appeal.

4. The appellant has raised the following issues:

- i) Power Purchase cost estimates and sales revenue estimates: The State Commission substantially reduced the estimate of power purchase cost as projected by the appellant.
- ii) Transmission and distribution losses: The State Commission has wrongly revisited the loss level trajectory in the middle of the Control Period, contrary to the provisions of the Tariff Regulations.

- iii) Return on Equity: The State Commission has disallowed any fresh equity to be infused by the appellant for Capital Projects and has only considered the Capital Projects to be fully debt based. This is contrary to the provisions of the Regulations.
- iv) Repair & Maintenance Cost: The Repair & Maintenance cost as approved by the State Commission is contrary to the provisions of the Tariff Regulations.
- v) Employees Cost: The State Commission has wrongly used escalation factor as weighted average of the Consumer Price Index (CPI) and Wholesale Price Index (WPI) for determining the employees cost. This resulted in under compensation of the actual employees cost which has increased at a

higher rate. The State Commission has also wrongly computed the employees cost.

- vi) Interest and Finance charges: The State Commission has not approved any equity infusion in the Capital Projects which is contrary to the Regulations. Further the State Commission has allowed interest rate without regard to the actual interest rate on the loans taken by the appellant.

The appellant had also raised the issue of working capital requirements which has not been pressed in view of the Judgment of the Tribunal in Appeal no. 12 of 2009. Thus this issue does not survive.

5. On the above issues Shri Anand K. Ganesan, learned counsel for the appellant has argued extensively. In reply, Ms. Shikha Ohri, learned

counsel for the State Commission has made forceful submissions in support of the findings of the State Commission.

6. After careful considering the contentions of the parties, the following questions would arise for consideration:

- i) Has the State Commission erred in reducing the power purchase cost claimed by the appellant without considering the actual data for the past and without any rationale?
- ii) Was the State Commission correct in revisiting the loss level trajectory in the middle of the control period contrary to its own Regulations?
- iii) Was the State Commission correct in not allowing any fresh equity by the appellant for

the Capital Projects in contravention to its Regulations?

- iv) Are the repair & maintenance charges determined by the State Commission contrary to the MYT Regulations?
- v) Has the State Commission determined the employees cost incorrectly based on erroneous computation of the escalation factor?
- vi) Has the State Commission incorrectly allowed the interest on term loan and working capital at lower rates?

7. The first issue is regarding power purchase cost allowed by the State Commission.

7.1. According to Shri Anand K. Ganesan, learned counsel for the appellant, the State Commission has

not considered the actual power purchase cost incurred in the past two years and the projections for the future as submitted by the appellant. The State Commission has subsequently tried up the power purchase cost and allowed the same on actual basis. However, the principle on which the appeal has been filed is that the State Commission ought not to have interfered with the projections of the appellant and substitute its own view in the absence of any finding of perversity in the projections of the appellant. He cited the decision in *Bangalore Electricity Supply Company Ltd. vs. Karnataka Electricity Regulatory Commission & another* reported in (2008) ELR 164 in support of his arguments.

7.2. According to Ms. Shikha Ohri, learned counsel for the State Commission, the State Commission while passing the impugned order duly considered the last

audited accounts and estimates projected by the appellant before approving the power purchase cost. The power purchase cost has since been trueed up by the State Commission by its order dated 10.6.2010.

7.3. We have noticed that the State Commission has not revised its plant-wise projection of energy availability and power purchase cost as approved in the MYT order dated 30.5.2008. Only the power purchase cost has been changed due to change in quantum of energy requirement approved by the State Commission based on the revised T&D loss reduction trajectory. Even the availability of energy from the new projects due to expected delay in commissioning of the projects was not changed as the State Commission felt that it could be taken care of during the true-up for power purchase. Regarding the cost of power purchase, while for the fixed charges the State

Commission has considered the fixed charges based on the relevant tariff orders of the Central Commission as applicable for FY 08 and FY 09, the variable charges are based on the power purchase data for FY 07, as submitted by the Board with escalation for the subsequent years. Thus the State Commission has not considered the actual per unit rate for FY 2007-08 while re-computing the power purchase rate for the multi year tariff period. The State Commission has also assessed revenue of Rs. 267 crores from sale of power outside the State while the sales were based on availability of 626 MUs of power from the new generating stations of Koldam and Barh-I & II in the year 2009-10 even though these power projects were rescheduled for commercial operation only in the year 2010-11.

7.4. Thus we feel that the State Commission has erred in not taking into account the actual cost of power purchase during the FY 2007-08 and revised schedule of commissioning of the new generating units while making assessment for power purchase cost. Thus the objective of updating the power purchase cost from that determined in the MYT order in the Annual Performance Review was defeated. The State Commission has since trued up the power purchase cost and, therefore, the substantive issue does not survive. However, as a matter of principle we are of the opinion that the State Commission should have taken into account the latest power purchase cost and the revised schedule of commissioning of the new generating units while determining the power purchase cost and sale of surplus power outside the state.

8. The second issue is regarding Transmission and Distribution losses.

8.1. According to the learned counsel for the appellant, once the T&D loss trajectory has been set up in the MYT order, the same could not be altered in the middle of the control period.

8.2. According to Ms. Shikha Ohri, learned counsel for the State Commission, the State Commission had to review the trajectory of the uncontrollable and controllable components in the Impugned Tariff Order on account of incorrect Transmission and Distribution Loss data provided by the appellant.

8.3. Let us first examine the Tariff Regulations. The relevant extracts are reproduced below:

*“ 8. Targets for Controllable Parameters*

*(1) The Commission shall set targets for each year of the control period for the items or parameters*

*that are deemed to be “controllable” and which will include:-*

*(a) Distribution losses, which shall be measured as the difference between total energy input for sale to all its consumers and sum of the total energy billed in its licence area in the same year;*

*(b) .....*

*(e) ...../*

*(2) The Commission shall normally not revisit the performance targets, once determined even if the targets are fixed on the basis of un-audited accounts.*

*(3) The target distribution loss levels for the State to be achieved by the distribution licensee at the end of the first control period shall be 14.5%.*

*Provided that the year-wise loss reduction trajectory for the control period shall be fixed for the distribution licensee in the multi year tariff order:*

*Provided further that profits arising from achieving loss level better than specified in the loss reduction*

*trajectory shall be shared in the ratio of 2/3<sup>rd</sup> with the licensee and 1/3<sup>rd</sup> in the contingency reserve for the first control period.*

*(4) Any financial loss on account of under performance with respect to distribution loss targets shall be to the licensee's account”.*

Thus, according to the Regulations, the performance target once fixed shall normally not be revisited. The loss level trajectory specified to be achieved at the end of the control period, namely FY 2010-11, was 14.5%.

8.4. We will now examine the findings of the State Commission in the Impugned order. The relevant paragraphs are reproduced below:

*“ 4.11: As per the MYT Regulations issued by the Commission, the base year of the Control Period is the financial year immediately preceding the first year of the Control Period i.e. FY-08. The*

*Commission had further clarified in the MYT Order that all the expenses projection and trajectory for the Control Period may be trued up by the Commission as and when the audited accounts for FY08 are made available.*

*4.12. Commission in its True up Order for FY07 had presumed that the T&D loss number for FY07 of 14.19% as per True up petition and overall T&D loss of 13.77% as per audited accounts, were on account of accounting error in sales figure which was distorting the T&D loss figure and had accordingly accepted revised figure of sales and T&D loss (17%) given by the Board and also directed the Board to inquire into the lapse, if any and submit the report to the Commission. The Board however did not submit any report in this matter. The Commission in its MYT Tariff Order had approved T&D loss figure of 16.5% for FY08 based on the revised T&D loss for FY07 at 17% and had accordingly used this as a base, figure for MYT projections.*

4.13. Now the Commission observes that the T&D loss for FY08 is 13.41% as per the True up petition filed by the Board and overall T&D losses are 13.52% as per audited accounts, evidently confirming that there is a secular trend in T&D loss figure since FY07.

4.14. On the basis of the analysis of the audited accounts for FY08 submitted by the Board for truing up, it is observed that the actual T&D loss figure for the Board, as per the true up order dated 11.8.2009, stood at 13.49%.

4.15. For the Control Period (FY09-FY11) in MYT order dated May 30,2008, the Commission had considered the T&D loss reduction trajectory of 0.75%, 0.75% and 0.5% in FY09, FY10 and FY11 respectively to reach a level of 14.5% by the end of the Control Period from base level of 16.5% at the start of the MYT period (FY08).

4.16. Since the Board has stood by the audited figures for T&D losses, the Commission is left with

*no option but to revise the T&D loss trajectory for the Control Period. In fact, all the objectors had also pointed out that in view of the Board having achieved a T&D loss level of 13.52% in the FY08, the much higher level of T&D loss assumed by the Commission for MYT period should be reviewed on the basis of actual figures of FY08.*

*4.17. The Commission is therefore revising the T&D loss trajectory for the Control Period based on the actual T&D loss levels in the base year FY08. Consequent to the revision of the T&D loss trajectory for the Control Period, the Commission has revised the energy balance, quantum of power purchase and the corresponding cost of power purchase for the Control Period”.*

*“4.20. As per the true up order dated 11.8.2009 for FY08, the Board has already achieved T&D loss level of 13.49% in FY08. For the Control Period, the Commission has now considered a revised T&D loss reduction trajectory of 0.35%, 0.35% and 0.30% in FY09, FY10 and FY11 respectively to*

*reach a level of 12.49% by the end of the Control period.*

*4.21. The revised T&D loss trajectory for the Control Period (FY09-FY11) shall be as shown in the table below:*

**Table 36: Approved T&D losses for the Control Period**

Losses (%)	FY09	FY10	FY 11
	Approved	Approved	Approved
Opening T&D Loss (%)	13.49%	13.14%	12.79%
T&D Loss Reduction (%)	0.35%	0.35%	0.30%
T&D Losses for the year (%)	13.14%	12.79%	12.49%
Transmission Losses (%)	3.71%	3.71%	3.71%
Distribution Losses (%)	9.79%	9.43%	9.12%

The State Commission has given detailed reasoning for revisiting the T&D loss level. In the present case due to incorrect figure of 17% of FY 2007, the State Commission had set the target distribution loss level to be achieved at the end of the first control period as 14.5%. While truing up the accounts for

FY 08, the State Commission in its order dated 11.8.2009 found that the actual T&D loss for the appellant stood at 13.49%. The target for T&D losses at the end of the control period i.e. FY 2010-11 could not be less than the actual T&D losses in the base year i.e. FY 2007-08. Thus the State Commission revisited the loss level target set for the MYT control period and revised the T&D loss trajectory with respect to the actual loss level in the base year. According to the Regulations, normally the T&D loss level once determined should not have been revisited even if the targets are fixed on the basis of the unaudited accounts. However, in this case as the base level T&D loss level in the true up were found to be less than the target fixed for the end of the control period, the State Commission revised the T&D loss trajectory. However, the reduction trajectory of 0.75%, 0.75% and 0.5% for

FY 09, FY 10 and FY 11 respectively was maintained with respect to the actual T&D losses in the base year. It would have been unreasonable to pass on the benefit of 2/3<sup>rd</sup> of the profit to the appellant as per the Regulations even if there was no actual reduction in the T&D losses during the control period, if the T&D loss trajectory had not been revised by the State Commission.

8.5. According to Regulation 43(1), to ensure smooth implementation of the MYT framework, the State Commission may undertake periodic reviews of licensees' performance during the control period, to address any practical issues, concerns or unexpected outcomes that may arise. This particular case relates to actual T&D loss in the base year after true-up of financials for FY 2007-08 coming out to be much less than the T&D loss trajectory for the control period at

the end of the control period necessitating intervention by the State Commission. According to the Regulations, the T&D loss trajectory was not to be interfered with under normal circumstances, but the instant case relates to abnormal circumstances.

8.6. In view of the above, we do not find any infirmity in the orders of the State Commission and decide not to interfere with the same.

9. The third issue is regarding return on equity:

9.1. According to the appellant, the State Commission has wrongly held that the future projects in the control period would be considered with 100% debt funding in view of the funding pattern of the past projects. This is in direct contravention of the Tariff Regulations.

9.2. According to the learned counsel for the State Commission, this issue has already been decided by

the Tribunal in its Judgment dated 25.11.2011 in appeal no. 12 of 2009.

9.3. Let us first examine the Regulations. The relevant Regulation is reproduced as under:

***“19. Debt – equity ratio:***

*For the purpose of determination of tariff, the equity and outstanding debt shall be determined for the base year by the Commission taking into consideration the licensee’s proposals, previous years debt- equity details and other relevant factors. However, for any fresh capitalization of assets, the Commission shall apply a debt-equity ratio of 70:30 on the capitalized amount as approved by the Commission for each year of the control period:*

*Provided that where equity employed is in excess of 30% the amount of equity for the purpose of tariff shall be limited to 30% and the balance amount shall be considered as loan. The interest rate applicable on the equity in excess of 30% treated*

*as loan has been specified in regulation 21. Where actual equity employed is less than 30%, the actual equity shall be considered”.*

Thus, for fresh capitalization debt-equity ratio of 70:30 has to be considered. If the equity is more than 30%, then the amount of equity for the purpose of tariff shall be limited to 30% and the balance amount shall be considered as loan. Where the equity employed is less than 30%, the actual equity shall be considered.

9.4. We will now examine the findings of the State Commission. The relevant paragraph is reproduced below:

*“4.115(c) The balance has been considered to be funded through debt and/ or equity. As per the MYT Regulations, the equity has been capped at a maximum of 30%; however, there is no cap on the dept funding. The Commission has analyzed the funding pattern of the Board for the past projects*

*and has observed that most of the projects taken up by the Board have been funded entirely through debt. Thus, the Commission has considered 100% debt funding for the future projects as well.”*

Thus the State Commission has decided that for future projects taken up by the appellant will be considered with 100% debt funding.

9.5. In our opinion, the above finding for considering 100% debt funding for future projects is contrary to the Regulations. The appellant is at liberty to invest upto 30% equity according to the Regulations. However, if the equity employed is less than 30% then the actual equity shall be considered. When the Regulations permit the employment of equity upto 30% for tariff purpose, the State Commission cannot restrict the same by a blanket order. The debt equity

ratio for the future projects should be decided according to the Regulations.

9.6. The learned counsel for the State Commission has contended that this issue has been decided in this Tribunal's Judgment dated 25.1.2011 in appeal no. 12 of 2009. We find that in this Judgment the Tribunal upheld the findings of the State Commission in MYT order dated 30.5.2008 where the equity had been limited to the actual equity infused in the various old and new projects. In existing projects where no infusion of equity could be established, 100% debt funding was considered. However, the findings in this Judgment also support the contention of the appellant in the present case.

9.7. Accordingly, we decide this issue in favour of the appellant.

10. The fourth issue is regarding Repair & Maintenance cost (R&M cost):

10.1. According to the learned counsel for the appellant, the R&M cost has been approved by the State Commission contrary to the Regulations. On the other hand, the learned counsel for the State Commission argued that the same has been determined according to the Regulations.

10.2. Let us first examine the Regulations. The relevant extracts are reproduced below:

***“17. Operation and Maintenance (O&M) Expenses***

*(1) Operation and Maintenance O&M) expenses shall include:-*

*(a) salaries, wages, pension contribution and other employee costs;*

*(b) administrative and general expenses;*

(c) *repairs and maintenance expenses; and*  
 (d) *other miscellaneous expenses. statutory levies and taxes (except corporate income tax).*

(2) *The distribution licenses shall submit the O&M expenses for the control period as laid down in the multi year tariff filing procedure. The O&M expenses for the base year shall be approved by the Commission taking into account the latest available audited accounts, business plan filed by the distribution licensee, estimates of the actual for the base year, prudence check and any other factors considered appropriate by the Commission.*

(3) *The O&M expenses for the n<sup>th</sup> year of the control period shall be approved based on the formula given below:-*

$$O\&M_n = (R\&M_n + EMP_n + A\&G_n) * (1 - X_n)$$

*Where-*

(a) *R&M<sub>n</sub> = K \* GFAn<sub>-1</sub> and;*

(b) *EMP<sub>n</sub> + A&G<sub>n</sub> = (EMP<sub>n-1</sub> + A&G<sub>n-1</sub>) \* (INDX<sub>n</sub> / INDX<sub>n-1</sub>)*

*Where –*

*‘K’ is a constant ( could be expressed in %) governing the relationship between O&M costs and*

*gross fixed assets (GFA) for the  $n^{\text{th}}$  year. The value of  $K$  shall be given in the MYT Order of the Commission;*

*INDX<sub>n</sub> – inflation factor to be used for indexing and shall be taken as a combination of the consumer price index (CPI) , the wholesale price index (WPI) and any other relevant factor;*

*EMP<sub>n</sub> – employee costs of the transmission licensee for the  $n^{\text{th}}$  year;*

*A&G<sub>n</sub> – administrative and general costs of the transmission licensee for the  $n^{\text{th}}$  year;*

*R&M<sub>n</sub> repair and maintenance costs of the transmission licensee for the  $n^{\text{th}}$  year;*

*X<sub>n</sub> is an efficiency factor for  $n^{\text{th}}$  year. Value of X<sub>n</sub> shall be determined by the Commission in the MYT tariff order based on licensee's filings, benchmarking approved cost by the Commission in past and any other factor that the Commission feels appropriate",*

According to the Regulations constant 'K' governing the relationship between Repair & Maintenance expenses and Gross Fixed Assets is to be given in the MYT order of the Commission.

10.3. Accordingly, the State Commission in the MYT order determined the 'K' factor as 0.99% using approved values of R&M expenses and opening Gross Fixed Assets for the period from FY 04 to FY 07. The O&M expenses were determined for the control period considering 'K' factor as 0.99%.

10.4. According to the Regulations, the O&M expenses which include the R&M expenses is a controllable factor and are not subjected to truing-up. However, in the impugned order the State Commission has again determined the value of 'K' considering the data for

opening Gross Fixed Assets and R&M expenses for the last five years i.e. FY 04 to FY 08 and re-determined 'K' factor as 0.93%. Accordingly, the State Commission has again determined the R&M expenses for each year of the control period considering the opening level of GFA as approved by the State Commission and the K factor of 0.93%.

10.5. Thus in the MYT order, the value of 'K' has been determined based on the data for the last 4 years i.e. FY 04 to FY 07 and the same was revised in the impugned order considering the data for last 5 years i.e. FY 04 to FY 08. In our opinion, this is contrary to the Regulations. The Regulations clearly state that the value of 'K' will be given in the MYT order. The Regulations also do not have any provision for review of 'K' value or review of approved R&M expenses or true up of R&M expenses. It is also not stated in the

Regulations that the value of 'K' is to be worked out on the basis of data of last 4 or 5 years including the immediate previous year. Thus there was no need for the State Commission to revisit the 'K' factor in the impugned order.

10.6. Accordingly, we decide this issue in favour of the appellant and set aside the findings of the State Commission in the impugned order in this regard.

11. The fifth issue is the employees cost:

11.1. According to the learned counsel for the appellant, the actual escalation applicable in the employees cost is much higher than the inflation factor allowed by the State Commission based on Wholesale Price Index (WPI) and Consumer Price Index (CPI). The dearness allowance of the employees had also increased by over 20% between FY 07 and

FY 08. In any event, the employees cost being more related to the Consumer Price Index and not having a correlation to the WPI, the indexation formula to be applied by the State Commission ought to be based on the CPI and the Dearness Allowance required to be given by the appellant. He has also pointed out a computation error in the calculation of the employees cost. The appellant had claimed the employees cost taking into account the 6<sup>th</sup> Pay Commission recommendations. The State Commission has postponed the recovery of the 6<sup>th</sup> Pay Commission recommendations but while deducting the capitalized employees cost for capital works in progress, the State Commission has proceeded on the basis of the appellants' claim including 6<sup>th</sup> Pay Commission recommendations. The State Commission should have

reduced the employees expenses to be capitalized in ratio of the approved and proposed employees cost.

11.2. According to the learned counsel for the State Commission, the employees cost has been determined according to the Regulations. The State Commission gave 75% weightage to CPI and 25% weightage to WPI while working out the inflation factor and determined the employees expenses according to the Regulations.

11.3. We have already examined the relevant Regulation-17 in paragraph 10.2 above. According to the Regulations, the inflation factor to be used for indexing the employees cost shall be taken as a combination of CPI and WPI and any other relevant factor. The State Commission has given 75% weightage to CPI and 25% weightage to WPI while working out the inflation factor for the employees

expenses. The contention of the appellant seems to be that the inflation factor should be used taking into account the actual employees expenses. This does not appear to be justified as the MYT Regulations specify O&M expenses as the controllable expenses which are not to be trued up during the control period. Any efficiency gain and loss are to be shared by the licensee and the consumers according to the Regulations.

11.4. In view of the above we do not want to interfere with the findings of the State Commission in regard to employees expenses. However, the appellant has pointed out some computation errors in calculation of the employees cost capitalized for capital works. This may be examined by the State Commission.

12. The sixth issue is regarding the interest and finance charges:

12.1. According to the learned counsel for the appellant, the State Commission has not approved any equity infusion for capital projects and the interest rate for term loan at the rate of 10.25% and working capital loans of 12.25% without regard to the actual interest rate of the loan taken by the appellant. The State Commission ought to allow the actual rate of interest as per the loan agreement, subject to prudence check.

12.2. According to the learned counsel for the State Commission, the interest rate of respective loans has been considered according to the Regulations.

12.3. The relevant Regulation is reproduced below:

***“21. Interest and Finance Charges***

(1) *Interest and finance charges on loan capital shall be computed on the outstanding loans, duly taking into account the schedule of repayment, and the interest rate, in accordance with the terms and conditions of relevant agreements of loan, bond or non-convertible debentures. Exception can be made for the existing or past loans which may have different terms as per the agreements already executed if the Commission is satisfied that the loan has been contracted for and applied to identifiable and approved projects. For the purpose of tariff determination, the outstanding debt at the end of each year of the control period shall be taken as:-*

*Outstanding debt at the end of  $n^{\text{th}}$  year = Outstanding debt at the end of  $(n-1)^{\text{th}}$  year + (plus) sum of amount of debt related to assets capitalized under each investment scheme during  $n^{\text{th}}$  year-(minus) debt repaid during  $n^{\text{th}}$  year,*

*For the first year of the control period,  $(n-1)^{\text{th}}$  year shall be the base year.*

*Amount of debt related to assets capitalized under an investment scheme during  $n^{\text{th}}$  year=(70% or actual, whichever is higher) **X** (multiply) (amount of capitalization approved by the Commission for such scheme in  $n^{\text{th}}$  year;*

*Provided that all loans considered for this purpose shall be identified with the assets created:*

*Provided further that the interest and finance charges of re-negotiated loan agreements shall not be considered, if they result in higher charges:*

*Provided further that the interest and finance charges on works in progress shall be excluded and shall be considered as part of the capital cost:*

*Provided further that neither penal interest nor overdue interest shall be allowed for computation of aggregate revenue requirement.*

*(2) The interest rate on the amount of equity in excess of 30% treated as notional loan shall be the weighted average rate of the loans of the respective*

*years and shall be further limited to the rate of return on equity specified in these regulations.*

## **22. Interest Charges on Working Capital**

*Rate of interest on working capital to be computed as provided hereinafter in these regulations shall be on normative basis and shall be equal to the short-term prime lending rate of the State Bank of India as on April 1 of the relevant year. The interest on working capital shall be payable on normative basis notwithstanding that the licensee has not taken working capital loan from any outside agency or has exceeded the working capital loan based on the normative figures”.*

12.4. The relevant findings of the State Commission in the impugned order are as under:

### **“Interest & Financing Charges**

*4.114 For the purpose of calculating the interest expenses for the Control Period the Commission prepared a source wise loan schedule. For this, the Commission has considered the outstanding loans at the end of FY08 as approved by the Commission*

*in the True-up for FY08 and the repayment schedule of the respective loans in the Control Period.*

*4.115 The Commission has analyzed the means of finance for all three functions separately and has considered the following for approving the means of finance of the Board for the Control Period.*

*(a) As per the MYT Regulations, debt or equity would be allowed only on the capitalized assets and not on the capital works in progress. Thus, the Commission has considered the assets capitalized for each function in each year as the funding requirement for that year of the Control Period.*

*(b) The Commission has thereby reduced the consumer contribution from the funding requirement determined above. For this, the Commission has considered the consumer contribution submitted by the Board and has adjusted the same in the proportion of funding*

*requirement approved by the Commission and that submitted by the Board.*

*(c) The balance has been considered to be funded through debt and /or equity. As per the MYT Regulations, the equity has been capped at a maximum of 30%; however, there is no cap on the debt funding. The Commission has analyzed the funding pattern of Board for the past projects and has observed that most of the projects taken up by the Board have been funded entirely through debt. Thus, the Commission has considered 100% debt funding for the future projects as well.*

*4.118. For approving the Interest and financing charges for the Control Period, the Commission has considered the following;*

*(a) For calculation of interest charges the Commission has considered the interest rate of the respective loans. The interest on new loans has been considered at 10.25% and the interest on*

*working capital loans has been considered at 12.25%.*

*(b) For capitalization of Interest expenses for the Control Period, the Commission has considered the capitalization of interest expenses proposed by the Petitioner and has adjusted the same in the ratio of approved capital works in progress (CWIP) and that proposed by the Petitioner”.*

12.5. Regarding the consideration of future projects on 100% debt funding, we have already dealt with the issue in paragraph-9. As regards the interest on loan, the State Commission has already considered the interest on loan on the existing loans according to interest rate of the respective loans. Only for new loan interest rate of 10.25% has been considered. Similarly, interest on working capital has been considered at 12.25%. The appellant has not been able to furnish any material which had been furnished

before the State Commission to establish that the new loans will be available at higher interest rates. In any case, the interest rate for the new projects will be subjected to true-up.

12.6. We do not find any infirmity in the order of the State Commission regarding rate of interest and decide not to interfere with the same.

13. Summary of our findings is as under:

13.1. The first issue is regarding power purchase cost allowed by the State Commission. Our finding on the issues is that the State Commission has erred in not taking into account the actual power purchase cost for the FY 2007-08 and revised schedule of commissioning of the new generating units while making assessment for power purchase cost. Thus, the objective of updating the power purchase cost in

the APR from that determined in the MYT order was defeated. The State Commission has since trued up the power purchase cost of the appellant and, therefore, the substantive issue does not survive.

13.2. The second issue is regarding Transmission and Distribution losses. According to the appellant, the T&D loss trajectory set up in the MYT order could not be altered in the middle of the control period. We have noticed that the State Commission had to revisit the T&D loss trajectory on account of incorrect T&D loss figure for the base year i.e. FY 2007-08 assumed at the time of passing the MYT order. The State Commission in the MYT order had taken T&D losses for base year 2007-08 as 16.5% and accordingly considered loss reduction trajectory of 0.75%, 0.75% and 0.5% for FY 09, FY 10 and FY 11 respectively to reach a figure of 14.5% by the end of Control Period. The

Commission had also clarified in the MYT order that the trajectory for the Control Period may be trueed up as and when the audited accounts for FY 08 were made available. On the true up of the FY 2007-08 it was found that the actual T&D losses for the FY 2007-08 stood at 13.49% which is less than the target of 14.5% set for the end of the control period i.e. FY 2010-11. In normal circumstances the T&D loss trajectory should not have been revisited by the State Commission. However, in this case due to incorrect data made available to the State Commission for the previous year, the State Commission had to review the T&D loss targets during the control period. If the T&D loss targets had not been revised the appellant would have been entitled to the gains due to T&D loss reduction during the MYT control period even without actually reducing the T&D losses below the T&D losses

achieved during the base year i.e. FY 2007-08. In any case, the T&D loss trajectory for the control period cannot be more than the actual T&D loss achieved during the base year. In view of above, we do not find any infirmity in the State Commission's findings and decide not to interfere with the same.

13.3. The third issue is regarding return on equity. The Regulations provide for debt-equity ratio of 70:30 for fresh capitalization of assets. However, where the actual equity employed is less than 30%, the actual equity has to be considered. The State Commission's finding for considering 100% debt funding for future projects is thus not in consonance with the Regulations. When the Regulations provide for 30% equity, the State Commission cannot restrict the same by a blanket order. Accordingly, this issue is decided in favour of the appellant with directions to the State

Commission to decide debt equity ratio for future projects as per the Regulations.

13.4. The fourth issue is regarding Repair & Maintenance cost. We have noticed that the State Commission has revised the 'K' factor used in calculating the Repair & Maintenance cost in the impugned order 0.93% based on the data for the last 5 years as against 0.99% determined in the MYT order based on the data for the last 4 years. The Regulations do not have any provisions for revision of the 'K' factor during the control period and clearly state that the 'K' factor will be will be given in the MYT order. There is also no mention that 'K' factor will be determined based on last 4 years or 5 years data. Thus revision of 'K' factor during the control period is contrary to the Regulations and there was no need for the State Commission to review the 'K' factor in the

impugned order. Accordingly, this issue is decided in favour of the appellant.

13.5. The fifth issue is regarding the employees cost. We do not find any infirmity in determination of inflation factor by the State Commission and therefore, do not want to interfere with the findings of the State Commission in this regard. However, the State Commission may look into the error in calculation of the employees cost as pointed out by the appellant.

13.6. The sixth issue is regarding the interest rate for term loan and working capital loans. We have noticed that the State Commission has considered the interest on loan on the existing loans according to the interest rate of the respective loans. Only for new term loan and working capital interest rate of 10.25% and 12.25% respectively has been considered. The

appellant has not been able to produce any material which was placed before the State Commission to establish that the new loans will be available at higher interest rates. Accordingly, we have decided not to interfere with the findings of the State Commission in this regard.

14. In view of the above we allow the appeal partly to the extent indicated above and direct the State Commission to give effect to our findings. No order as to cost.

15. Pronounced in the open court on this **11<sup>th</sup> day of July, 2011.**

**(Justice P.S. Datta)**  
**Judicial Member**

**( Rakesh Nath)**  
**Technical Member**

REPORTABLE / NON-REPORTABLE

vs