

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

Appeal No. 13 of 2007

Dated the August 27, 2007.

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

The Municipal Corporation of Greater Mumbai
BEST Bhawan, BEST Marg
Colaba, Mumbai

-Appellant

Versus

Maharashtra Electricity Regulatory Commission
World Trade Centre No. 1, 13th floor
Cuffe Parade, Colaba, Mumbai

-Respondent

Counsel for Appellant : Mr. S.P. Bhatia, Advocate
Mr. Sunil Kumar, Advocate
on behalf of M.V.Kini & Co.
Mr. Ramji Srinivasan, Advocate
Ms Mandakini Singh, Advocate

Counsel for Respondent : Mr. Jayant Bhushan, Sr. Advocate
with Mr. Buddy. A. Ranganadhan,
Advocate
Mr. Arijit Maitra, Advocate
Mr. Kamlesh Mittal, Sr. Director
Mr. Srikant Thorat, Sr. Manager and
Mr. Venkatesh, Consultant for MERC

JUDGMENT

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

This appeal, filed under Section 111 of The Electricity Act, 2003 challenges the judgment and order dated November 8, 2006 in case No. 32 of 2006 of Maharashtra Electricity Regulatory Commission (MERC or the Commission in short).

2. The appellant has sought the following relief :

- (a) Allow the appeal by directing the respondents to provide return on equity @ 16% on the basis of equity determined by the respondents vide their order dated March 09, 2006 read with order dated February 25, 2006 in case No. 4 of 2006 and Impugned Order to that extent be set aside;

Facts of the appeal:

3. The facts giving rise to this appeal lie in a narrow compass.

4. The appellant BEST, provides two essential services i.e. transportation by OMNI bus in the city of Mumbai and the extended suburbs and supply of electricity in the island city of Mumbai.

5. The appellant submitted its Annual Revenue Requirement (ARR in short) and tariff proposal to the Commission for financial year year 2004-05 and financial year 2005-06 on March 11,2004, for approval of the Commission. The ARR included among others expenditure, interest on internal fund, additional depreciation and deficit of bus division.

6. The appellant thereafter submitted the additional data and further clarifications to the MERC to enable them to conduct technical validation session. A public notice was also issued in leading newspapers on October 28,2005 regarding a public hearing to be held on December 12, 2005. Accordingly, public hearing was held on December 21, 2005 in the office of the MERC. The Commission heard the submissions of the appellant and also that of the objectors such as East India Hotels Ltd. and Mumbai Grahak Panchayat. The MERC thereafter issued operative order dated February 25, 2006 inter alia determining the Annual Revenue Requirement of the appellant and fixing the revised tariff of the appellant. The detailed order dated March 09,2006 was also issued by MERC, wherein, the MERC specifically allowed the return on equity @ 16% in favour of the appellants, by considering Normative Debt equity ratio of 70:30. However, MERC denied various other expenses claimed by the appellants such as interest on internal funds, additional depreciation and cross subsidizing deficit of bus division etc. as available to a local authority. Thereupon, the appellants had preferred an appeal No. 61 of 2006 to this Tribunal. This Tribunal vide its order and judgment dated August 18, 2006 while upholding

some of the contentions of the appellant had granted interest on internal funds and Government grants.

7. Pursuant to the various directions issued by this Tribunal in its order and judgment dated August 18, 2006, MERC had re-determined the ARR for FY 2004-05 and 2005-06 in respect of the appellants vide order dated September 26, 2006. Being aggrieved by the said order dated September 26, 2006, the appellants filed a review under Section 94(1)(f) of The Electricity Act, 2003 and the said review, being case No. 32 of 2006, was decided by an order dated November 08, 2006 wherein, MERC while upholding its earlier order dated September 26, 2006 rejected the appellants' contention that the appellants are entitled for return on equity as provided under Regulation 76.1.1 of the MERC (Terms and Conditions of Tariff) Regulation 2005.

8. Being aggrieved by the order and judgment of MERC dated November 08, 2006 the appellants have preferred this appeal.

9. We have heard the submissions advanced by the learned counsel for the parties. It was submitted by the learned counsel for the appellant that the impugned order is in violation of and contrary to the Regulation 76.1.1 of the MERC (Terms and Conditions of Tariff) Regulation, 2005. Following relevant provision of the said clause were brought to our attention.

“ 76.1.1 The Distribution Licensee shall be allowed a return at the rate of 16 per cent per annum, in Indian Rupee terms, on the amount of approved equity capital:

.....Provided further that in case of a local authority engaged, before the commencement of the Act, in the business of distribution of electricity, the opening balance of equity capital shall be stipulated appropriately by the Commission in its order passed under sub-section (3) of Section 64 of the Act.”

10. Learned counsel for the appellant alleged that the Impugned Order of MERC is contrary to its earlier order dated March 09, 2006 read with order dated February 25, 2006 in case No. 4 of 2004 and that the Impugned Order of MERC dated November 8, 2006 is in breach of the order and judgment of this Tribunal dated August 18,2006. It is further contended by the appellant that the respondents have grossly misconstrued the views taken by this Tribunal in its order and judgment dated August 18,2006 in appeal No. 61 of 2006 and that this Tribunal at Pt. No. X para 74 of its judgment dated August 18,2006 in appeal No. 61 of 2006 had granted interest on internal funds and Government grants and the grant of said interest was in addition to and not in substitution of return on equity already granted by the respondents.

11. Our attention is drawn to para 74 of our judgment dated August 18, 2006 which is extracted below:-

'74 Taking up this point, we have to examine as to whether disallowance of interest on internal funds as well as funds granted by the Government, is justified. The MERC has disallowed interest claimed and this has given rise to the grievance. The learned counsel for the appellant did not claim return on such internal funds or the Government grant which has been utilized in the electricity distribution, presumably because of the restriction found in the Regulation. In our view, the appellant has not claimed "Return on Equity" on those funds. The learned counsel for the first respondent- MERC, contended that no interest is payable on the internal funds drawn from the coffers of the Corporation as well as the Government grant. We are unable to sustain such an argument advanced on behalf of MERC. Internal fund has been drawn and utilized in the electricity distribution business and this is not being disputed by the respondent. So also, a substantial sum has been received by way of grant and utilized by the appellant in the electricity distribution business. In terms of Regulation pointed out by the MERC, the appellant could be denied of return on such internal funds as well as the grant but there is neither justification nor there is any reason to deny interest since those funds have been utilized by the appellant in electricity business. Internal funds though is drawn from the coffers of the Corporation for all purposes of this business, viz electricity distribution, it is from the Corporation though it is

the owner of the electricity distribution business yet funds have been drawn and utilized. When the appellant is expected to maintain the entire revenues and expenditure in respect of electricity business in an air tight compartment for the purpose of approval of ARR as well as determination of tariff, we do not find any justification to deny interest on the internal funds drawn by the appellant from sections other than electricity as well as the grant from the Government. There is no provision in the Tariff Regulations with respect to payment of interest on the internal funds received and utilized by the appellant in the electricity business, so also with respect to the grant. It is a grant to the Corporation by the Government and it is not a grant to the consumers. This position is fairly admitted by the learned counsel for MERC. Therefore, it is a flow of funds from sources outside the electricity business. Hence even in respect of grant also, be it a free grant or refundable without interest, in our considered view MERC should have allowed interest. The denial of interest cannot be sustained”.

12. Learned counsel for appellant reiterated that this Tribunal specifically held that the appellants have not claimed return on equity on the Government grant and internal funds and the appellant's claim on equity is other than the Government's grant and internal funds, as has been granted by MERC vide its order dated March 9, 2006 read with order dated February 25, 2006 in case No. 4 of 2004. This Tribunal has not disturbed the original order of MERC as to granting of return on equity. The order for granting interest on internal funds and Government grant is an

absolutely distinct and different issue. Interest on internal funds is not in substitution of return on equity as is sought to be interpreted by the Commission. The order of the Tribunal is only with respect to such of those funds on which return on equity was not claimed by the appellants.

13. Learned counsel emphasized that it is the finding of MERC in its order dated March 9, 2006 that 70%, which is considered normative debt of the capex of the Financial Year and which is not considered for calculating return on equity, has necessarily to be considered for 6% interest on internal funds. The return on equity and interest on internal funds are independent of each other and one cannot be a substitute for the other.

14. Learned counsel contended that the views expressed by the respondent under the impugned order is erroneous and contrary to Regulation 76.1.1 read with the Judgment of this Tribunal dated August 18, 2006 in appeal No. 61 of 2006 inasmuch as the respondents illegally denied the return on equity as provided under Rule 76.1.1 of the MERC (Terms and Conditions of Tariff) Regulation, 2005 and also denied the interest on capital expenditure as the appellants are entitled for interest @ 6% by virtue of the judgment of this Tribunal on the total amount of capital expenditure for the particular year after apportionment of 30% of the total capital expenditure for the purposes of return on equity.

15. Learned counsel further contended that the return on equity granted by the MERC was not the issue before this Tribunal in appeal No. 61 of 2006 and,

therefore, it does not make any reference to the same in its order dated August 18,2006. There is also no mention by this Tribunal regarding grant of return on equity by MERC in its detailed order dated March 09,2006. The return on equity granted by the MERC is, therefore, not disturbed by this Tribunal.

16. Per contra learned counsel for MERC stated that the main guiding factor for the Commission to assess the Review Petition of BEST were: (i) the BEST appeal to the Appellate Tribunal challenging the detailed order of the Commission and (ii) the Appellate Tribunal's judgment in the case (case No. 61 of April, 2006), as the detailed order of the Commission is superceded by Appellate Tribunal's judgment. BEST, during the ARR and Tariff determination process for FY 2004-05 and FY 2005-06, as well as its appeal before the Appellate Tribunal for Electricity (ATE), had claimed interest on Internal Funds. It has very lucidly explained under point No. 43 of its appeal before the Appellate Tribunal dated April 18, 2006, as to how its claim of Interest on Internal Funds of Rs. 46.42 Crores for 2003-04 and Rs. 70.82 crores in 2004-05 was the least cost solution and was also the most beneficial to it's consumers out of the three options namely (a) Return on Regulatory Equity, (b) Interest on Internal Funds and (c) Return computed in line with the Schedule VI of the erstwhile Electricity (Supply) Act, 1948.

17. Learned counsel for the respondent Commission submitted that Tribunal has appreciated the above submission and argument of the least cost option and directed that interest on Internal Funds as well as Government grant be allowed at the rate of 6% per annum. As regards Government grants, neither BEST nor MERC

(under its Regulations), have considered the cost of interest to be borne by the consumers as there is no such interest element in the MERC (Terms and Condition of Tariff) Regulations, 2005. However, the Appellate Tribunal has allowed 6% interest on the Government grants utilized in the electricity business of BEST and the same has now been allowed by the Commission apart from interest on the actual amounts received from the Internal Funds.

18. Learned counsel for MERC asserted that the Capital Expenditure and Capital Base of BEST is funded by Internal Funds, Government grants, Government loans and other loans. MERC contends that BEST's contention that apart from interest on Internal Funds it should further get return at 16% on notional equity allowed by applying MERC Regulations is against the principle set out by the Tribunal. Such a contention by BEST it is alleged, is inconsistent with its own petition before the Tribunal. Learned counsel submitted that MERC has allowed interest at the rate of 6% on the Net Internal Funds, Government Grant/Assistance. The Commission has also allowed interest at actual on all loan funds of BEST as these are to be serviced at specific interest rates.

19. We have considered the respective contentions advanced on either side as well as points raised in the appeal. We observe that the respondent Commission has heavily relied upon para 43 of the BEST appeal No. 61/06 wherein BEST had brought out that interest on Internal Funds proposed by it was the least cost proposition and was most beneficial to the consumers. We note that in appeal No. 61/06 the appellant had also raised issue regarding '*Additional Depreciation and*

Interest on Internal Funds' in paras 41,42,43,44 and 45. It was brought out by BEST that the special requirement and circumstances prevailing in BEST require that the claiming of Additional Depreciation and Interest on Internal Funds were to be included while computing ARR of the appellant. In our view BEST had not only opted for the Interest on Internal Funds but had simultaneously demanded Additional Depreciation.

20. This Tribunal had separately dealt with the matter of additional depreciation. In para 59 of its judgment in appeal No. 61/06. This Tribunal had upheld the decision of the MERC to disallow additional depreciation as the same was not as per the Tariff Regulations of MERC. This Tribunal had separately considered the question of Interest on Internal Funds and the Government grant. The following point was formulated for decision on the issue of Interest on Internal Funds by this Tribunal.

“(X) Whether the disallowance of interest by MERC on internal of fund and the funds received by way of grant from the Government is illegal ?”

This point was answered in favour of the appellant and for the actual amount received from Internal Funds as well as the grant utilized in the electricity distribution business, the Commission was directed to allow 6% interest.

21. We observe that In the ARR and tariff order for the FY 2004-05 and 2005-06 one of the subjects for determination was the claim for interest on internal funds.

The BEST in its ARR and tariff petition had stated that its funding was mainly done through internal sources. It asked for interest of 7% on internal funds. This claim was objected on the ground that interest, as per Regulation was allowable only on loan capital, which should be restricted to borrowing from external lenders. EIH pointed out that BEST had contended that since it did not have the equity base and consequently could not claim any return on equity, it should be allowed to claim interest on internal funds to mirror all internal equity. This was objected to by EIH on the ground that BEST had not incurred any cost in raising internal funds. On behalf of BEST it was submitted that at Section 5.2.8, calculation had been given to estimate return under various options to show that interest was the option most beneficial to the consumers. The BEST submitted that if interest is given on internal funds at the rate of 7%, the cost would amount to Rs.46.42 Crores for 2003-04 and Rs.70.82 Crores in 2004-05. On the other hand, if 16% return is given on internal funds in the manner return is given on equity, the cost for 2003-04 would amount to Rs.120.45 Crores and for 2004-05, Rs.118.75 Crores.

22. The Commission ruled as under: *“However, the Commission has computed return on “Notional Equity” for the purpose of computation of ARR as per Section 76.1 of the MERC (Terms and Conditions of Tariff) Regulation 2005. The underlying objection is to apply common methodology for all the licensees in the State as per MERC Regulations in order to bring in uniformity in determination of return on equity. The Commission has computed Opening Equity for FY 2004-05 (as on 01st April, 2004) for computation of ARR. Thus for FY 2005-06 the Commission has*

considered the debt equity ratio of 70:30 to fund the fresh capital investment as per MERC Regulation. Computation of return on Notional Equity is as follows:

Table: Return on 'Notional' Equity for FY 2004-05 (Rs. Cr.)

Particulars	<u>FY 2004-05</u> BEST Revised data	<u>FY 2004-05</u> MERC Approval
Gross Fixed Assets	1022.93	1022.93
Plus: Work in Progress	9.61	9.61
Less: Contribution made by consumers for service lines (cumulative)	45.94	45.94
Less: Government assistance (cumulative)	45.63	45.63
Fixed Assets	940.97	940.97
Less: Accumulated depreciation		328.89
Adjustment for Depreciation		29.60
Capital Base		641.68
Debt/Actual loans	658.68	50.07
Equity (Balance) – end of year	282.29	591.61
Annual allowable capital cost for year		69.64
Normative equity (30%)		20.89
Opening Equity for the year		570.72

Particulars	<u>FY 2004-05</u> BEST Revised data	<u>FY 2004-05</u> MERC Approved
Computation of Return		
Return @ 16% on equity capital	45.17	
Return @16% on equity capital at commencement of year		91.31
Return @ 16% on 50% of equity portion of annual allowable cost for the year		1.67
Return for the year	45.17	92.99

23. The capital base has been calculated taking into account the gross fixed assets valuing Rs.1022.93 Crores and adding the value of work in progress amounting to Rs.9.61 Crores and deducting the contribution made by consumers and the assistance received from the Government. The fixed assets are then reduced by accumulated depreciation and adjustment of depreciation giving the capital base of Rs.641.68 Crores. The actual loan, to the extent of Rs.50.07 Crores, has been deducted giving an equity of Rs.591.61 Crores. There is nothing to show that in calculating Notional Equity any or what amount of internal funds, other than Government assistance was taken into account. The claim for return on Government assistance was declined. The Chart did not actually specify how internal funds at all were incorporated in calculation of capital base.

24. Thus MERC approved the capital base of Rs.641.68 Crores and equity of Rs.570.72 Crores at the beginning of 2004-05 and granted return of 16% on equity capital amounting to Rs.91.31 Crores. The equity capital was computed by taking into account the gross fixed assets, work in progress, less contribution by consumers towards service lines and Government assistance. Adjustment was made for depreciation for the subsequent years 2005-06, based on the Notional Equity for the years 2004-05 and adding there on equity capital portion of allowable capital cost for previous financial year. The notional capital was calculated at Rs.591.61 Crores. Subsequent Table summarizing the Annual Revenue Requirement shows that the Commission granted, inter alia, interest on loan amounting to Rs.3.80 Crores for the FY 2004-05 and Rs.6.97 Crores for the

FY 2005-06. In the column of return on equity, MERC approved return for 2004-05 amounting to Rs.92.99 Crores and for 2005-06, Rs.95.82 Crores. Coming to interest on internal funds, the claim of BEST is shown at Rs.59.46 Crores and Rs.51.10 Crores for the years 2004-05 and 2005-06 respectively. The Commission did not grant any interest on internal funds. The BEST has asked for a revenue of Rs.1626.70 Crores and Rs.1622.23 Crores for 2004-05 and 2005-06 respectively. MERC approved the revenue requirement of Rs.1456.74 Crores and Rs.1574.74 Crores for the two years respectively. (As per data, supplied by BEST, shown on Page 44 of the tariff order for 2004-05 and 2005-06, the return/interest on internal funds of 2004-05 was Rs.70.82 Crores, whereas in the Chart, at Page 84, interest claimed on internal fund is shown as Rs.59.46 Crores for 2004-05 only.)

25. In appeal No. 61 of 2006, BEST challenged the decision of the Commission and reiterated the claim for interest on internal funds coupled with additional depreciation. The judgment dated August 18, 2006 of this Tribunal held that disallowance of additional depreciation was not liable to be interfered with. At the same time it was held that disallowance of interest by MERC on internal funds and funds received by way of grant could not be sustained. The Tribunal directed to award interest of 6% on such sum. Dealing with this aspect, the judgment said *“taking up this point, we have to examine as to whether disallowance of interest on internal funds as well as funds granted by the Government, is justified. The MERC has disallowed interest claimed and this has given rise to the grievance. The learned counsel for the appellant did not claim return on such internal funds or the*

Government grant which has been utilized in the electricity distribution, presumably because of the restriction found in the Regulation. In our view, the appellant has not claimed "Return On Equity" on those funds. The learned counsel for the first respondent-MERC, contended that no interest is payable on the internal funds drawn from the coffers of the Corporation as well as the Government grant. We are unable to sustain such an argument advanced on behalf of MERC. Internal funds have been drawn and utilized in the electricity distribution business and this is not being disputed by the respondent. So also, a substantial sum has been received by way of grant and utilized by the appellant in the electricity distribution business. we do not find any justification to deny interest on internal funds drawn by the appellant from sections other than electricity as well as grant from the Government. When there is no dispute with respect to the internal flow of funds and the Government grant which were actually utilized on the distribution business, the claim of interest at 7% per annum, which is a minimum, is fair and we do not find any reason for the Commission to reject the same."

26. The Commission passed a supplementary order on September 26, 2006. The Commission's compliance is recorded as under:

"Commission's Compliance:

19. In compliance, the Commission has allowed interest on internal funds and on government assistance (based on the submissions made under the ARR Petition dated 27th September 2005 submitted by BEST), in lieu of the Return on Regulatory Equity [as per the MERC (Terms and Conditions of Tariff) Regulations 2005] to be included as a part of the ARR. BEST

has also submitted in its Petition dated 18th April 2006 admitted with the Appellate Tribunal for Electricity (Ref. point no.43 on page 17 of the BEST Petition before the Appellate Tribunal) that Interest on Internal Funds be allowed in the ARR as it is the least cost proposition in comparison to the Return on Regulatory Equity approach and the approach as per Schedule VI of the erstwhile Electricity (Supply) Act 1948.

20.The calculation of Interest on Internal Funds and that on Government Assistance based on the ARR Petition of BEST dated 27th September 2006 is shown below. However, the Commission shall scrutinize the basis of arriving at the internal accruals as arrived by BEST in its Petition and actual figures as per audited accounts for FY 04-05 and FY 05-06, as BEST has submitted the figures for calculation of Interest on Internal Funds for FY 05-06 based on Budgeted Estimates. Also, the Commission has earlier scrutinized the Return on Regulatory Equity approach in determination of the ARR in its detailed order dated 9th March 2006. In the interest of time, to avoid further delay in implementation of revised tariff prospectively, this will be scrutinized in the next ARR, Tariff Determination exercise and consequent Truing Up process to be taken up by the Commission.

Table 1: Interest on Internal Funds

Particulars	ARR Petition: Supply Divn. (Rs. Lakhs) FY 04-05	MERC Approval* (Rs. Lakhs) FY 04-05	ARR Petition: Supply. Divn. (Rs.Lakhs) FY 05-06 (BE)	MERC Approval*(Rs. Lakhs) FY 05- 06 (based on BE)
Net Assets	66,926	66,926	70,365	70,365
Other Assets	82,930	82,930	80,428	80,428
Sub-Total (A)	149,856	149,856	150,793	150,793
Less				
Amount Invested out side the business	633	633	396	396
Long Term Loans				
Mega City	2,011	2,011	1,566	1,566
Public Loan	460	460	460	460
DPDC	287	287	271	271
Bank of Maharashtra/Bank of India	0	0	0	0
APDRP	903	903	2,710	2,710
Liabilities				
Deposits	28,008	28,008	28,679	28,679
Current Liabilities	14,181	14,181	21,782	21,782
BEST Staff Benefit Fund	168	168	182	182
GEF	15,826	15,826	17,322	17,322
Govt. Assistance	2,757	2,757	4,563	4,563
Sub-Total (B)	65,234	65,234	77,931	77,931
Total Assets Used (A) – (B)	84,622	84,622	72,862	72,862
Add Back Govt. Assistance/Grants (as per Appellate Tribunal's Judgment)	-	2,757	-	4,563
Total Assets Used / Internal Funds including Govt. Assistance	84,622	87,379	72,862	77,425
Interest on internal Funds and on Government Assistance	5,924 (Interest at 7%)	5,243 (Interest at 6%)	5,100 (Interest at 7%)	4,646 (Interest at 6%)

27. What is striking is that interest on internal funds has been granted in lieu of return on regulatory equity. This was not the judgment of this Tribunal. The appellant certainly did not offer to forego the 16% return on equity available as per the Regulations. The strategy of the appellant was to ask for additional depreciation plus interest on internal funds as well as Government grants. The MERC without identifying how internal funds had gone into calculating the base capital and notional equity had eliminated the very item of internal funds in the calculations of the revenue requirement. So far as Government grants were concerned, it specifically denied interest thereon on the ground that no interest on this account was payable by the appellant. The appellant certainly did not intend to relinquish the return on calculated notional equity in order to get interest on internal funds and on Government assistance. The situation was very clear. The MERC declined to give interest and this Tribunal specifically ruled that interest be given on government grants. So far as the internal funds are concerned, this Tribunal ruled that interest on internal funds should also be given. The Tribunal did not say that for granting interest on internal funds the Commission has to withdraw the return on notional equity calculated by it. What the Tribunal intended was to give interest on that amount of internal funds which did not go into calculation of capital base or notional equity in any way. In case no amount of internal fund has gone into the calculation of capital base and notional equity, the entire internal funds used in equity business of BEST is entitled to earn interest. However, in case any internal fund was actually included into notional capital, for which return on equity of 16% was already granted, the same was not part of internal funds qualifying for interest. As can be

seen from the Table given in para 26 above, internal funds amounted to Rs.846.22 Crores for the year 2004-05 and Rs.728.62 Crores for 2005-06 which is quite distinct from the notional equity as mentioned earlier.

28. In the result, on a consideration of the entire matter, we find full justification and rationale in the contention of the appellant and, therefore, we allow the appeal and hold that the return on equity already allowed by the Commission in its order dated March 9, 2006 be retained. In addition, interest @ 6% on the Government grants and such of the internal funds which did not go into calculation of the capital base or notional equity in any way, should be allowed. The Commission is directed to work out the aforesaid interest and return on equity elements and allow the same in the ARR for the year 2008-09.

Pronounced in the open court on **August 27, 2007.**

(Mrs. Justice Manju Goel)
Judicial Member

(H.L. Bajaj)
Technical Member