

Counsel for Respondent (s):Mr. Ramesh Babu M.R.
Mr. Amarjit Singh Bedi
Mr. Dinesh Kumar for R.2

JUDGMENT

PER HON'BLE JUSTICE M. KARPAGA VINAYAGAM, CHAIRPERSON

Kerala State Electricity Board (KSEB) is the Appellant. The Kerala State Electricity Regulatory Commission (State Commission) is the Respondent.

2. Aggrieved over the order passed by the State Commission dated 12.08.2009 which rejected some of the claims made by the State Electricity Board, this Appeal has been presented by the Appellant.

3. The basic facts are as follows:

4. The Appellant is a deemed licensee for the electricity transmission, distribution and trading in the State of Kerala. It also undertakes generation of electricity besides above activities.

5. The Appellant on 28.01.2008 filed a Petition before the State Commission for truing up of the Audited Accounts of the Appellant for the year 2005-06 and sought adjustment for the revenue gap of Rs. 144.58 crores. After public hearing, the State Commission by the order dated 24.04.2009 decided on the truing up petition for the year 2005-06.

6. On being aggrieved over the disallowance of some of the claims, the Appellant on 12.05.2009 filed Review Petition before the State Commission for the review of the order dated 24.04.2009 on the ground that there were errors apparent on face of record.

7. The State Commission after entertaining the said Review Petition invited the comments from the public. Accordingly public hearing was held on 23.06.2009. The

State Commission further sought clarification from the Appellant. Accordingly the same were furnished. Ultimately the State Commission partly allowed the Review Petition by the Impugned Order dated 12.08.2009 by admitting an amount of Rs. 15.64 crores out of Rs. 341.56 crores as claimed by the Appellant. In the said Impugned Order dated 12.08.2009 the State Commission refused to accept the audited expenses certified by the Comptroller and Auditor General of India (CAG) under the following heads during the FY 2005-06:

1. Cost of Power Purchase
2. Repair and Maintenance Expenses
3. Employees Cost
4. Administrative and General Expenses
5. Disallowance of Interest and Finance Charges
6. Other Miscellaneous Expenses.

8. Having dissatisfied with the disallowance of claims on the above heads, the Appellant has filed the present Appeal.

9. The Appellant has made the following submissions:

“(A) Power Purchase Cost:

10. The disallowance of Power Purchase Cost for the loss level not achieved should be based on the pooled power purchase cost including the Appellant’s own generating stations. It should not have been merely based on some higher generation costs. The pooled cost after including the generation of electricity by the Appellant works out to Rs.1.01 per unit. The disallowance of power purchase cost for 126 MUs should be only based on Rs. 1.01 per unit and not Rs. 1.71 per unit.

(B) Repair and Maintenance Expenses:

11. The State Commission has wrongly restricted the Repair and Maintenance expenditure to the extent of

expenditure approved at the time of decision on ARR, though electricity Board, the Appellant, actually incurred higher repair and maintenance expenses on account of additional new assets by creating new generating capacity and new sub-station, lines etc.

(C) Disallowance of Employees Expenses:

12. The State Commission has not allowed the actual Employees Expenses for the year 2005-06 which is Rs. 862.51 crores but it has restricted the employees cost only to Rs. 853.55 crores. This wrong conclusion has been arrived at by the State Commission without considering the business growth of the utility and inflation.

(D) Disallowance of Administrative and General Expenses.

13. The State Commission wrongly disallowed the actual Administrative and General Expenses for the year 2005-06

and not allowed the amount of Rs. 62.26 crores towards electricity duty paid by the Appellant as a pass through. Besides electricity duty the Electricity Board has incurred Rs. 50.58 crores as A&G expenses of which the State Commission has approved only Rs. 33.21 crores, the amount approved in the tariff order for the FY 2005-06. The State Commission should have appreciated that with increased energy sales and the addition of 4.09 lakhs new consumers the administrative and general expenses have arisen.

(E) Disallowance of Interest and Finance Charges:

14. The State Commission wrongly disallowed Rs. 32.74 crores for interest on security deposit for the year 2005-06 on the ground that the actual payment of interest on the security deposits was only Rs. 3.26 crores. The State Commission has not appreciated the facts that the Appellant is preparing the accounts as per accrual basis

and as such interest accrued to be calculated even though the actual disbursement is made for the subsequent year.

(F) Disallowance of Other Expenses:

15. The State Commission disallowed the expenditure under the head "Other Expenses" only on the ground that the same is in excess of what it had earlier approved under this head without considering the facts that the actual expenditure under the head "Other Expenses" is more as the Board is following prudent accounting practices like creation of provision for bad and doubtful debts as per the observations of the Comptroller and Auditor General of India. The State Commission has made wrong presumption that once provision has been made for bad and doubtful debts, the Board will completely deduct the provision made from outstanding arrears and no further efforts will be made to recover such arrears in future. This is entirely wrong. The State Commission has also

disallowed prior period expenses relating to provision of interest on security deposit for FY 2004-05 disbursed during FY 2005-06 and interest on belated payment of electricity duty for the period 1995-96 to 2004-05. The State Commission has not appreciated that the payment of electricity duty for imported energy from Central Generating Stations to the Government was under dispute for long time since 1988 which was finally settled in the year 2002. Besides it the State Commission had disallowed the actual transmission and distribution losses it has treated the difference between what was allowed and what has been achieved by the Appellant and disallowed Power Purchase Cost of Rs. 21.55 crores”.

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16. The Learned Counsel for the State Commission in reply to above points elaborately argued the matter in justification of the Impugned Order of the State Commission dealing with above mentioned claims made by

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the Appellant by pointing out the reasons given by the State Commission for the disallowance of such claims.

17. In the light of the rival contentions urged by the Learned Counsel for the parties the following questions of law would arise in the present Appeal:

1. Can the State Commission disallow the actual expenses of the Appellant as per Audited Accounts without their being in prudence on the part of the Appellant?
2. Can the State Commission deny the electricity duty payable by the Electricity Board to the Government which forms part of the Administrative and General Expenses of the Appellant?
3. During the course truing up, can the State Commission refuse to allow to the Appellant's

expenses even though the Appellant had actually and necessarily incurred without their being in dispute or mismanagement on the part of the Appellant?

18. On these issues we have heard the Learned Counsel for the parties and perused the records and the Written Submissions filed by all parties. We have given our anxious consideration for the points argued by both the parties.

19. The Appellant's main contention in the Appeal is that the Impugned Order is not sustainable because the State Commission has not accepted the figures contained in the audited accounts. It is also further submitted by the Appellant that the present Appeal needs to be allowed consistent with the judgment dated 12.11.2009 passed by the this Tribunal in Appeal No. 94 of 2008 dealing with

truing up finances in the previous FY namely 2003-04 and 2004-05.

20. At the outset, it shall be stated that the State Commission while examining the accounts is not bound by the audited accounts. The accounts may be genuine as per the Auditor's Report. But, it is the State Commission which has to examine the accounts to ascertain the performance of the licensee in relation to the desirability of the expenditure in the interest of the consumers. This point has already decided by the Judgment of this Tribunal in Appeal No. 94 of 2008 as well as the decision of Hon'ble Supreme Court in West Bengal Electricity Regulatory Commission vs. CESC Ltd. (2002) (8)SCC 715.

21. Let us refer to the relevant observations made by this Tribunal in Appeal No. 94 of 2008:

“ In the truing up process the actual expenditures are examined and the expenditure with various heads are trued up. So far as the effect of audit is concerned, it establishes the genuineness of accounts and expenditure incurred. The Commission has to allow only as much expenditure as pass through as meets the targets set by it or is found to be prudent and necessary”

22. This decision was given by this Tribunal on the strength of the ratio decided by Hon’ble Supreme Court. We will now refer to the relevant observations made by the Hon’ble Supreme Court in the decision referred in (2002) (8) SCC 715.

“In this process, the Commission, in our opinion, is not bound by the Auditors’ Report..... There may be any number of instances where an amount may

be genuine and may not be questioned, yet the same not reflect good performance of the company or may not be in interest of the consumers. Therefore, there is an obligation on the Commission to examine the accounts of the company which may be genuine and unchallenged on that count still in the light of the above requirements of Section 29(2) (g) to (h). In the said view of the matter admitting that there is no challenge to the genuineness of the accounts, we think on this score also the accounts of the company are not ipso facto binding on the Commission.”

23. The above observations would reflect the ratio decided by Hon’ble Supreme Court. What is to be seen in this Appeal where each item of expenses allowed or disallowed

by the State Commission is correct or not in the facts of the case and the materials placed before of the Commission.

24. Let us first deal with the head 'Repairs and Maintenance Expenses'. According to the Appellant, there is no valid reason for the disallowance of the various elements of Repair and Maintenance Expenses as claimed by the Appellant. It has been further stated by the Appellant that the Repair and Maintenance Expenses are incurred for proper maintenance and sustenance of the assets and therefore there is no justification for the State Commission to have adopted approach of rejecting the claim on general ground that it is a controllable expenditure, whereas the Repair and Maintenance Expenses by its nature is not controllable which has to be incurred but they maintain the assets which would be dependent on actual requirements from time to time. It is

noticed that in the Annual Revenue Requirement (ARR) the State Commission had allowed a provision of Rs. 85.25 crores which was about 14.45% higher than 2004-05 actual. As against this, the Appellant claimed Rs. 93.82 crores in the truing up petition towards R&M Expenses. As a matter of fact, the State Commission while approving the ARR for the year 2005-06, had sought detailed information and particulars regarding the physical and financial plan for R&M Expenses.

25. Unfortunately the Appellant could not provide the same in time. It is also noticed that the State Commission had also directed the Appellant to furnish a detailed function wise physical and financial Repair and Maintenance Programme for the year 2005-06. But the Appellant did not produce any material before the State Commission for justifying the increase in the Repair and

Maintenance Expenses. In the absence of the proper substance for increase in R&M Expenses, the State Commission could only allow the approved level of R&M Expenses for the year 2005-06. Of course the Appellant had given details of the R&M Expenses duly audited but the State Commission was unable to accept the said audited accounts, blindly in the absence of the relevant materials to be placed by the Appellant before the State Commission. In view of the above, the finding given on this head by the State Commission, cannot be said to be wrong. However, for future it would be desirable for the State Commission to determine the norms for R&M Expenses with appropriate escalation factors which is a better approach as scrutiny of actual R&M expenses for prudence check is cumbersome and approach based on norms will give correct commercial signal to the Electricity Board. Accordingly, we direct the State

Commission to decide the norms within a period of 6 months

Disallowance of the Employees Expenses.

26. According to Appellant, the State Commission has not allowed the actual Employees Expenses for the year 2005-06 which is Rs. 862.51 crores and it had restricted the employees cost to Rs. 853.55 crores. The Appellant in the truing up petition has claimed that the actual expenses towards employees cost is Rs. 862.51 crores as against the approved level of Rs. 845.51 crores. The increase in expenditure towards Salary and Dearness Allowance has been completely accepted by the State Commission. The Salary and DA to the tune of Rs. 435.55 crores was allowed as against the approved level of Rs. 359.36 crores. However, in the case of other allowances which is controllable, the State Commission has allowed only a sum

of Rs. 43.12 crores as against the claim of Rs. 52.08 crores. The other allowances which are not allowed was Overtime and Staff Welfare Expenses. The State Commission has held that the employees cost of the Appellant is already very high that the Appellant did not produce any material to substantiate the efforts taken to reduce such expenses. Therefore, the finding given by the State Commission on this head would not suffer from any infirmity.

Disallowance of Administrative and General Expenses.

27. According to Appellant, the State Commission has wrongly disallowed the actual Administrative and General Expenses by not allowing the amount of Rs. 63.26 crores towards electricity duty paid by the Appellant. The Appellant claimed the A&G Expenses of Rs. 113.84 crores, in the truing up petition, as against the approved ARR figure of Rs. 90.70 crores. Out of Rs. 113.84 crores Rs. 63.26 crores was on account of the electricity duty to be

paid to the Government under Section 3(1) of Kerala Electricity Duty Act which cannot be passed on to the consumers as held by this Tribunal in Appeal No. 94 of 2008.

28. The A&G Expenses other than electricity duty is Rs. 50.58 crores as against the approved cost of Rs. 33.21 crores. Regarding the increase in legal charges, conveyance and travel expenses, etc. the Appellant did not produce any material before the State Commission to substantiate the requirement of excess expenditure. In such circumstances the State Commission has allowed A&G Expenses other than electricity duty at the approved level only. As such, we do find any merit in the contention urged by the Appellant on this claim.

Disallowance of Interest and Finance Charges.

29. It is submitted by the Appellant with regard to this claim, that the State Commission wrongly disallowed Rs. 32.74 crores for interest on security deposits without considering the fact that the Appellant has been preparing the accounts as per the accrual basis and the interest accrued to be considered is actually disbursed for the year 2006-07.

30. The State Commission had approved Rs. 583.6 crores towards interest and financing charges in the ARR and ERC for the year 2005-06. As against this, the actual amount claimed by the Appellant is Rs. 565.82 crores, though the actual interest charges for outstanding liability was less than the figure of ARR.

31. The State Commission in the truing up maintained the interest charges for outstanding liabilities at the same figure of Rs. 463.99 crores as allowed in the ARR as against the actual of Rs. 451.44 crores. The other interest charges is Rs. 114.37 crores as against Rs. 119.61 crores approved in the ARR. Out of this, the items which are not in the control of the Appellant are allowed as per the actual of the trued up. The only item disallowed in the truing up is interest on security deposits. Even according to the Appellant through its reply dated 31.10.2008 to the State Commission the actual disbursement of interest as security deposit for the year 2005-06 was only Rs. 3.26 crores as against the approved amount of Rs. 35.40 crores. Therefore, the State Commission has rightly allowed the amount actually disbursed. As such these findings on this claim is perfectly justified.

Disallowance of Other Misc. Expenses.

32. According to Appellant, the State Commission has not allowed the provisions for Bad and Doubtful Debts by making erroneous judgment in curtailing the expenses from the Audited Accounts. It is further stated by the Appellant that it is not correct on the part of the State Commission to come to the wrong conclusion that once a provision has been made for Bad and Doubtful Debt, the Board will not have any incentive to collect the receivables in time and deduct the amount from the outstanding arrears.

33. The Appellant has claimed Rs. 460.03 crores as prior period expenses. Out of this amount, Rs. 173.14 crores is interest on belated payment of electricity duty. The State Commission has correctly concluded that this amount cannot be passed on to the consumers. It is also held that another amount of Rs. 28.73 crores towards interest

payable on security deposits as on 1.04.2004 cannot be allowed because the interest on security deposit is payable effective only from 01.04.2005.

34. As regards the other debits, the Appellant has claimed Rs. 132.29 crores as against Rs. 24.20 crores approved in the ARR. On the same account, the claim for the year 2004-05 was only Rs. 36.50 crores. The Appellant's claim for 2005-06 includes Rs. 129.56 crores on provisions for Bad and Doubtful Debts. The Appellant has stated that higher provisions for Bad and Doubtful Debts expenses are made based on the comments of Comptroller and Auditor General of India (CAG) in the previous year's report. It is clear from the above facts that the Appellant has provided unusually higher provisions of 10.36% without any explanation for such higher provision.

35. In all the previous years the provisions for Bad and Doubtful Debts was in the range of 1% to 1.8%. Therefore, the claim made by the Board for the year 2005-06 cannot be said to be reasonable. Moreover, the Appellant could not substantiate for higher claim.

36. The State Commission has taken a clear stand towards writing off the Bad Debts. Though the Appellant has stated that the higher provision is made as per CAG report, the same was not produced. In the truing up petition the Appellant has made substantially higher provisions under Bad and Doubtful Debts compared to previous years. As per the audit and accounts of the Board, the Appellant in the past has provided much less provisions as Bad Debts. For the year 2005-06 the Appellant has made provision of Rs. 121.56 crores as Bad Debt which is 9% of the total receivables against the sale of power. The Appellant has

not placed on record the specific purpose for keeping higher provision. Compared to the previous years provision of Rs. 26.86 crores the Appellant has provided Rs. 105.07 crores more for 2005-06 which is not reasonable. The Appellant could not convince the State Commission for making the higher claim through the materials. The rest of the claims of the Appellant under the said head admittedly had been allowed in the truing up petition. Therefore, there is no merit in this ground also.

Transmission and Distribution Loss

37. According to Appellant, in the process of truing up the State Commission has disallowed the actual Transmission and Distribution Loss of the Appellant whereas it has treated the differences between what was allowed and what has been achieved.

38. The State Commission had approved Transmission and Distribution Loss reduction to the tune of Rs.2.72% as proposed by the Appellant and fixed the target level of internal loss as 21.89%. In the truing up petition the Appellant has stated the actual loss reduction achieved is only 1.99% and the internal transmission and distribution losses is 22.96%. In the ARR petition for 2005-06 the Appellant proposed to a target loss level as 22.59% but the actual loss reported was 22.96% which was higher than that proposed by the Board.

39. According to the State Commission, the Appellant could not produce any material to substantiate for reasons for not achieving the loss reduction targets. Appellant merely stated in the two petitions that the loss reduction target could not be achieved due to failure for the replacement of Electro Mechanical Meters with Electronic

Meters. However, it is noticed by the State Commission that the performance of the Appellant on replacement of even faulty meters is tardy. Capital expenditure also could not be achieved to the targeted level. Considering of these factors, the State Commission decided that the underachievement of losses are to be adjusted at the average power purchase cost. It is also noticed from the Impugned Order, that the State Commission had considered the loss reduction achieved by the Board fixed transmission and distribution target for 2005-06 based on the actual loss level of 24.95% for 2004-05. Accordingly the loss target for 2005-06 was refixed as 22.23% instead of approved level of 21.89%. The additional energy purchased due to non achievement of transmission and distribution loss to the tune of 0.73% was deducted from the power purchase cost.

40. **Summary of the findings:**

(i) The main contention of the Appellant is that the State Commission has not accepted figures contained in the Audited Accounts. This point has already been decided by the Judgment of this Tribunal in Appeal No. 94 of 2008 as well as decision of the Hon'ble Supreme Court in West Bengal Electricity Regulatory Commission vs. C.E.S.C. Limited (2002)(8) SCC 715. The State Commission, while examining the account is not bound by the Audited accounts. The Commission has to allow only as much expenditure as pass through in tariff as is found to be prudent and necessary.

ii) Regarding Repair & Maintenance expenses, the Commission has allowed Rs. 85.25 crores against the Appellants' claims of Rs.93.82 crores in the truing up

petition. The State Commission had already allowed about 14.45% higher amount than the actuals for the financial year 2004-2005 in the ARR for the FY 2005-06. Unfortunately, the Appellant could not provide the data sought by the Commission to justify the increase beyond the expenditure already allowed in the ARR. In the absence of proper substance for increase in R&M expenses, the State Commission could only allow approved level of R&M expenses for the year 2005-2006 in the true-up of financials. In view of above, the findings given by the State Commission cannot be said to be wrong. However, for future the State Commission has been directed to determine the norms for R&M expenses with appropriate escalation factors within a period of six months as mentioned in para 25 of this Judgment.

iii) Regarding employees expenses, the State Commission has allowed Rs. 853.55 crores against the actual

employees' expenses of Rs. 862.51 crores. The State Commission has allowed expenses in all heads except over time and staff welfare expenses for the reason that the Appellant could not produce any material to substantiate the efforts taken to reduce such expenses. Therefore, the State Commission on this head would not suffer from any infirmity.

- iv) The State Commission has not allowed Rs. 63.26 crores of electricity duty to be paid to the Government under Section 3(1) of the Kerala Electricity Duty Act. This issue has already been decided by this Tribunal in Appeal No. 94 of 2008 in view of the provisions of the Kerala Electricity Duty Act, according to which electricity duty cannot be passed on to the consumers. Regarding disallowance of legal charges, conveyance charges and travel expenses, the Appellant could not produce any

material before the State Commission to substantiate the requirements of excess expenditure.

As such, we can not find fault with the decision of the State Commission.

- v) Regarding dis-allowance of interest and finance charges, the only item disallowed is the interest on security deposit. The State Commission has allowed interest on security deposit to the extent of actual disbursement for the year 2005-2006. As such this finding is also perfectly justified.
- vi) Regarding bad and doubtful debts, the Commission has observed that the Appellant has provided unusually high provisions without any explanation for such high provisions. The State Commission has also correctly held that interest on belated payment of electricity duty can not be passed on to the consumers. It is also held that another amount of

Rs. 28.73 crores towards interest payable on security deposit as on 1.4.2004 can not be allowed as the interest is payable effective only from 1.4.2005. Therefore, we do not find any fault with the decision of the State Commission in this regard.

vii) The Appellant also could not achieve the transmission and distribution loss targets set up by the State Commission. According to the State Commission, the Appellant could not produce any material to substantiate for not achieving the loss reduction target. Accordingly, we hold that the finding of the State Commission in this regard is also justified.

41. In view of our conclusions referred to above, the findings rendered by the State Commission on these heads in the Impugned Order are perfectly justified. Hence, there

is no merit in this Appeal. Consequently the same is dismissed. The State Commission is, however, directed to take action on the determination of norms for R&M expenses with suitable escalation factors according to para 25 of the judgment. No order as to costs.

(Rakesh Nath)
Technical Member

(Justice M. Karpaga Vinayagam)
Chairperson

Dated: 13.01.2011

REPORTABLE/NON REPORTABLE