

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

Appeal No. 115 of 2008

Dated : 28th May, 2009

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

IN THE MATTERS OF:

Reliance Infrastructure Ltd.
(formerly Reliance Energy Limited)
Reliance Energy Centre,
Santacruz (East),
Mumbai

... Appellant

Versus

- 1. The Maharashtra Electricity Regulatory Commission**
World Trade Centre No.1,
13th Floor, Cuffe Parade,
Colaba,
Mumbai – 400 001

- 2. Mumbai Grahak Panchayat**
Sant Dnyaneshwar Marg,
Vile Parle (W),
Mumbai – 400 056

3. Prayas

C/o Amrita Clinic,
Athawale Corner,
Karve Road,
Pune – 411 004

4. Thane Belapur Industries

Post: Ghansoli,
Navi Mumbai – 400 071

5. Vidarba Industries Association

Civil Lines,
Nagpur – 400 041

... Respondents

Counsel for the appellant : Ms. Anjali Chandurkar,
Ms. Smieetaa Inna
Mr. Shiv Kumar Suri

Counsel for the respondents: Mr. Buddy A. Ranganadhan for
Resp. No.1

J U D G M E N T

Justice Manju Goel, Judicial Member

The present appeal is directed against the order of the Maharashtra Electricity Regulatory commission (the Commission for short) dated 26th May, 2008, in Case No. 64 of 2007 in the matter of Reliance Infrastructure Limited's (formerly known as Reliance Energy Limited) transmission business, annual infrastructure revenue for the FY 2007-08 and tariff petition for FY 2008-09.

Facts:

2) The appellant, earlier known as Reliance Energy Limited, for its transmission of electricity business submitted an application for trueing up FY 2007, mid year review for FY 2008 and determination of tariff for FY 2009 on 30.11.07 which was registered as Case No. 64 of 2007. The impugned tariff order was passed on this application. The MERC computed the interest on working capital as 0.60 Crores for FY 2007. The MERC further held that for FY 2007 the normative rate of interest should be considered as 10.75% which was a Short Term Prime Lending rate for the State Bank of India as on the date of filing of the application. The Commission further found that the appellant had actually not incurred any interest as the working capital was met through internal funding. The Commission considered this amount of Rs.0.60 Crores as efficiency gain on the premise that there was no actual interest incurred by the appellant, also known as Rinfra-T. Further, the Commission allowed a sum of Rs.0.46 Crores as incentive available to the appellant on account of the appellant achieving the target availability in the transmission system higher than 98%. However, the Commission while considering the income tax liability of the appellant has excluded a sum of Rs.0.46 Crores.

3) The appellant has disputed in this appeal the Commission's decision to consider the interest on the working capital provided by

an internal source as efficiency gain and the decision to exclude the income tax payable on the incentive amounting to Rs.0.46 Crores.

4) The appellant contends that the source of funding for working capital has no relevance to the interest on such working capital which can be allowed to be recovered through tariff. The appellant contends that interest earned on internal funds deployed cannot be treated as efficiency gain.

5) It is contended by the appellant that it has been allowed Rs.0.45 Crores by way of incentive as per the Regulations and this amount is liable to be taxed and therefore the tax component of this amount should also have been allowed to be recovered. It is contended by the appellant that the benefit of better performance has been passed on to the consumers in terms of 1/3rd share of the efficiency gain and greater availability of transmission corridor and there is no rationale in not considering the income from transmission availability incentive for estimation of income tax liability.

6) The Commission has not filed any reply or written submission. We have heard the counsel for the appellant.

Decision with reasons:

7) The appellant claimed the incentive on account of availability greater than 98% in accordance with Commission's order dated 27th June, 2006 in Case No. 50 of 2005. The Commission computed the incentive on account of higher availability at Rs.0.45 Crores. However, the income tax liability on such incentive has been denied to the appellant. The relevant part of the impugned order reads as under:

“As regards tax on income arising out of transmission availability incentive, the Commission is of the view that the expenses incurred for achieving better performance (such as A&G, R&M, etc.) including higher transmission availability have already been allowed as pass through by the Commission and allowing tax on income arising out of better performance will put additional burden to consumers. Hence, the Commission has not considered the tax on income arising out of transmission availability incentive. ...”

8) The relevant provisions dealing with how income tax liability will be dealt with is available in Regulation 50.2. The relevant provision is as under:

“50.2 Income-tax

50.2.1 Income-tax on the income of the Transmission Business of the Transmission Licensee shall be allowed for inclusion in the aggregate revenue requirement:

50.2.2 The Transmission Licensee shall include an estimate of the income-tax liability of his Transmission Business along with the application for determination of tariff, based on the provisions of the Income-Tax Act, 1961:

Provided that any change in such income-tax liability on account of assessment under the Income-tax Act, 1961 shall be dealt with as being on account of uncontrollable factors:

Provided further that any change in such income-tax liability on account of changes in the provisions of the Income-Tax Act, 1961 shall be dealt with as being on account of uncontrollable factors:

Provided further that any change in such income-tax liability on account of change in income of the Transmission Licensee from the approved forecast shall be attributed to the same controllable or uncontrollable factors as have resulted in the change in income and shall be dealt with accordingly.” (emphasis added).”

9) It can be seen from the paragraph quoted above that the Commission has not relied upon any Regulation for denying the income tax liability as a pass through. So far as the question of income tax on the amount allowed as incentive is concerned, since income tax is payable on the amount there is no reason why the income tax liability should not be allowed to be recovered through the transmission tariff to be earned by the appellant. Accordingly, we have no hesitation to hold that the part of the incentive which is subjected to income tax shall pass through in tariff.

10) So far as the question of efficiency gain in employing internal sources is concerned, the view of the Commission is as under:

“3.4 Interest on working capital

As regards Interest on Working Capital, REL submitted that the interest rate has been considered at 10.25% as considered by the Commission in its Order dated October

3, 2006. Accordingly, REL estimated the revised Interest on Working Capital (IWC) considering the components considered in the Tariff Regulations, as Rs.0.74 Crore as against Rs. 0.08 Crore approved by the Commission. REL-T further submitted that the primary reason for increase is due to the increase in the allowable O&M expenses in accordance with the ATE Judgment. Further, REL-T submitted in its reply to additional queries raised by the Commission that REL had not availed any loan for the purpose, and has funded such working capital requirement through internal accruals. Hence, REL has not actually incurred any expenditure towards interest on working capital during FY 2006-07.

The Commission has estimated the normative working capital interest for FY 2006-07 in accordance with the Commission's Tariff Regulations and based on expenses approved in this Order after truing up. However, the Commission has computed the sharing of gains/losses on the difference between normative working capital interest and the actual working capital interest incurred, which in this case is zero, since this is a controllable parameter. Further, the Tariff Regulations stipulates that rate of interest on working capital shall be considered on

normative basis and shall be equal to the short-term Prime Lending Rate of State Bank of India as on the date on which the application for determination of tariff is made. As the short-term Prime Lending Rate of State Bank of India at the time when REL filed the Petition for tariff determination for FY 2006-07 was 10.75%, the Commission has considered the interest rate of 10.75% for estimating the normative interest on working capital, which works out to Rs.0.60 Crore.”

11. The Commission has directed that the interest on working capital be treated as efficiency gain and is required to be shared as per Regulation No. 19. The treatment given to the interest on working capital is as under:

“Interest on Working Capital

As discussed in the above paragraphs, the actual interest on working capital incurred by REL during FY 2006-07 is nil and the normative interest on working capital approved by the Commission considering other elements of expenses as approved after truing up, works out to Rs.0.60 Crore. As the actual expenditure under this head is zero, the Commission has considered the entire normative interest

on working capital as efficiency gains and has considered sharing of the same with the distribution licensees in the appropriate ratio, as discussed while sharing efficiency gains due to reduction in R&M expenses.”

12) It is submitted on behalf of the appellant that when working capital is funded through internal sources of the appellant, the internal funds also carry cost. It is further submitted that such funds employed elsewhere would have carried interest income.

13) The Commission observed that in actual fact no amount has been paid towards interest. Therefore, the entire interest on working capital granted as pass through in tariff has been treated as efficiency gain. It is true that internal funds also deserve interest in as much as the internal fund when employed as working capital loses the interest it could have earned by investment elsewhere. Further the licensee can never have any funds which has no cost. The internal accruals are not like some reserve which does not carry any cost. Internal accruals could have been inter corporate deposits, as suggested on behalf of the appellant. In that case the same would also carry the cost of interest. When the Commission observed that the REL had actually not incurred any expenditure towards interest on working capital it should have also considered if the internal accruals had to bear some costs themselves. The

Commission could have looked into the source of such internal accruals and the cost of generating such accruals. The cost of such accruals or funds could be less or more than the normative interest. In arriving at whether there was a gain or loss the Commission was required to take the total picture into consideration which the Commission has not done. It cannot be said that simply because internal accruals were used and there was no outflow of funds by way of interest on working capital and hence the entire interest on working capital was gain which could be shared as per Regulation No. 19. Accordingly, the claim of the appellant that it has wrongly been made to share the interest on working capital as per Regulation 19 has merit.

14) Accordingly, we allow the appeal with the following directions:
(a) The Commission shall allow as pass through the income tax liability on account of higher PLF incentive, (b) The Commission shall not treat the entire interest on working capital for the year in question as efficiency in gain

15) The Commission shall give effect to our judgment in the ensuing truing up and tariff order.

16) Pronounced in open court on this **28th day of May, 2009**.

(H. L. Bajaj)
Technical Member

(Justice Manju Goel)
Judicial Member