

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

Appeal No. 111 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,
Behind Cooper Hospital,
Vile Parle (W),
Mumbai – 400 056
- 3. Prayas**
C/o Amrita Clinic,
Athawale Corner, Karve Road,

Deccan Gymkhana
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 21st April, 2008, in Case No. 65 of 2007 in the matter Reliance Infrastructure Limited's (formerly known as Reliance Energy Limited) generation business, (also known as REL-G) annual performance review for the FY 2007-08 and tariff petition for the FY 2008-09. The Commission vide the impugned order assessed the annual revenue requirement and fixed the tariff under

section 61 and 62 of the Electricity Act, 2003. The appellant is aggrieved on account of the following counts:

- i) The Commission has held that any gain in net generation out of reduction in the auxiliary consumption is realized through extra sale by REL-G and any benefit of better auxiliary consumption would be treated in the truing up of revenue and not in the truing up of expenditure. Accordingly, the Commission has not allowed the efficiency gain on additional net generation available on account lower auxiliary consumption and has considered the revenue from sale of additional energy as efficiency gain. The appellant contends that lower auxiliary consumption is already factored in lower actual fuel cost and lower variable cost of generation is worked out for the entire net generation including the additional energy available on account of lower auxiliary consumption. The appellant contends that the Commission ought to have computed efficiency gains of entire net generation i.e. on entire energy sold by REL-G and should not have considered the entire revenue from such sale as efficiency gain.

- ii) The Commission has considered the entire interest on working capital as efficiency gain since working capital requirement of the appellant for the FY 2007 had been met through internal accrual and not through debt. The appellant contends that this would be contrary to clause 34.5(e) of MERC (Terms & Conditions of Tariff) Regulations 2005 which provides that the rate of interest on working capital shall be on normative basis and shall be equal to short term prime lending rate of State Bank of India. It is contended that irrespective of the source from which the working capital is obtained the Commission should have allowed interest and the same could not have been considered as efficiency gain.
- iii) The Commission has held that allowing income tax on change in income arising out of better performance and PLF incentive would be additional burden on the consumers and has not allowed the income tax on PLF incentive to be part of revenue requirement although the incentive itself has been taken as part of revenue. It is contended by the appellant that the incentive would lead to higher income tax liability for REL-G and the income tax

thereon should naturally be passed on to the consumers. In this connection it is also submitted that the benefit of better performance is passed on to the consumers in terms of cheaper power due to higher availability.

- iv) The Commission has disallowed expenses under sub-head of 'Contributions and Donations' under A&G expenses for the FY 2007. The appellant contends that the said amount was expended towards community development and social welfare (such as maintenance of schools and technical training of all local youth of Dahanu where REL-G generation plant is located), maintenance of parks, gardens, plantations and other horticultural activities (as part of green belt in marshy areas required as per MPCB guidelines) and other environmental management & monitoring activities which formed a very small portion of O&M expenses. The appellant disclosed that such expenses were allowed when claimed separately in previous years although for the year in question, since these expenditures have been clubbed with 'Contributions and Donations' they have been disallowed.

- v) While the Commission has accepted the wage revision provision for the FY 2007, the full impact of wage revision on employee expenses of FY 2008 and FY 2009 has not been allowed. The Commission has approved employee expenses for the FY 2008 and for the FY 2009 based on normative and inflationary rise over FY 2007 amount and ignored the fact that balance liability due to wage revision of FY 2007 is actually paid in 2008. Similarly, the Commission has not considered increased expenditure on account of terminal benefits such as Provident Fund, Gratuity and Superannuation on account of wage revision while the increased terminal benefits under the same settlement have been allowed for the FY 2007.
- vi) The Commission has considered only Rs.10 Crores per year towards R&M of Fuel Gas Desulphurization (FGD) plant under partial truing up of FY 2008 and for tariff determination for the FY 2009 whereas the Commission had approved Rs.16.96 Crores per year on previous occasions.

2) The Commission has not filed any response. We have heard the learned counsel for the appellant and have perused the written submissions.

Decision with reasons:

3) Efficiency gain on account of lower auxiliary consumption: Regulation 19.1 deals with sharing of gains and losses due to controllable factors. The gain in the present case has been caused by lower auxiliary consumption. The gain has to be shared in the manner prescribed in Regulation 19.1. One-third of the gain has to be passed on as rebate in tariff while one-third can be utilized at the discretion of the generating company. The remaining one-third has to be retained in a special reserve to meet future exigencies. The appellant computed the total efficiency gain at Rs.78.13 Crores. This was based on approved operational norms of heat rate and auxiliary consumption. The Commission, however, had the following to say on the appellant's claim for one-third of the gain out of controllable factors of reduced auxiliary consumption and better lower heat rate:

“... However, the Commission observes that REL has computed the efficiency gain based on net heat rate. If efficiency gain is computed on the basis of net heat rate, then the benefit of the better auxiliary consumption will get passed on twice as any gain in the net generation out of

the reduction in the auxiliary consumption is realized through the extra sales by REL-G. Therefore, the Commission has considered the efficiency gain on account of fuel cost on the basis of gross heat rate and any benefit out of the better auxiliary consumption would be treated in the truing up of the revenue and not in truing up of the expenditure. Further, the Commission has considered the sharing of gains in line with Tariff Regulations and has considered the sharing of gains as one third to be shared with the distribution licensee, i.e., REL-D, and two thirds of the gain to be retained by REL as against the REL submission of retaining one third of the gains as a special reserve for absorbing future losses.

The summary of the efficiency gain/loss as computed by REL and as approved by the Commission, due to variation in fuel cost, is shown in the Table below:

Table: Gain and loss due to variation in fuel cost as approved by the Commission (Rs. Crore)

Particulars	REL	Commission
Efficiency Gains	[REC_n – Act. Var cost] x Net Generation	Based on Gross SHR
<i>Efficiency Gains</i>	78.13	72.35
<i>To be passed on to Distribution Licensee (Consumers)</i>	26.04	24.12
<i>To be retained as reserve</i>	26.04	-
<i>To be retained by REL-G</i>	26.04	48.23

4) As per the Commission's calculations the total efficiency gains is only Rs.72.35 Crores and not Rs.78.13 Crores. According to the Commission, in case efficiency gain is calculated in the manner done by appellant, the appellant will get benefit of efficiency gain twice. The reason for so believing is the Commission's view that any gain in net generation out of reduced auxiliary consumption results in extra sales by REL-G. The Commission has considered the efficiency gain on account of fuel cost on the basis of gross heat rate and any benefit out of better auxiliary consumption to be treated in the truing up of revenue and not in the truing up of expenditure. The appellant, however, explains that the production is determined by demand and not by auxiliary consumption. The appellant claims that the better operational parameters have actually gone in reducing the cost of production rather than in increase in sales as the generation has been only to the extent needed to meet the demand plus the auxiliary consumption. It will not be correct to say that on account of reduced auxiliary consumption there has been increase in sale to the extent of reduced auxiliary consumption. In fact, auxiliary consumption is a part of cost. When auxiliary consumption is reduced the total amount to be produced is also reduced. A generating company is required to generate as much as is required to meet the demand of the purchaser. In case generating company has to sell more power it has to produce more power. The production does not increase on

account of lower auxiliary consumption. Only the need to produce is reduced to the extent the auxiliary consumption is reduced. Therefore, reduction in auxiliary consumption does not actually mean increase in the sale of electricity units produced. The benefits of the better operational parameters go to the consumer in the form of reduced cost of generation and as sharing of efficiency gain as per provisions of Regulation 19. To this extent we find merit in the appeal.

Treatment to interest on internal sources:

5) The appellant has employed internal sources to meet the demand for working capital. The Commission has not denied the interest on the working capital employed from internal sources. The Commission has treated such interest as efficiency gain so that one-third of such gain could be shared with the distribution company/the consumers. The Commission gave the following observations on this point:

“3.10 Interest on working capital

As regards the 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 Interest on Working Capital (IWC) considering interest rate @ 10.25% as per the

components considered in the Tariff Regulations, with the revised Interest on Working Capital estimated at Rs.17.13 Crore as against Rs.10.98 Crore approved by the Commission. REL-G further submitted that the primary reason for deviation is due to some elements of working capital, namely receivables for sale of electricity and payables for fuel, which are provided for in the Tariff Regulations, but were not considered by the Commission in its Order while estimating interest on working capital.

Further, REL-G has submitted in its reply to additional queries raised by the Commission that it has not availed any loan for working capital and has funded such working capital through internal accruals. Hence, REL has not actually incurred any expenditure towards interest on working capital during FY 2006-07.

Regulation 34.5 (d), of the Tariff Regulations stipulates as follows:

“In case of own generating stations, no amount shall be allowed towards receivables, to the extent of supply of power by the Generation Business to the Retail Supply Business, in the

computation of working capital in accordance with these Regulations”.

Accordingly, the Commission has not considered the receivables from sale of electricity, while estimating the interest on working capital.

The Commission has estimated the normative working capital interest for FY 2006-07 based on expenses approved in this Order after truing up and the Commission’s Tariff Regulations. However, the Commission has computed the sharing of gains/losses on the basis of 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.6.35 Crore.

“The Commission has estimated the normative working capital interest for FY 2006-07 based on expenses approved in this Order after truing up and the Commissions Regulations. However, the Commission has computed the sharing of gains/losses on the basis of 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.6.35 Crore.”

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3.15 Sharing of gains and losses in FY 2006-07

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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.6.37 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 fuel cost.”

6) 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.

7) 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.

Contributions and Donations:

8) Expenses mentioned as contributions and donations were incurred by the appellant towards community development, social

welfare and environmental activities. Environmental activities included brick making, maintaining green belt, maintaining parks, landscaping etc. the Commission on this aspect had the following to say:

“The Commission observed that the ‘contribution/donations’ sub-head under A&G expenses includes an expense of Rs.1.96 Crore as against the actual expenses of Rs. 0.02 Crore in FY 2005-06. The Commission asked REL to submit the basis and need for this expense, and also to provide the rationale for including this expense as recoverable from consumers. REL, in its reply, submitted that it incurred expenditure towards community development, social welfare and environmental activities such as maintenance of parks, plantation and maintenance of nursery and horticulture activities, environmental monitoring, etc.”...

The Commission is of the view that if the company or the shareholders of the company wish to contribute/donate towards charitable causes and community development, the same should be contributed from the return earned out of the business, rather than passed on to the Utility’s consumers. Hence, for truing up purposes for FY 2006-07,

the Commission has not considered the expense of Rs. 1.96 Crore”.

9) It is submitted on behalf of the appellant that in earlier years such expenditures were allowed whereas for the year in question such expenses clubbed under Contributions and Donations have been disallowed. It is explained by the appellant that Contributions and Donations were towards community development, social welfare and environmental activities such as brick making activities, maintenance of schools and technical training of local youths, environmental management activities including green belt programme in marshy areas around power station which includes parks, plantations, nursery and landscaping as per guidelines of Maharashtra Pollution Control Board (MPCB) and small gifts in the forms of prizes and mementoes in recognition of good performance. It is contended by the appellant that almost all the expenses falling under the heading Contributions and Donations have been incurred for statutory compliance. The consent to operate issued by MPCB for appellant's Dahanu thermal power station stipulates that a green belt with tree plantations shall be maintained up to 100 meters periphery of the station towards Dahanu and not less than 50 meters periphery on three sides. It is also contended that the appellant is required to comply with the direction regarding utilisation of the ash of the power station as per instructions contained in notification issued by Ministry of Environment &

Forest. The appellant has filed a copy of the Maharashtra Pollution Control Board's order consent No. BO/WPAE/Thane-68/CC/131 dated 23.03.04 under section 26 of the Water (Prevention & Control of pollution) Act 1974 & under section 21 of the Air (Prevention & Control of Pollution) Act, 1981 and under Rule 5 of the Hazardous Wastes (Management & Handling) Rules 1989 in respect of thermal power station at Dahanu. The order mentions the conditions for the permission which, *inter alia*, include utilisation of the ash and maintenance of a green belt on all the four sides of the power plant. If the appellant is statutorily required to carry out certain activities in order to run the power plant it will only be appropriate that the expenses towards such activities is allowed to be recovered. However, the entire expenses disallowed namely Rs.1.96 Crores is not incurred on account of such activities. The Commission has to identify those expenses which are incurred to meet statutory obligations and those incurred to voluntarily under take social welfare measures. The Commission is, thereafter, to allow as pass through the expenses incurred to meet statutory obligations.

10) The appellant has cited a judgment of this Tribunal in appeal No. 251 of 2006 relating to the tariff order for FY 2005-06 and 2006-07. However, that judgment has no reference to activities carried out to meet the norms for protection of environment or in respect of the activities related to community development and social welfare.

Income tax liabilities on incentives:

11) The appellant claimed an amount of Rs.22.79 Crores as PLF incentive for the FY 2006-07. The Commission permitted an amount of Rs.21.83 Crores as PLF incentive and considered the said amount as part of the revenue for FY 2007. However, coming to the income tax liability on the amount of incentive allowed the Commission had the following to say :

"As regards tax on income arising out of sharing of gains due to better performance and PLF incentive, the Commission is of the view that the expenses incurred for achieving better performance (such as A&G, R&M, etc.) including higher PLF has 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 sharing of gains due to better performance and PLF incentive income.

Based on above principles, the Commission has estimated the income tax of REL-G on stand alone basis by considering the income and expenses as per approved

*ARR after truing up for FY 2006-07, as Rs. 7.69 Crore.”
(pgs. 69-70)”*

12) As can be seen from the portion of the impugned order, quoted above, the Commission has disallowed the tax arising out of the better performance on the ground that the same would be an additional burden on the consumers. The Commission itself has not quoted any Regulation under which income tax on the incentive allowed can be denied to a generating company. The Regulation 34.2.1, of the MERC Tariff Regulations, which deals with income tax does not make any exception for the income arising out of incentive. Therefore, as per the Regulation the appellant is entitled to recover the income tax payable on the change in income on account of PLF incentive. Therefore, we find merit in the appellant's prayer for income tax on incentive to be given to it as a pass through.

13) The other two prayers related to employees expense and R&M of fuel gas de-sulphurization plant have not been pressed.

14) In view of our above discussion, we allow the appeal in part. The Commission will have to allow the claim of the appellant towards efficiency gain on account of lower auxiliary consumption, treatment of interest on internal sources, contributions and donations as well as income tax liabilities and incentives. So far as

prayers related to employees expenses and R&M of fuel gas de-sulphurization plant are concerned, the same are not pressed and hence rejected.

15. We allow the appeal in part with the following directions:

- a) The Commission will allow the claim of the appellant towards efficiency gain on account of better operational performance on the entire actual exbus energy sent out rather than on the basis of truing up of revenue
- b) The interest on working capital, for the year in question, shall not be treated as efficiency gain
- c) The income tax payable on the PLF incentive will be treated as pass through
- d) The Commission shall identify expenses which are incurred to meet statutory obligations and treat such expenditure included in the head 'contributions and donations' as pass through in tariff.

e) The claim of the appellant towards employees expenses and R&M on fuel de-sulphurization plant are rejected as not pressed.

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

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

(H. L. Bajaj)
Technical Member

(Justice Manju Goel)
Judicial Member