Before the Appellate Tribunal for Electricity
(Appellate Jurisdiction)

Appeal No. 24 of 2006

Dated the September 12, 2006.

Present: - Hon'ble Mr. Justice E. Padmanabhan, Judicial Member
Hon'ble Mr. H.L. Bajaj – Technical Member

Haryana Vidyut Prasaran Nigam Ltd. …..Appellant
Sector-5, Panchkula-134109(Haryana)

Versus

Haryana Electricity Regulatory Commission ……Respondent
SCO, 180, Sector-5, Panchkula-134109(Haryana)

For the Appellants : Mr. Neeraj Kumar Jain, Advocate
Mr. Sanjay Singh, Advocate
Mr. S.K. Aggarwal, CAO,HVPNL
Mr. Bharat Singh, Advocate

For the Respondents : Mr. Ashwani Talwar, Advocate
Mr. Rajesh Kumar Monga,
Law Officer

Judgment

This appeal is directed against the order dated August 12,2003 passed by the Haryana Electricity Regulatory Commission ('Commission') with regard to determination of Annual Revenue Requirement (ARR) for Transmission and Bulk Supply Business for FY 2003-04 and determination of Bulk Supply and Transmission Tariff.

2. The appellant has prayed for the following reliefs:

i) Allow the present appeal and set aside the order dated August 12, 2003 passed by the Commission.

ii) Any other order or direction which is deemed fit in the facts and circumstances of the case.

3. The facts of the case leading to this appeal are briefly given below:-

Appellant submitted application for approval of its Annual Revenue Requirement and fixing of Bulk Supply & Transmission Tariffs (ARR &BST) on December 31, 2001 for the financial year 2002-03 and on December 31, 2002 for the financial year 2003-04.

4. On January 25, 2002 the Commission issued a letter directing the appellant to file a revised Bulk Supply Tariff proposal based on its connected load of its distribution subsidiaries. In compliance of this letter of the Commission, the appellant filed the revised Bulk Supply Tariff application on February 9, 2002. On March 22, 2002 the Commission issued a deficiency letter directing the appellant to file the supplementary information within two weeks. The appellant filed additional information on April 9, 2002. Thereafter, the filing was treated as complete by the Commission.

5. In the mean time the Commission decided to proceed with the public hearing on the ARR and BST, inviting objections and suggestions. The Commission received written objections from four persons/organizations. The appellant filed its reply before the Commission to those objections and comments raised by four organizations.

6. The Commission conducted public hearings before the approval of ARR and determination of BST on May 27, 2002 and June 25, 2002, providing adequate opportunity to all persons concerned to put forward their views and objections on the filings made by the utility including the public, the staff of the Commission and the appellant. During public hearing held on May 27, 2002, the Commission sought certain additional information from the appellant, which was supplied on June 20, 2002. During public hearing held on June 25, 2002, the Commission again desired certain additional information from the appellant. The additional information desired by the Commission was filed on June 8, 2002. The hearing was concluded on

June 25, 2002 and orders were reserved. The Commission passed the orders on the ARR & BST on August 16, 2002.

7. It is represented by the appellant that as the Commission had not considered some of the points raised by the appellant, the appellant was constrained to prefer review petition to review the orders dated August 16, 2002 passed by the Commission.

On November 07, 2002 the Commission issued notice to the appellant for a hearing on the review petition. However, the hearing was postponed. Subsequently, a hearing on the review petition was again fixed for February 19, 2003, which was also postponed without assigning any reason.

8. On December 31, 2002 the appellant submitted application for an Annual Revenue Requirement for the financial year 2003-04. The Commission issued deficiency letter dated April 02, 2003 directing the appellant to file further information within 15 days. The appellant filed its reply along with additional documents on April 21, 2003.

9. The Commission issued public notice in newspaper widely circulated in the state of Haryana on May 18, 2003 inviting objections to ARR filed by the appellant, latest by May 30, 2003. Public hearing was held on July 08,2003. Order dated August 12, 2003 was delivered by the Commission with respect to Annual Revenue Requirement and Bulk Supply & Transmission Tariffs for financial year 2003-04 as well as on the Review Petition filed by the appellant in respect of the orders passed by the Commission on Annual Revenue Requirement and Bulk Supply & Transmission Tariffs for financial year 2002-03 for its transmission and bulk supply business.

10. Aggrieved by the impugned tariff order dated August 12,2003, the appellant preferred the First Appeal Order No. 5028 of 2003 before the High Court of Punjab and Haryana. The High Court vide by its order dated September 13, 2005 permitted

the appellant to withdraw the appeal with liberty to file the same before this Tribunal. Hence the present appeal.

11. In the Memorandum of appeal though a number of grounds have been raised the learned counsel confined himself during arguments to few of the points. Hence it is unnecessary to extract the grounds enumerated in the appeal Memorandum.

12. Arguments were advanced by the learned counsel for the parties. Written submissions were also made by both. The points that arise for consideration in this appeal are:

A. Whether the Commission acted erroneously and with illegality in not allowing the terminal benefits on actuarial basis?
B. Whether the disallowance of Working Capital Loans on the basis of Schedule VI of the Electricity (Supply) Act, 1948 is sustainable?
C. Whether the disallowance of interest on Provident Fund (PF) Bonds as claimed by the appellant is liable to be interfered?
D. Whether the Commission erred in law by its failure to make provision to compensate the appellant by providing increase in tariff for the period September 1,2003 to March 31, 2004?

Point 'A'

13. Learned Counsel for the appellant pleaded before us that the appellant is bound to make provisions, on accrual basis, under Accounting Standard-15, Accounting for Retirement Benefits in the Financial Statements of Employers towards terminal benefits, based on the valuation made by the actuary. It has been brought to our notice that the Accounting Standard (AS)- 15 came into effect in respect of accounting periods on and or after April 1, 1995 and it is mandatory in nature. It is pertinent to note, at this stage, that as per Black's Law Dictionary accrual accounting method means: an accounting method that records entries of debits and

credits when the liability arises, rather than when income or expenses received or disbursed.

14. The appellant in its ARR for financial year 2002-203 and 2003-04 has claimed terminal benefits expenses on accrual basis on the basis of valuation made by the actuary. However, Commission has allowed the terminal benefits expenses on the actual cash pay out basis.

15. The Commission has failed to appreciate that appellant is bound to make provision on accrual basis under Accounting Standard-15, towards terminal benefits based on the valuation made by the actuary. If this amount is not provided and invested by the appellant then it would not be able to discharge its liability towards terminal benefits to the former employees, who retire from service on attaining the age of superannuation.

16. Appellant further contended that the Commission has failed to appreciate that it had acted with illegality in dis-allowing the expenditure of terminal benefits. Once it had come to the conclusion that the Corpus is required to be created, linking it with the earning of profit is against all cannons of accountancy, financial management and prudent business practices. The Commission has failed to appreciate that it may not be possible to make contribution for all the previous years (for which no contribution was made due to adoption of method of cash pay out basis) when the appellant starts earning profits and these profits may not be sufficient for the purpose in question. If for the terminal benefits, the method of cash pay out is adopted, the present consumers will be charged less for consumption of electricity whereas the future consumers will have to pay more and bear a part of the burden that present consumer should have borne. This aspect has been lost sight by the Commission in its anxiety to reduce the allowable expenses and consequential revision of tariff, if any.

17. The Commission has failed to appreciate that the erstwhile HSEB was a statutory body constituted under The Electricity Supply Act, 1948 and was not required to maintain its accounts according to the provisions of The Companies Act, 1956. The appellant is a company constituted under Companies Act, 1956 and has to comply with the provisions of the said Act including so far as they relate to maintenance of accounts. Section 209 of the Companies Act, 1956 requires that the accounts of the Company shall be made on accrual basis. Sub Section (5) of Section 209 of the Companies Act, 1956, further provides that if any of the persons referred to in sub section (3) fail to take all reasonable steps to secure compliance by the Company of the requirement of this Section i.e. Section 209, or has by his own willful act been the cause of any default of the Company there-under, he shall, in respect of each offence be punishable with imprisonment for a term which may extend to six months or with fine which may extend to Rs. 10,000 or with both. If the pensionary contribution is booked at payout basis then a part of the liabilities will remain un-depicted in the books of accounts and the account of the company will not reflect a true and fair working of the company, which would be violative of Section 209 and Section 211 of Companies Act, 1956. The said provisions are mandatory.

18. Per contra the respondent Commission pleads that keeping in view the deficit position of the appellant, the Commission deferred it until the appellant is able to generate cash surplus. Allowing terminal benefits on the basis of actuarial valuation basis at this stage would lead to additional borrowings by the appellant and hence consumers will have to bear the burden of high interest expenses. Had the appellant been in an operational surplus, it would have been viable to create a corpus to discharge the future liability accruing for the current period as the appellant is not required to pay during the next year or even in near future.

19. Concedingly both appellant and respondent realize that a corpus is required to be created to pay terminal benefits payable on a future date. While we appreciate concern of the Commission regarding interest payment, we are convinced that once the Accounting Standards-15 are mandatory in nature and accounts are required to

be kept on accrual basis , there is no way in which the appellant can deviate from this basic accounting principle. In view of this position we answer this point in favour of the appellant and set aside the directions issued by the Commission in this regard.

Point 'B'

20. The issue lies in a narrow campus. The appellant contends that the Commission has allowed interest on working capital loan by computing the working capital requirements as per Schedule VI of Electricity (Supply) Act, 1948. It is contended that the Schedule VI neither defines working capital nor the method of computation of interest on working capital loan. Schedule VI, inter-alia, defines the method of computation of capital base for working out reasonable return. For the purpose of computation of capital base, certain elements of working capital like cash and bank balance, stores are included in capital base. It is further contended that only that part of working capital is included in the capital base, which is to be financed out of owner's equity and rest has to be financed out of working capital borrowings.

21. The appellant argued that the loans are financial commitments made by the appellant to the lender and once a loan is taken, it is ploughed into the business and cannot be withdrawn all of a sudden without drastically jeopardising the business of the Company. It is contended that the loan will continue to remain in business unless it is redeemed by the company either from profit/surplus earned from the business or by taking fresh loan. It is not possible to pay these loans in one go even if the appellant wants to do so. Disallowing interest on loan is like taking away carpet under the feet of the appellant. The Commission had approved the loans amounting to Rs. 2852.21 crore in the year 2001-02. This shows that the Commission had approved the loans to that extent. If no additional amount of loan is allowed even then the same amount of interest is required during the financial year 2002-03 and 2003-04 in order to service the loan already obtained upto the financial year 2001-02 and continue till they are re-paid back. Prudent commercial practice demands

tapering of working capital loan so that the small loan is paid back every year without drastically affecting the business of the Company.

22. The appellant contended that even the decision of the Commission regarding working capital loan was not an unanimous decision. One of the Members had dissented in this respect from the other members of the Commission. It will be pertinent to extract very contents of the dissenting note of one of the Members of the Commission, which reads as below:-

> *" The Commission in its previous order dated August 6,2001 had allowed the working capital amounting to Rs. 10442.3 million in addition to HVPNL Bonds to Pension Fund Trust amounting to Rs. 6730.00 Million and HVPNL Bonds to Provident Fund Trust amounting to Rs. 3791.80 Million as working capital related loans, whereas the Commission has now allowed only Rs. 3000 Million against licensee's projection of Rs. 16948.20 Million as loan for working capital. This reduction to Rs. 3000 Million is a drastic decision and it will affect the business of licensee adversely. The manner in which working capital has been calculated on the basis of Schedule VI of 'The Electricity (Supply) Act, 1948" does not seem to be correct as the VI th Schedule paragraph XVII is meant for defining of capital base which in turn is required for calculation of the reasonable return only. Disallowing the working capital loans on this basis is not justified.*
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> *Concern of the Commission about rising trend in working capital loans is genuine, but reducing the working capital amount so drastically in one go is not justified. Commission has allowed an arbitrary amount as working capital borrowing without any reasonable basis of its computation. We should not treat it as a matter of generosity in declaring any arbitrary amount as working capital allowed. Rather it should be based upon some analysis/assessment of prudent requirement of the licensee for its business. Commission should allow the working capital based upon some benchmarking*

in electricity industry besides keeping in mind the ground realities of the licensee that it inherited from erstwhile HSEB and its present state of affairs.

In view of the above I am of the opinion that working capital should be allowed equivalent to at least three month's amount of ARR of Transmission & Bulk Supply Business".

23. Per contra the respondent Commission held that the appellant has been excessively borrowing towards working capital. The increase in such borrowings has no correlation with the size of appellant's business operations, increase in borrowing is due to the appellant's poor financial management, lack of cost control and operational inefficiencies. The electricity consumers cannot be burdened with such huge interest cost of excessive borrowings made by the appellants. In their view the Commission allowed a reasonable interest cost that could be justifiably passed on to the electricity consumers.

24. The Respondent Commission further held that working capital is the most expensive short term borrowing and hence needs to be kept at the minimum level. Working capital is the difference in Current Assets and Current Liabilities (CA-CL). However, the nature of current assets and current liabilities needs to be managed i.e. the receivables needs to be managed in such a way that the gap between the two is kept at a minimum or optimum. Contrary to this financial cannon, the appellant either neglected to collect its dues or for some reasons not able to do so, thereby requiring huge working capital to discharge its current liabilities. This has to be avoided in the interest of the appellant by efficient financial management.

25. The respondent Commission further argued that it is bound by its Tariff Regulations to base its calculations as per Schedule VI of the Electricity (Supply) Act, 1948. It needs to be appreciated that working capital even if defined for the purpose of arriving at capital base as envisaged in Schedule VI to the Electricity (Supply) Act, does not change its nature. A part of it may be funded from owners equity and

the rest by the borrowings. Thus working capital envisaged as per the Schedule VI is valid for all purposes. It is wrong to interpret that the working capital as per Schedule VI only includes a part of the working capital that needs to be financed out of owner's equity and rest as borrowing. This interpretation is nothing distortion of financial principles wherein equity is deployed in assets and not used to fund short term borrowings. The working capital as envisaged in Schedule VI provides the correct parameters i.e. cash and bank balances, stores and spares etc. to determine the working capital requirement.

Here, it may be pertinent to understand the concept of working capital. According to "The Economies of Public Utility Regulations" by BARNES, a reputed author, working capital is defined as under:-

> *" Working capital consists of that capital above investments in fixed assets and intangible which is necessary for economical and satisfactory conduct of the enterprise. Working capital in the sense in which it is employed, does not include the total liquid funds with which the business is conducted. It is not the property business has: that is, it is not the excess of current assets over current liabilities"*

Cash in hand, bank balance, stores and materials are the principal components of working capital. The normal sources of working capital are: (a) investments and reinvestments that is, profit ploughed back into the concern; (b) credit facilities, including borrowings and (c) utilization of depreciation or other reserves. For the purposes of rate regulation only that portion of the working capital consisting of investments or profits ploughed back need be included in the capital base. Therefore we are inclined to agree with the appellant that para XVII (1)(e) represents only part of the working capital and not the entire working capital requirement.

We appreciate the anxiety and concern of the respondent Commission that the appellant should use their resources efficiently and through effective working and prudent management practices reduce their working capital requirements. However, the Commission having approved borrowings in the earlier years cannot expect the appellant to drastically reduce the interest element on the capital already borrowed till it is liquidated. Any drastic reduction of working capital at this stage will impair the working of the appellant. Taking into consideration of the entire matter though the Commission cannot be said to have faulted in its view, for the year in view the working capital requirement of the appellant is fixed to its average requirement of three months and for future years the working capital requirement of the appellant be fixed to its average two (2) months requirement. We shall not forget the fact that the appellant is in possession of funds collected as advance consumption charges for two months and cash flow of collections from consumers takes place on a day to day basis as per billing cycle. If the appellant manages its finances efficiently, there is no necessity for heavy requirements apart from the deposits available with it and day today collections.

Point 'C'

26. Learned Counsel for the appellant contended that the appellant is paying regular annual interest on the PF Bonds issued by HVPNL to PF Trust, being a deemed loan. As PF Trust is a separate entity, the appellant is required to pay interest to it on PF Bonds. The appellant contends that the respondent Commission cannot reduce the PF pay out from the PF Bond amount as PF Bond issued by the appellant to PF Trust is a deemed loan and still reflected in its books. The appellant is paying regular interest on these Bonds and will continue to do so till the PF Bonds are fully redeemed. We agree with the contention of the appellant and decide this point in its favour.

Point 'D'

27. The appellant contends that the new tariff for the FY 2003-04 came into effect from September 1, 2003, meaning thereby that the old tariff continue to apply between April, 2003 to August, 2003. The appellant has been allowed to recover revenue at an average tariff of Rs. 1.85 per unit from April, 2003 to August, 2003 and at an average tariff of Rs. 1.91 per unit from September, 2003 to March, 2004. Thus the appellant was not in a position to recover the net aggregate revenue requirement approved by the Commission due to under recovery of tariff by six paise per unit during the period April, 2003 to August, 2003. This would deny the appellant from legitimate claim of revenue to the extent of Rs. 454.82 million. It is brought to our notice that the Commission did not make any provision to compensate the appellant by way of increased tariff for the remaining period of the year from September, 1, 2003 so as to recover net aggregate revenue requirement for the whole year as approved by the Commission.

28. We find full justification and rationale in this contention of the appellant and, therefore, decide this point in its favour. We direct the Commission to compensate the appellant while undertaking truing up exercise and see that the shortage is made good, less the accumulated vast difference will have a heavy impact in the future years.

29. In the result on a consideration of the entire matter:

(i) The point 'A' is answered in favour of the appellant and the directions of the Commission is modified.

(ii) On point 'B' regarding allowing interest on working capital, for the two years in question the Commission shall allow interest by taking three months average requirement and for future the working capital of the appellant be fixed to its average two months requirements, till its finances improve.

(iii) We decide point 'C' and 'D'in favour of the appellant and the Commission is directed to compensate the appellant through the truing up exercise.

(iv) In respect of points (A), (B) & (C) and (D) the Commission shall give effect to the directions in the next truing up exercise.

30. The parties shall bear the respective costs.

Pronounced in the open court on the 12th day of September, 2006.

(Mr. H.L.Bajaj)	**(Mr. Justice E. Padmanabhan)**
Technical Member	**Judicial Member**

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No. of corrections