

**Before the Appellate Tribunal for Electricity**  
**APPELLATE JURISDICTION, NEW DELHI**

Appeal No. 38 of 2005, 39 of 2005, 122 of 2005 & 48 of 2006

Dated this 29<sup>th</sup> day of September, 2006

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

Appeal No. 38 of 2005 :

M/s. BSES Yamuna Power Ltd.

Shaktri Kiran Building

Karkardooma, New Delhi – 110 065

... Appellant

Versus

1.     The Delhi Electricity Regulatory Commission  
       Viniyamak Bhavan, C-Block, Shivalik  
       Malviya Nagar, New Delhi – 110 017

2.     Through Secretary (Power)  
       Department of Power, Delhi Secretariat  
       8<sup>th</sup> Level, B-Wing, I.P.Estate,  
       New Delhi – 110 001.

... Respondents

Appeal No. 39 of 2005 :

M/s. BSES Rajdhani Power Ltd.

BSES Bhavan, Nehru Place,

New Delhi

... Appellant

Versus

1.     The Delhi Electricity Regulatory Commission  
       Viniyamak Bhavan, C-Block, Shivalik  
       Malviya Nagar, New Delhi – 110 017

2.     Through Secretary (Power)  
       Department of Power, Delhi Secretariat  
       8<sup>th</sup> Level, B-Wing, I.P.Estate,  
       New Delhi – 110 001.

... Respondents

Appeal No. 122 of 2005 :

M/s North Delhi Power Ltd.  
Sub-Station Building, Hudson Lane,  
Kingsway Camp, Delhi – 110 017

... Appellant

Versus

1. The Delhi Electricity Regulatory Commission  
Viniyamak Bhavan, C-Block, Shivalik  
Malviya Nagar, New Delhi – 110 017
2. Govt. of NCT of Delhi  
Through Secretary (Power)  
Department of Power, Delhi Secretariat  
8<sup>th</sup> Level, B-Wing, I.P.Estate,  
New Delhi – 110 001.
3. M/s Tata Power Co. Ltd.  
Bombay House, 24 Homi Mody Street  
Fort, Mumbai – 400 001
4. M/s Delhi Power Co. Ltd.  
Shakti Sadan, Kotla Marg,  
New Delhi – 110 002.

... Respondents

Appeal No. 48 of 2006 :

M/s North Delhi Power Ltd.  
Sub-Station Building, Hudson Lane,  
Kingsway Camp, Delhi – 110 017

... Appellant

Versus

1. The Delhi Electricity Regulatory Commission  
Viniyamak Bhavan, C-Block, Shivalik  
Malviya Nagar, New Delhi – 110 017
2. Govt. of NCT of Delhi  
Through Secretary (Power)  
Department of Power, Delhi Secretariat  
8<sup>th</sup> Level, B-Wing, I.P.Estate,  
New Delhi – 110 001.
3. M/s Tata Power Co. Ltd.  
Bombay House, 24 Homi Mody Street  
Fort, Mumbai – 400 001

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4. M/s Delhi Power Co. Ltd.  
Shakti Sadan, Kotla Marg,  
New Delhi – 110 002.

... Respondents

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in all the appeals

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Dated : September, 2006

**FINDINGS SUBMITTED ON "RATE OF DEPRECIATION"**  
**AS PER DIRECTION OF HON'BLE SUPREME COURT**  
**IN CIVIL APPEAL NO. 2733 OF 2006**

1. These four appeals stand posted before this Appellate Tribunal for Electricity as per directions of the Hon'ble Supreme Court dated 23.08.06 passed in Civil Appeal No. 2733/06. The Hon'ble Supreme Court directed this Appellate

Tribunal to consider, examine whether the conclusions of the Commission are supportable in facts and in law, determine and indicate the same to the parties.

2. Before we proceed to examine whether the conclusions of the Commission are supportable in facts and in law, as directed by the Hon'ble Supreme Court, we may point out that the counsel appearing on either side have interpreted the directions differently, each one according to their reading and perception and on that premise submitted written arguments as well. In view of the different stand taken, we had to spend considerable time in hearing the matter, yet the counsel appearing in these batches of appeals persisted on their respective interpretation.
3. In our view, the Hon'ble Supreme Court has directed this Appellate Tribunal to consider the conclusions of the Commission as if they were good and sufficient for the purpose of making a departure from Schedule VI rates and we are called upon to examine whether the conclusion of the Commission is supportable in facts and in law. In other words it is our sincere endeavor to comply with the directions of the Hon'ble Supreme Court to examine, whether the conclusions of the Regulatory Commission are supportable in facts and in law?
4. It may not be necessary for us to refer to earlier interim orders/directions issued by Hon'ble Supreme Court, as is sought and contended by Mr. S. B. Upadhyay, Sr. Counsel appearing for Regulatory Commission before us. We deem it essential for us to consider and examine the point: Whether the conclusion of the Commission in fixing depreciation at 3.75% is sustainable in facts and in law? The material portions of the directions issued by Hon'ble Supreme Court reads thus : -

*“ .. we feel it would be appropriate for the Appellate Tribunal to consider the conclusion of the Commission as if they were good and sufficient for the purpose of making a departure from the Schedule VI rates./ ----- Without expressing any final opinion, we direct the Tribunal to examine whether the conclusions of the Commission are supportable in facts in law. ...”*

5. In the light of the said directions, as already referred to, the counsel appearing on either side made their submissions each one from a different perception and angle of the directions of the Hon'ble Supreme Court, apart from making written submissions.
6. On a consideration of the submissions and in the light of the above directions issued by Hon'ble Supreme Court we are bound to frame appropriate points for consideration and answer the same. The learned counsel for the appellant as well as contesting respondent referred to the earlier judgment of ours as well as statutory notifications, provisions, material portion of the orders of the first respondent Regulatory Commission, where according to them, reasons in support of the conclusion of the Commission get reflected. In the light of what has been argued before us and the directions of the Hon'ble Supreme Court we frame the following points for consideration:
  - A. Whether the conclusion of the commission in allowing depreciation at 3.75% is sustainable on facts and in law?
  - B. Whether the appellant/Discom in each one of the appeals has sustained their claim of depreciation at 6.69% in law and on facts?

Both points could be considered together conveniently.

7. It is pointed out that the first respondent, Regulatory Commission, by its order has just allowed depreciation at 3.75% on the assets of the respective Discoms. It is contended vehemently and in verbose that the appellants / Discoms shall not be denied depreciation as claimed by them viz. 6.69% and there is neither justification nor legality nor logic nor basis to deviate and fix depreciation at 3.75%. It is further contended for the appellants that the conclusion of the Commission are not sustainable in facts and in law. The counsel for appellants/Discoms further contended that onus lies on the Regulatory Commission to establish the reduction in depreciation to 3.75% is justifiable in fact and in law. Besides it is pointed out that it is for the Regulatory Commission to justify and sustain its conclusion on the reasons contained in the impugned order as well as review orders passed by the Regulatory Commission. In other words, the learned counsel for the appellant, sought to change the role of the Commission from that of quasi-judicial statutory functionary to that of litigating party in the present proceedings.
8. The learned counsel for the Regulatory Commission during hearing as well as in their written submissions, pointed out that there exist cogent reasons as reflected by the impugned order to deviate from the principles and rates notified by the Ministry of Power on 31.01.92 and as amended on 29.03.94 ,issued in terms of VI Schedule to The Electricity (Supply) Act, 1948. The question whether DERC could deviate and whether it had indicated reasons for such deviation from Schedule VI is the subject matter of pending appeal before the Hon'ble Supreme Court. However, while cautioning ourselves, we may add that there may be certain degree of over lapping, which, we may not be able to avoid as the points are not only interconnected but interwoven. Hence, we proceed to discuss with caution.
9. Mr. V. R. Reddy, Sr. Counsel and Mr. S. B. Upadhyay, Sr. Counsel who appeared for DERC in all the appeals made their submissions. The material

portion of the written submission submitted on behalf of the Regulatory Commission on 08.09.06 by Mr. S.B.Upadhyay reads thus :

*... It is significant to note that under the said order the Hon'ble Supreme Court took specific note of the earlier order dated 13.6.2006 permitting the process of determination to be continued by the Appellant Commission as directed by the Hon'ble Appellate Tribunal. Reference to the said earlier order is evidently intended to indicate that the said order remains unaltered by the subsequent order dated 23.8.2006. It is submitted that the observations of the Hon'ble Supreme Court in the order dated 23.8.2006 considered in the aforesaid background suggest that this Hon'ble tribunal is directed only to examine whether the conclusions of the Commission are supportable in facts and in law. There is thus no warrant for the inference that this Hon'ble Tribunal is expected / directed to examine the matter of determination of depreciation in-depth and render a finding, as any such construction of the Hon'ble Supreme Court's order would lead to an anomalous situation of both the Regulatory Commission and this Hon'ble Tribunal parallely carrying out an identical exercise."*

10. However, in the written submissions submitted on 11<sup>th</sup> Sept. '06, the counsel for the DERC has summarised his stand as under :

*"... This Hon'ble Tribunal by virtue of the said order dated 23<sup>rd</sup> August, 2006 of the Supreme Court had only to decide whether the conclusion reached by the Commission, whereby it has consciously decided to allow depreciation @ 3.75% is supportable in facts and in law without further undertaking the task of determining as to what would be the appropriate allowable percentage of depreciation. In support of their contention that the allowable percentage should in all events be 6.69%, the appellants have contended that the reasons for reducing*

*the percentage to 3.75% given by the Commission in its order dt. 26.06.2003 and the review order dtd. 25.11.2003 has no reasons at all in the eye of law.....”*

11. The appellants before us on their part submitted thus :

*“5. It is respectfully submitted that the Hon’ble Supreme Court without expressing any opinion on the merits has asked the Hon’ble Tribunal to*

*A. To consider the conclusion of the Commission as if they were good and sufficient for the purpose of departing from Schedule VI rates.*

*B. In this context, consider in the present proceedings as to whether the conclusion of DERC of reducing the depreciation rate from 6.69% to 3.75% was justified in matrix of facts and law that apply to the said conclusions after considering all the contentions raised or to be raised by the parties on the question of depreciation.*

*6. The Appellants submit that the onus lies on the DERC to establish to the satisfaction of this Hon’ble Tribunal that the reduction in the depreciation rate from 6.69% to 3.75% is justifiable in fact and in law. DERC has to justify its conclusions based on the reasoning contained in its Impugned Tariff Orders as also in the Impugned Review Orders in the case of NDPL, and satisfy this Hon’ble Tribunal, inter alia that:*

*a. There exists cogent reasoning in the various Impugned Orders (as applicable to each of the respective Appellants) for DERC to deviate from the then applicable rate of depreciation of 6.69% derived from the principles and the rates specified by the Ministry of Power’s Notification dated 31.01.1992 as amended on 29.03.1994, issued*



*under the 6<sup>th</sup> Schedule to the Electricity Supply Act, 1948 ('Ministry of Power Notification'), which reasons justify the departure to supplant the said rate by a new rate of 3.75%."*

12. Now let us refer to statutory provisions. Section 28 of The Delhi Electricity Reform Act 2000, provides for "Licensee's, Revenues and Tariff". Sub-Section (2) of the Section 28 enables the Commission to prescribe the terms and conditions for the determination of licensees, revenues and tariff by regulations and in doing so the commission shall be guided by parameters enumerated in Clauses (a) (b) and (c) in proviso to sub-Section (2) of Section 28. Sub-section (7) of Section 28 mandates that any tariff implemented under Section 28 shall be just and reasonable, and be such as to promote economic efficiency in the supply and consumption of electricity and satisfy all other relevant provisions of the Act and conditions of relevant license.
13. Sub Section (3) of Section 63 of the DERA Act ordains that the provisions, of the said Act shall prevail in the manner and to the extent provided therein and the provisions of The Indian Electricity Act 1910 and The Electricity (Supply) Act 1948 in so far as the National Capital Territory of Delhi is concerned, shall be read subject to the modifications and reservations enumerated in Sub-section (3) of Section 63. With respect to specific provisions of the supply Act, to the extent the DER Act has made specific provisions, the provisions of the Electricity (Supply) Act shall not apply in the NCT of Delhi.
14. In terms of Section 28 (2) proviso the commission shall be guided by the financial principles and their application provided in the Sixth schedule to the Electricity (Supply Act) read with Section 57 and 57 (A) of the said act. There is no gain in saying that the financial principles and their application in the VI Schedule are mere guidance alone and that they need not be followed or implemented with respect to the three Discoms. We may refer to the

impugned order of DERC and refer the reasons which weighed with DERC in support of its conclusions and we shall examine whether such reasons are valid reasons in law and on facts? Now let us refer to reasons which could be culled out from the order of DERC or which finds reflected as pointed out by the counsel for DERC. We shall analyse the reasons which weighed with the commission in fixing the rate of depreciation in the case on hand.

15. The reasons, which the DERC has assigned in support of its conclusion in fixing depreciation at 3.75% as pointed out by the learned counsel for the commission are;

(a) depreciation is an important element of fixed costs; (b) depreciation is built into tariff computation with a view to provide a source of funding to repay installments of debt capital; (c) when once the loan is repaid the excess depreciation charged by the utility is adjusted against the depreciation in future, by not allowing depreciation till such time the normal cumulative depreciation matches the actual cumulative depreciation charged; (d) the discom has not taken any loan in the FY 2002-03 and there is no incidence of loan repayment; (e) unutilized depreciation is a means to finance capital investment; (f) fair life of line and cable network of distribution is 25 years as per notification of Ministry of Power and the average depreciation works out to 3.60%; (g) reduction in depreciation will not affect the utilities operations as all legitimate and prudent expenditure is being considered for the purpose of determination of ARR; (h) depreciation is to be utilized for meeting working capital requirement in the order of priority namely; i) Loan repayment, if any ii) Capital investment iii) Working capital requirement and (i) from a regulatory perspective, depreciation is a small amount of the original cost of capital asset, built into the tariff computation to provide a source of funding to repay installment of debt capital.

16. As against the above eight aspects highlighted by the Regulator which find place in the tariff order as well as in the review order in these batch of appeals, the grounds advanced on behalf of the three discoms in support of their claim are;

(i) as a Company registered under the Companies Act, the Discom has to allow and provide for depreciation in its books of accounts as per the norms prescribed in terms of Section 205 (1) read with Section 350 of the Companies Act and Central Government notification (MOP); (ii) the Ministry of Power in its Notification specified the depreciation rate for the different categories of accessories and has not prescribed for charging depreciation based on the useful life of the assets; (iii) in the BST order issued on 22.2.2002, DERC has provided depreciation at 6.69% without reference to the computation based on the useful life of the assets; (iv) Para 17 of the Policy direction provides for issuance of a tariff order of the distribution licensees will facilitate investors to have a full idea of the various elements in the fixation of the tariffs, hence it is necessary for DERC to issue orders, on par with bulk supply tariff; (v) tariff element covered in the BST order, which received approval prior to invitation of bids for privatization, included both revenue and expenditure items and based upon which the investors submitted their bids as it is an assurance and representations contained in the policy direction and the BST order; (vi) the Ministry of Power notification has specified a straight line method of depreciation at an annual rate of 7.84% for lines and cable network which have a fair life of 25 years; (vii) the methodology adopted for calculating depreciation on the basis of fair life of the assets is not only contrary to the BST order and policy directions, but also inconsistent with the Ministry of Power notification on depreciation; and (viii) there is no change in the circumstances or grounds warranting departure from the principles adopted in the BST order.

17. Before analyzing the reasons advanced by either side, let us consider what is depreciation? How it operates and accounted for?
18. Incidentally, we would like to point out that the expression “ Depreciation” is being assigned different meaning and different connotation by each one of the parties. Hence it is required to analyze what is depreciation? The expression ‘depreciation’ means a decrease in value of property through wear, deterioration or obsolescence. Depreciation is allowable as a deduction both according to accountancy principles and according to the Indian Income Tax Act. Depreciation represents the diminution in value, of a capital assets, when applied to the purpose of making profit or gain.
19. It is settled law that the appellant like any other generator or distribution Company should carry on its activities viably depreciating and on sound economic principles that provide for the purpose of the utility. Being a distribution utility it may not be driven by pure profit motive alone but at the same time it must maintain its affairs on sound economic principles and a reasonable return. In this respect it is relevant to refer to earlier pronouncement of the Hon’ble Supreme Court in Kerala Electricity Regulatory Commission V/s Govind Prabhu and Bros. reported in (1986) 4 SCC 198. Where the Hon’ble Supreme Court held thus:

*“The State Electricity Board is a public utility monopoly undertaking which may not be driven by pure profit motive- not that profit is to be shunned but that service and not profit should inform its actions. It is not the function of the Board to so manage its affairs as to earn the maximum profit; even as a private corporate body may be inspired to earn huge profits with a view to paying large dividends to its shareholders. But it does not follow that the Board may not and need not earn profits for the purpose of performing its duties and discharging its obligations under the statute. It stands to common*

*sense that the Board must manage its affairs on sound economic principles. Having ventured into the field of commerce, no public service undertaking can afford to say it will ignore business principles which are as essential to public service undertakings as to commercial ventures. If the Board borrows sums either from the government or from other sources or by the issue of debentures and bonds, surely the Board must of necessity make provision year after year for the payment of interest on the loans taken by it and for the repayment of the capital amounts of the loans. If the Board is unable to pay interest in any year for want of sufficient revenue receipts, the Board must make provision for payment of such arrears of interest in succeeding years. The Board is not expected to run on a bare year-to-year survival basis. It must have its feet firmly planted on the earth. It must be able to pay the interest on the loans taken by it; it must be able to discharge its debts; it must be able to give efficient and economic service; it must be able to continue the due performance of its services by providing for depreciation etc; it must provide for the expansion of its services, for no one can pretend the country is already well supplied with electricity. Sufficient surplus has to be generated for this purpose. Either the character of Electricity Board as a public utility undertaking or the provisions of the Electricity (Supply) Act will preclude the Board from managing its affairs on sound commercial line though not with a profit-thirst. The principles of efficiency and economy are, therefore, not forsaken but resolutely emphasized. However, pure profit motive, unjustifiable according to us even in the case of a private trading concern, can never be the sole guiding factor in the case of a public enterprise."*

20. In Orissa State Electricity Board V/s IPI Steel 1995, Vol. IV SCC 320 it was held by their Lordships that provisions have to be made for depreciation of machinery, equipment, buildings, plants and machines, stations and

transmission lines. In Pilibhit Electricity Supply Co. Special Officer 1996 (11) SCC page 288 the Hon'ble Supreme Court laid down the method of computing depreciation and calculation of such depreciation on the concerned assets has to be done in accordance with Sixth Schedule in the Electricity (Supply) Act 1948. In this respect of Hon'ble Supreme Court observed thus:

*“Only the method of calculation of depreciation has to be applied by way of reference to the Sixth Schedule. But the type of asset for which depreciation has to be computed is not to be gathered from the Sixth Schedule”.*

21. Straight line depreciation spreads the depreciable value evenly over the useful life of an asset. Depreciation does not generate cash. Depreciation simply allocates the original cost of an asset to the periods in which the asset is used, nothing more and nothing less. Accumulated depreciation is summation of the amounts of the original cost already written off to expenses in prior periods. Thus even the accumulated depreciation is not a pile of cash waiting to be used.
  
22. Fixed assets normally valued at cost, less depreciation. Depreciation is provided on assets having a limited life, and it is a measure of the wear and tear and loss in value due to obsolescence . Depreciation is a part of the cost of the assets charged as an expense for the period. Depreciation for a period is, thus shown as an expense in the Profit & Loss Account and is deducted from value of the assets in the balance sheet. At the risk of repetition, we point out that the expression “depreciation” means a deduction in respect of an outgoing which is not an item of actual expenditure or is one which cannot be treated as an outgoing of a revenue nature. In terms of Schedule VI depreciation is one of the expenditures properly incurred, such expenditures may have a reflection on “Clear Profit”.

23. Depreciation is a measure of wear and tear and loss in value due to obsolescence. Depreciation is a process of allocation, not of valuation. Depreciation relates both to the use of the assets and time. In the words of the Supreme Court the expression "depreciation" means a deduction in respect of an outgoing which is not an item of actual expenditure or is one which cannot be treated as an outgoing of a revenue nature- permitted to be deducted in the computation of the profits and gains of business. ( See AIR 1991 SC 1322. 1991 (2) SCC 684).
24. Depreciation among others serves the following purposes, which include:
- i) Arriving at the cost of the product and quoting price on the basis of the costs. So depreciation is shown as an expense in income statement and is a "charge" on profit.
  - ii) Showing the assets in the balance sheet at their true value. Accordingly depreciation deducted, from the cost of the assets in the balance sheet, so as to reveal the true financial health of organization.
  - iii) To work for the replacement and renewal of assets.
25. To put it differently, Depreciation is a process of allocation of cost. Depreciation is not a source of funds. Funds are generated by sales of power and not by depreciation, which is an expenditure properly incurred in terms of Schedule VI.
26. Professor Dr. Nand Dhameja, Indian Institute of Public Administration, New Delhi in his book " Finance and Accounting for Managerial Competitiveness" (1998 edition reprint) with respect to "Depreciation" has expressed as under:

### **“Depreciation as a Source of Funds:**

Depreciation sometimes, is viewed as a source of funds and is provided to create funds for the replacement of the assets. This is not a correct viewpoint. No doubt a number of companies follow the Depreciation Fund Method or other methods for the replacement of assets, but depreciation does not provide funds, it is sales which provide funds.

### **“Statement about Depreciation”**

| Sl. No. | Wrong Statement   | Correct Statement   |
|---------|---|---|
| 1.      | Depreciation fails to consider the factor of obsolescence.                        | The useful life of the asset takes into consideration the rate of obsolescence as well as the rate of physical deterioration. |
| 2.      | The primary function of depreciation is to provide for the replacement of assets. | The primary function of depreciation is to spread the cost of an asset over its useful life.                                  |
| 3.      | Depreciation is process of valuation  | Depreciation is a process of location of cost.  |
| 4.      | Reserve (or allowances) for depreciation is reservoir of cash resources           | Reserve (or allowance) for depreciation is merely an asset valuation account.   |
| 5.      | Depreciation is a source of funds.  | Funds are generated by sales, not by accruing depreciation  |

In the leading book “ Economics” by LIPSEY & CHRYSAL (Tenth Edition) published by Oxford University Press, the said authors have summarized thus on the element of depreciation:

*“ Firms are in business to make profits. They earn income by making and selling good and services, but they must pay all their costs of production. The cost of labour includes wages, pension contributions, and other payments that must be made whenever labour is employed. In addition to the wage bill, firms have also to pay the cost of interest*



*on debts, the cost of goods and services bought from other firms, and the cost of any rented inputs such as land and buildings. Firms must also impute costs for using their own capital equipment such as buildings, machinery, and office equipment. This cost, which is called **depreciation**, is correctly measured by the reduction in the value of the assets that will occur if firms use them over the period in question. After deducting all these costs, the remainder is what firms call their profits. This is the return on their owners' capital. Some of this may be distributed to the share-holders in the form of dividends while the rest is retained for reinvestment. If the investments are sound, the value of the firm increases and this adds to the owners' capital."*

27. Before proceeding further we have to mention as to " what working capital means"? The excess of current assets over current liabilities is known as working capital. This distinction has been obviously lost sight by DERC. It is a settled law that the provisions of the VI Schedule to The Electricity Supply Act 1948, were evolved for special purpose, as has been held by the Supreme Court in Ahemedabad Miscellaneous Industrial Workers Union Vs. Ahemadabad Electricity Company Ltd. AIR 1962 SC.1255. That apart to encourage utilities, accelerated depreciation has been notified by the Government of India, with an avowed object to encourage investment in power sector.

28. Now let us refer to Section 28 (2) of The DER Act, which is the live wire of the present issue, and the basic criteria for the scheme of privatization, reads thus:

*"(2) The Commission shall, subject to the provisions of Sub-section (3), be entitled to prescribe the terms and conditions for the determination of the licensee's revenues and tariffs for regulations duly*

*published in the Official Gazette and in such other manner as the Commission considers appropriate:*

*Provided that in doing so, the Commission shall be guided by the following parameters, namely:-*

*(a) the financial principles and their application provided in the Sixth Schedule to the Electricity (Supply) Act 1948 (54 of 1948) read with, Section 57 and 57A of the said Act;"*

29. Section 28 (7) (b) provides that any tariff implemented " shall be just and reasonable and be such as to promote economic efficiency in the supply.....  
A conjoint reading of the above provisions, would mean that the commission shall adopt such financial principles as provided in the Sixth Schedule to Electricity Supply Act 1948 read with Sec. 57 and 57A of the said Act, apart from, the tariff promoting economic efficiency in the supply etc. The scope and purport of Section 28 requires to be noted. Sub-section (3) reads thus:

*"(3) Where the Commission departs from the factors specified in the Sixth Schedule of the Electricity (Supply) Act, 1948 (54 of 1948) while determining the licensee's revenues and tariffs, it shall record the reasons therefore in writing."*

30. The above is an enabling provision, which enables the Regulatory Commission to depart from the factors specified in the Sixth Schedule while determining the revenues and it shall record reasons therefor. It is rightly pointed out that Schedule VI contains very many factors. The commission may depart from all or any of the factors which find a place in Schedule VI. In respect of the factor " Depreciation" such deviation is suggested by the DERC. But it is not clear from the tariff order as to which of the other factors the commission has chosen to depart. There is total non application of mind which is fatal blow to the approach of the Commission. Be that so, we shall

now examine whether the reasons sought to be suggested by the commission for fixing the rate of depreciation at 3.75%, is legally sustainable.

31. The Electricity Supply Act 1948 Schedule VI para XVII defines various terms for the purposes of the said VI Schedule. Para XVII (2) defines clear profit as:

*(2) "clear profit" means:*

*The difference between the amount of income and the sum of expenditure plus specific appropriations made up in each case as follows:*

*(a) income derived from-*

*(i) gross receipts from sale of energy, less discounts applicable thereby;*

*(ii) rental of meters and other apparatus hired to consumers;*

*(iii) sale and repair of lamps and apparatus;*

*(iv) rents, less outgoings not otherwise provided for;*

*(v) transfer fees;*

*(vi) investments, fixed and call deposits, and bank balances;*

*(vii) other general receipts accountable in the assessment of Indian income-tax and arising from the ancillary or incidental to the business of electricity supply;"*

(2) (b) enumerates the expenditure properly incurred on generation, distribution interest on loans, etc. including "depreciation" as set out in the schedule.

"(b) (Expenditure properly incurred on)

(i) generation and purchase of energy

x x

(x) depreciation computed as (hereinbefore ) set out;

xx xx xx xx xx xx xx xx

32. We shall now proceed to examine the reasons which weighed with the commission. First of them, being "depreciation is an important element of fixed cost". Fixed cost shall not be denied and it has to be allowed in terms

of Schedule VI. Hence partial disallowance is an obvious misconception and conceptual error. Depreciation is an allowable expenditure under Schedule VI as well as under the Indian Companies Act 1956 and Income Tax Act. Taking up the next reason i.e. "Depreciation is built into tariff computation with a view to provide source of funding to repay installments of debt capital". We are to point out that depreciation is a measure of the wear and tear and loss in value due to obsolescence. It is a process of allocation and not of valuation. It is not a cash flow nor depreciation is a source of funds. Hence, it is a misconception to assume that depreciation is built into tariff with a view to provide a source of funding to repay installments of debt capital. A glance of Schedule VI and Section 29 of DER Act renders such an approach fallacious.

33. Nextly, it is mentioned that when once the loan is repaid the excess depreciation charged by the utility is adjusted against the depreciation in future, but not allowing depreciation till such time the normal cumulative depreciation matches the actual cumulative depreciation charged." In this respect, it is to be pointed out that depreciation could be charged and adjusted in future years. But depreciation if not provided for a year, it could be carried over. Even this will not be a source of fund to repay loan. As stated supra, depreciation, is a deduction in respect of outgoing, which is not an item of actual expenditure. Depreciation is a process of allocation of cost and not a source of funds. Depreciation is a part of the cost of the assets charged as an expense for the period.
34. Taking up next reason i.e. as the discom has not taken any loan in the F.Y. 2002-03, there is no incidence of loan payment. This reason is a clear misreading of Schedule VI, besides being erroneous. It is true that the discom has not taken any loan in the F.Y. 2002-03. This does not mean that depreciation could be denied. We have already pointed out that depreciation is not a source of income and it is a deduction in respect of outgoing which is

not an item of actual expenditure, and it is a part of profit and it is also part of the assets charged resulting in deduction in respect of outgoing, which is not an item of actual expenditure or one which cannot be treated as outgoing revenue in nature. The approach of the Commission as reflected by the reason i.e. "the unutilized depreciation is a means to finance capital investment", has been casually suggested without understanding what depreciation is for and with what object the depreciation has been provided for by the legislature to an utility. Again it has to be pointed out that depreciation does not generate cash and it simply allocates the original cost of an asset to the periods in which the asset is used. Even the accumulated depreciation is not a pile of cash awaiting utilization either towards discharge of loan liability nor it could be utilized as working capital nor cash is available in the hands of utility as imagined by the Regulator.

35. Nextly, we may also point out that the approach of the Commission that reduction in depreciation will not affect the operation, is incorrect and fallacious one. The depreciation is one of the allowable expenditure and if the rate of depreciation is slashed down the same will disable the discom from sourcing replacement of one or other of the equipment/machinery/distribution system which requires replacement. It is nothing but an assumption to suggest that all the legitimate and prudent expenditure have been allowed for the purpose of ARR. The commission has proceeded on the misconception that depreciation is to be utilized for meeting working capital requirement as well as loan repayment, capital investment etc. This again is a fallacious reasoning without proper understanding the concept of depreciation or its purpose or object behind allowance of depreciation as an authorized expenditure properly incurred. As already pointed out depreciation is neither a cash-flow nor is it available in cash for being utilized to discharge the loan repayment or to make capital investment or use it towards working capital requirement. We have already referred supra as to what is working capital means.

36. It is a misconception to assume and to proceed that depreciation can be utilized for any one of the three purposes viz (i) Loan repayment (ii) capital investment and (iii) working capital requirement as sought to be suggested by the Regulatory Commission. Further reasoning that depreciation is built into tariff computation only to provide the source of funding to repay installments of debt capital, is again a conceptual error without comprehension as to what depreciation is, and how it is reflected into ARR.
37. Taking up methodology adopted for calculating the rate of depreciation, we hasten to point out that the commission proceeded on the reasoning that the average fair life of the lines and cable network of distribution system, which are the major items of equipment/machinery, is 25 years and therefore the average depreciation works out to 3.6.0%. This is nothing but misreading of the Notification issued by the Ministry of Power. In fact accelerated depreciation has been allowed to encourage and enable the utility to replace old and worn-out equipment, to arrange loan from bank or PFC to purchase new machinery or equipment for replacement.
38. In terms of the Notification dt. 29/3/94, for transformers depreciation at 7.81% is allowed, switchgear including cable connection depreciation at 7.84% is provided, Overhead lines on fabricated steel operating at nominal voltage higher than 66 kV, 5.27% depreciation is provided, for lines on fabricated steel operating at nominal voltage higher than 13.2 kV but not exceeding 66 kV, depreciation at 7.84% is provided ; for lines on steel or reinforced concrete support depreciation at 7.84% is provided; for underground cable including joint boxes and disconnected boxes 5.27% depreciation is provided etc. These rates of depreciation as per Notification has to be allowed as an authorized expenditure on a straight line method. It is not as if depreciation has to be worked out by division of fair life value by

the rate of depreciation notified after deducting the residual life. Such an approach is an apparent error.

39. The above said depreciation rates are to be calculated on a straight-line method as seen from column IV of the Notification issued by Ministry of Power. The 29<sup>th</sup> March, 1994 Notification is an amendment to the 31<sup>st</sup> January, 1992 Notification of Ministry of Power. A note has been appended by the Ministry of Power, to the said Notification, which the Commission has lost sight. The said note makes all the difference. The note reads thus:

“ The reference to the straight line method in this notification is intended to differentiate the same from the reducing balance method and not for derivation of rates from the fair life of the assets and the residual value”. The Notification has provided for accelerated depreciation with a view to ensure replacement of equipments and to encourage entrepreneurs”.

40. The approach of the DERC that depreciation has to be fixed by taking the fair life of the asset less the residual value, and it has to be divided by the rate of depreciation set out in the notification and the same works out to 3.60%, is a mis-reading of the notification . The percentage of the depreciation is specified for each item of equipment and that alone has to be adopted to work out depreciation on straight line method. The average depreciation as per the notification of the Ministry of Power works out around 7% with respect to various equipment/ lines/cables/transformers etc. This would mean that the claim of depreciation at 6.69% by the discom is fair and reasonable and the conclusion of the commission in allowing 3.75% towards depreciation is an apparent error and misconception.

41. Now let us refer to the reasons assigned on behalf of the utilities to sustain their claim of depreciation at 6.69% per annum. The foremost being the BST

order should have been followed even with respect to depreciation in terms of the policy guidelines. There is force in this contention advanced on behalf of the discoms. Reasons (v), (vi), (vii), (viii) and (ix) referred on behalf of the discoms deserve to be sustained and we do not find any reason or justification to deny depreciation which the discom is entitled to in terms of the notification. There is no reason to deny depreciation at the rate of 6.69% claimed by the discom as it is an allowable expenditure in terms of Schedule VI and there is no valid reason to deviate from BST tariff.

42. Policy direction which are binding are relevant and the same should not have been lost sight . The following policy directions were rightly and heavily relied upon by Discom:

“(i) While generally the incentive to be allowed to the licensee (including additional incentives by deviating from the principles laid down in the Sixth Schedule (Supply Act, 1948), should be determined by the Commission on an annual basis, the Government is of the considered view that in the larger public interest and to effectively achieve the proposed disinvestment and privatization, it is necessary to impart certainty to the incentives payable over a specified period and to make these incentives attractive as a part of the transfer arrangements, in order to ensure successful disinvestment. In the absence of such a certainty it may not be possible to attract private sector participation in the distribution of electricity.

(ii) From the date of issuance of these directions till the end of 2006-07 and subject to provisions of paras 11 and 12 above and all expenses that shall be permitted by the Commission, tariff shall be determined such that the distribution licensees earn, at least, 16% return on the issued and paid up capital and free reserves (excluding consumer contribution and revaluation reserves but including share



premium and retained profits outstanding at the end of any particular year.

(iii) Issuance of a tariff order of the distribution licensees will facilitate investors to have a full idea of the various elements (revenue, expenses) in the fixation of the tariffs. It is necessary for the Commission to issue order(s) determining the bulk supply tariff applicable to each of the three DISCOMS for purchase of electricity from TRANSCO. Such a tariff order for the DISCOM may be issued before bidding. However, in order to ensure that the time gap between corporatisation and privatization is minimal, the Transfer Scheme shall be made effective as close to the date of privatization as possible. Thus the Commission may issue the tariff order on the basis of the notified (but not effective) Transfer Scheme and in accordance with the provisions of these policy directions."

43. The above policy directions of NCTD which are binding on discom and commission have been lost sight by the Regulatory Commission. The strong reliance placed on these binding policy directions have been ignored by the Regulatory Commission.
44. Further on behalf of discom, it is rightly pointed out that the Commission has accepted the weighted average depreciation rate proposed for GENCO and the same is generally in line with the said Ministry of Power Notification. Further, the weighted average depreciation rate has been approved by the Commission vide its earlier Tariff Order, namely for the entire DVB i.e. for generation, transmission & distribution put together. The Commission has, therefore, reworked the depreciation rates for TRANSCO and each of the DISCOMS to match the overall weighted average depreciation rate of 6.83% for the total gross fixed assets of all the successor entities (entire DVB). The

depreciation rate for TRANSCO and DISCOMS, thus, worked out to 6.69% and tariff was determined on that basis.

45. The Commission had issued the BST order, prior to inviting bids for privatization on February 22, 2002. The tariff elements covered in the BST order included both, revenue and expense items, viz. depreciation, taxes, and return on equity. The investors submitted their bids and eventually invested money on the basis of assurance and representations contained in the policy directions and the BST order. The BST Order used a weighted average depreciation rate of 6.69% deriving the same from the Ministry of Power (MoP) notification issued in 1994. The MoP notification has specified a straight-line method of depreciation at an annual rate of 7.84% for lines and cable network which have a fair life of 25 years. The methodology adopted to calculate depreciation on the basis of the fair life of the assets is not only contrary to the BST Order and Policy Directions, but also inconsistent with the statutory notification on depreciation issued by Government of India..
46. The Utility has submitted that the BST order indicated that the depreciation rates would be modified based on the original cost of fixed assets as recorded in the Fixed Asset Register (FAR), which the petitioner was directed to submit to the Commission by June 30, 2002, and the petitioner had duly complied with the directive and provided the details to the Commission. The utilities are justified in contending that the Commission has ignored a material piece of evidence in the form of FAR details provided to the Commission.
47. The Regulatory Commission proceeds as if, the entire assets of the DISCOM are only lines and cables while the very transfer scheme under which assets stand transferred in favour of each DISCOM are not only distribution assets but also general and other assets. The distribution assets as found in the gazette Notification could be broadly summarized as under:-

### **“Distribution Assets**

All the 66 kv and 33 kv grid substations along with the associated 66 kv and 33 kv transmission lines, 11 kv and LT lines, on different types of supports with various sizes of conductors and step up/step down transformers, breakers protective and metering devices and control rooms, testing laboratories, right of the way, building, roads, diesel generating sets or other conventional and non-conventional generating units, service connections and installations inside consumer premises, street lighting and signal system owned by or maintained by the board on behalf of the Municipal Corporation of Delhi and other Government agencies but excluding fittings, fixtures and installations owned by private persons or local authorities and excluding in particular the 66kv and 33kv lines emanating from the 40kv and 220 kv substations as well as Generation Undertaking feeding the NDMC and MES areas of supply.

### **General Assets/liabilities are:-**

Special tools and equipments, material handling equipment, earth movers, bulldozers, concrete mixtures, cranes, trailers, heavy and light vehicles, furniture, fixtures, office equipments, air-conditioners, refrigerators, computers and signal systems, spares, consumables, raw-materials, civil work installations including roads, buildings, schools, dispensaries, testing laboratories and equipment, training centers, workshops, work in progress, machineries, and equipment sent for repairs, scrap and obsolete materials.”

48. Apart from the above, there are other assets and moveable properties including plant and machinery, motor car, jeeps, trucks, cranes, trailers and other vehicles, furniture, fixtures, air-conditioners, computers, etc., to the extent, they are utilized and operated by or associated with the distribution assets and general assets.

49. In the light of the above categories of assets, DISCOM is entitled to depreciation as allowable expenditure at various rates as prescribed by notification dated 29<sup>th</sup> March, 1994 issued by Ministry of Power. We are only referring to the rates of depreciation. The Rate of 3.75% arrived at, is not in accordance with the Ministry of Power Notification.

|  | Description of Assets   | Revised           |                              |
|--|---|-------------------|------------------------------|
|  |   | Fair Life (years) | Depreciation (Straight Line) |
|  | Transformers  | 25                | 7.81                         |
|  | Switchgear including cable connections  | 25                | 7.84                         |
|  | Batteries   | 5                 | 33.40                        |
|  | Underground cable including joint boxes and disconnected boxes  | 25                | 5.27                         |
|  | Overhead lines/lines on fabricated steel operating at nominal voltages higher than 66 kV                          | 35                | 5.27                         |
|  | Lines on fabricated steel operating at nominal voltages higher than 13.2 kilovolts but not exceeding 66 kilovolts | 25                | 7.84                         |
|  | Lines on steel or reinforced concrete supports  | 25                | 7.84                         |
|  | Meters  | 15                | 12.77                        |
|  | Self propelled vehicles   | 5                 | 33.40                        |
|  | Air-conditioning plants   |                   |                              |
|  | Static  | 15                | 12.77                        |
|  | Office furniture and fittings   | 15                | 12.77                        |
|  | Internal wiring including fittings and apparatus  | 15                | 12.77                        |

These are the rates of depreciation notified by the Ministry of Power and on an average for the items of equipment/machinery or assets depreciation works out around 7% P.A.

50. The commission proceeded as if the asset value ( less residual value) is to be divided by the fair life of the asset to arrive at the rate of depreciation. The commission, despite the fact that Government of India, Ministry of Power Notification by a note clarified that " The reference to the straight line method in the notification is intended to differentiate the same from reducing method and not for derivation of rates from the fair life of the asset and the residual value", opted to work out the rate of depreciation by dividing the asset value (less residual value) by the fair life. This misreading resulted in the Commission assuming that the rate of depreciation is only 3.75 per cent. The Government in its wisdom, and in exercise of statutory power, has allowed accelerated rate of depreciation, so as to attract investment and also to enable the DISCOM to fund for the purchase of equipment to replace the defunct or obsolete one.

51. The Commission also lost sight of the following clauses in the Ministry of Power Notification:-

"The Central Government, after consultation with the Central Electricity Authority, hereby specified that a licensee shall provide for depreciation in its annual statement of accounts commencing on 1<sup>st</sup> April, 1994, such sum as may be calculated in accordance with the straight line method of depreciation in respect of assets indicated in column at the rates indicated in columns of the schedule annexed.

(i) When any asset has been written down in the books of the undertaking to ten per cent or less of its original cost, no further depreciation shall be allowed in respect of that asset.

(ii) No arrears of depreciation for previous years shall be charged in any statement of accounts of a subsequent year.

**Note:-** The reference to the straight line method in this notification is intended to differentiate the same from the reducing balance method and not for derivation of rates from the fair life of the asset and the residual value."

52. On a consideration of the notification as well as the details of the equipment as reflected by the transfer of the assets in favour of the DISCOM, the rate of depreciation definitely works out at an average of 6.69 per cent as claimed by the appellant and there is no doubt even assuming that fixed assets register is not traceable or not available, the same will not in any manner could be used as reason to reduce the rate of depreciation. In fact, we have already given an opportunity to the DISCOM, as directed in our judgment to produce fixed assets register, which shall be examined by the Commission while undertaking truing up exercise. The counsel for the DISCOM rightly pointed out that for the BST tariff depreciation has been allowed at a particular rate for identical equipment and there is no reason to treat the DISCOM differently.
53. The conclusion of the Commission for reducing the rates of depreciation cannot be sustained as the Discom is entitled to depreciation as prescribed in the Schedule VI read with Government Notification and there is no reason to deviate from the BST tariff or from the tariff determined for the earlier period. Depreciation being an allowable expenditure cannot be denied unless in terms of Section 28(2) of The Delhi Electricity Reforms Act, 2000 a deviation is conscientiously made for reasons recorded in that behalf.
54. The policy directions issued by the Delhi Government is binding on the Commission in terms of statutory provisions of DERA Act, 2000. The first five

year period being transitory, the policy directions ought to have been enforced by the Regulatory Commission. The contention that the provisions of The Electricity Act, 2003 will govern and the provisions of DERA Act, 2000 has to give way to the Electricity Act, 2003 cannot be sustained. Such a contention, if accepted will run counter to Section 185 of The Electricity Act, 2003 as DERA Act, 2000 which is included in the Schedule has also received ascent of the President apart from being it is saved. The provisions of the DERA Act, 2000 shall apply to Delhi since there is no inconsistency between The Electricity Act, 2003 and DERA Act, 2000. The above contention advanced to the contra by Mr. S.B. Upadhyay, learned counsel for the Commission cannot be sustained. That apart Schedule VI to the Electricity (Supply) Act, 1948 has been specifically referred to and provided for in the DERA Act, 2000. Hence, it is not open to Mr. Upadhyay to contend to the contra.

55. The contention advanced with respect to policy directions of the Government of NCTD and giving a narrow meaning to the policy directions by Mr. Upadhyay is not acceptable to us. It is not only the return of the 16% ROE which Discom is entitled to apart from its entitlement for depreciation as may be allowed in terms of Schedule VI viz. 6.69%. It is true that the policy directions of NCTD has not specifically indicated 6.69% depreciation but it has indicated that depreciation shall be at the same level as has been allowed for BST tariff. In other words BST tariff has been shown as a parameter for the Discom at least during the transitory period of five years. Allowance of 16% ROE is distinct and separate from allowable depreciation of 6.69% claimed by the Discom in terms of Schedule VI. In other words after deducting the allowable expenditure alone, 16% ROE has been provided for to the Discom.

56. The interpretation placed by Mr. Upadhyay on the notification issued by Government of India with respect to rate of depreciation and the methodology suggested by the learned counsel is a misdirection and cannot be sustained. The interpretation placed on the Govt. of India notification and the further contention

that the Discom is entitled to only 3.75% of depreciation is a clear misconception and misreading. The reasons which, according to Mr. Upadhyay, prevailed with the Regulatory Commission in fixing depreciation at 3.75%, as already discussed above cannot be sustained. Whether there is a loan to be discharged or not, depreciation being allowable expenditure, which a Discom is entitled to. It is not correct to contend that the bulk of the fixed assets of the Discom are line or cable works alone. We have already extracted the items of equipments/machinery which were transferred in favour of the Discom under the transfer scheme. As is seen from Government of India Notification, the Discom is entitled to accelerated depreciation and there is no ground to deny depreciation as claimed by the Discom.

57. In our earlier judgment we have issued directions to enable the Discom to prepare the Fixed Assets Registers and submit the same for prudent check by the Commission. This was only with a view to afford an opportunity to the Discom to establish the fixed assets which each one of them is holding. We were informed during the hearing that the Discoms have already updated the Fixed Assets Registers with reference to crucial date and submitted the same before the Regulatory Commission and the exercise as directed in this behalf is in progress. Therefore, merely because FAR is not available it is no ground to deny depreciation, one of the allowable expenditure in terms of Schedule VI. For the earlier year the Commission directed the methodology of estimating depreciation by applying weighted average depreciation rate to total fixed assets. The Commission has also adopted the weighted average depreciation rate with respect to GENCO as well as its earlier tariff order for the entire DVB including generation, transmission and distribution put together.

58. The depreciation that was allowed by the Commission with respect to Transco as well as GENCO works out to 6.69% and there is no reason to treat the Discom differently. The depreciation norms and rates as fixed by the Government of India



is an allowable expenditure, which the Discom is entitled to and it works out to 6.69%. The assets owned by the Discom are of a nature whose depreciation rate range between 5.87% and 7.84% as set out in Col. 5 of 1994 Ministry of Power Notification. The fair life of assets as seen from the MOP Notification is not at all linked to and shall not be used to derive the depreciation rate as contended by the counsel for the Commission before us. The notification enable the Discom to claim the accelerated rate of depreciation, which alone would enable the utility to meet its high capex and opex requirements.

59. The rate of depreciation at 3.75% fixed by the Commission, at the risk of repetition, we point out is a misdirection and misreading of the Notification issued under Schedule VI of The Electricity Act, 1948. The contention advanced by the Discom with respect to claim of 6.69% of depreciation also will fall in line with Sections 205, 209, 211, 616 (c) of The Indian Companies Act, 1956 read with Schedule VI of The Electricity Act, 1948 and 61 of The Electricity Act, 2003.
60. Thus gleaned from any angle, we hold on Point A that the denial of depreciation to utility at 6.69% is not sustainable either in law or in facts and on Point B the allowance of depreciation at 3.75% by the Commission in our view is not sustainable as it runs counter to the statutory notification as well as statutory provisions of the Delhi Electricity Reforms Act, 2000 Policy Direction of the NCT Delhi and The Electricity Act, 2003 read with Schedule VI of The Electricity (Supply) Act, 1948.

Dated this 29<sup>th</sup> day September, 2006.

(Mr. H.L. Bajaj)  
Technical Member

(Mr. Justice E. Padmanabhan)  
Judicial Member

**Directions to the Registrar:**

We direct the Registrar of this Appellate Tribunal;

- (i) to further submit this findings to the Hon'ble Supreme Court in Civil Appeal No. 2733 of 2006
- (ii) to furnish copy of this findings to the appellant and respondents in the four appeals.