

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

Appeal No. 12 of 2009

Dated 25th January, 2011

**Present: Hon'ble Mr. Rakesh Nath, Technical Member
Hon'ble Mr. Justice P.S. Datta, Judicial Member**

In the matter of:

Himachal Pradesh State Electricity Board,
Vidyut Bhawan,
Shimla-171 004.

... Appellant

Versus

1. Himachal Pradesh Electricity Regulatory Commission,
Keonthal Commercial Complex, Khalini
Shimla-171 002
2. Sh. Gautam Nath Thakur,
President, Manali Hoteliers' Association,
The Mall, Manali-175131,
Distt. Kullu, Himachal Pradesh.
3. Sh. Jagannath Sharma,
The President,
The Kullu Hotels & Guest Houses Association,
Hotel Naman, Akhara Bazar,
Kullu, Distt. Kullu, Himachal Pradesh-175 101.
4. Sh. Rakesh Kumar Sharma,
GACL Colony, Unit Himachal,
PO Darlaghat, Tehsil Arki,
Distt. Solan, Himachal Pradesh-173 208.

5. Sh. Satish Mehta,
M/s. Auro Spinning Mills,
P.B. No. 7, Sai Road, Baddi,
Teh. Nalagarh, Distt. Solan, H.P. -173 205.
6. Sh. Ashok Singla,
Director,
M/s. H.M. Steels Ltd.,
Trilokpur Road, Village Johron,
Kala Amb, Distt. Sirmaur, HP-173004.
7. M/s. Sri Rama Steels Ltd.,
Village Bated, Baddi Road,
Barotiwala, Distt. Solan, HP-174103
8. M/s. J.B. Steels Rolling Mills,
Distt. Sirmour, Himachal Pradesh-173 001
9. Sh. S.K. Kala,
Manager Electrical and Instrumentation,
ACC Gagagl Cement Works,
PO Barmana, Distt. Bilaspur, HP-174013.
10. Sh. Rakesh Bansal,
(For CII, PIA & BBNIA, KACCI),
House No. 110, Sector-12,
Panchkulla, Haryana-134109.
11. Sh. D.C. Katoch,
President,
Hotel Association, Chamunda Devi,
C/o Hoel Sadar, Kangra Valley,
Distt. Kangra (H.P.)-176 052.
12. Er. P.N. Bhardwaj,
Consumer Representative,
Residence at ARCADIA,
P.O. Dharampur, Distt. Solan,
H.P.-173209.

Counsel for Appellant(s) : Mr. M.G. Ramachandran,
Mr. Anand K. Ganesan,
Ms. Swapna Seshdari &
Ms. Ranjitha Ramachandran

Counsel for the Respondent(s): Mr. Achintya Dwivedi &
Ms. Shikha Ohri

JUDGMENT

PER HON'BLE MR. RAKESH NATH, TECHNICAL MEMBER

This appeal has been filed by Himachal Pradesh State Electricity Board against the order dated 30th May, 2008 passed by Himachal Pradesh Electricity Regulatory Commission by which the State Commission has determined the Annual Revenue Requirements and tariff of the Appellant for the Multi Year Tariff period 2008-09 to 2010-11.

2. The Appellant is the Electricity Board responsible for generation, transmission and distribution of electricity in the State of Himachal Pradesh. The State Commission is the Respondent. In the impugned order the State Commission

did not allow some costs. Aggrieved with the State Commission's order the Appellant has filed this Appeal.

3. Various issues had been raised by the Appellant in the Appeal. However, during the hearing, in view of the truing up proceedings conducted by the State Commission subsequent to passing of the impugned order, the Appellant has restricted the present Appeal to the following issues:

- a) Interest & Finance Charges – Disallowance of equity for the projects of the Appellant.
- b) Power purchase cost payable for Baspa Hydro Electric Project.
- c) Employees cost.
- d) Disallowance of Pension and Gratuity Fund.
- e) Working Capital Requirements of the Appellant.
- f) Capital cost for the Larji and Khauli projects.

H.P. State Electricity Board (Appellant)

4. The learned counsel for the Appellant in support of his case has submitted the following on the various costs not allowed to the Appellant in the impugned order:

i) **Interest & Finance Charges – Disallowance of equity for the projects of the Appellant.**

The State Commission has not allowed any equity for the hydro projects of the Appellant for the Multi Year Period. The State Commission has not considered any equity in the old projects; and for the new projects also the State Commission has considered 100% debt with no equity contribution. The only reason given by the State Commission for the above is that the old projects of the Appellant have been funded based on 100% debt and the same practice is being continued for the future. Old projects were generally funded through Government funds and the Government

being 100% share holder of the Appellant, the funding was generally through equity. Further, in terms of the Regulations framed by the State Commission, the normative debt: equity ratio to be considered is 70:30 and, therefore, the Appellant is entitled to 30% of the capital cost to be considered as equity.

ii) **Power Purchase cost payable for Baspa Hydro Electric Project:**

Baspa Hydro Electric Project is a generating station established by an Independent Power Producer (IPP) in the State of Himachal Pradesh. The power from Baspa Project is supplied to the Appellant at the tariff regulated by the State Commission. The capital base for the purpose of tariff for Baspa Project was determined by the State Commission by order dated 24.2.2007 to be applied for the period 2003-04 onwards. The State

Commission earlier directed that the arrears from 2003-04 onwards be paid over a period of 7 years to avoid tariff shock. However, by the order dated 7.2.2008 passed in the review petition, the State Commission directed the entire arrears to be paid by the Appellant within the first three months of the tariff year 2008-09. However, the State Commission by the impugned order directed the recovery of the same by the Appellant in the retail tariff over a period of 6 years by creating a regulatory asset to avoid tariff shock. This is wrong. Also, the State Commission while creating a regulatory asset has only applied an interest rate of 10% which is not representative of the prevailing market rate of interest. Even the long term interest rate approved by the State Commission in the impugned order is 10.25%. The Appellant ought not be put to a loss on this account.

iii) **Employees Cost**

The State Commission has not taken into account the impact of the Sixth Pay Commission recommendations on the ground that the implementation of the recommendation is likely to take time and may go beyond the control period of the tariff order. However, according to the Appellant, the Sixth Pay Commission recommendations have now been implemented. The Appellant has craved leave to approach the State Commission with requisite material for truing up of the employees cost.

iv) **Disallowance of Pension and Gratuity Fund**

The Appellant had proposed creation of a Pension & Gratuity Fund for the terminal benefit liabilities for the Appellant's employees. In the absence of the fund, the Appellant has been paying the

terminal benefit liabilities and including the same in the revenue requirements from year to year basis. Creation of Pension & Gratuity Fund being more efficient manner of managing the terminal benefits should have been allowed by the State Commission.

v) **Working Capital Requirements of the Appellant**

The State Commission while determining the working capital requirements of the Appellant has reduced the power purchase expenses of the Appellant by one month in line with the provisions of the Tariff Regulations framed by the State Commission. According to the Appellant, power purchase expenses are paid within one week of the bills being raised and consequently, the Appellant does not enjoy the cash for the month. The State Commission ought to have considered

the submissions of the Appellant and relaxed the Regulations to the extent.

vi) **Capital cost for Larji and Khauli Project:**

The State Commission has determined the provisional capital cost and tariff for Larji and Khauli Projects of the Appellant for want of various particulars. Subsequently, the Appellant has provided the requisite details and data for the capital cost determination. The petition for determination of the capital cost is pending before the State Commission. In view of this, the Appellant has not sought to press the capital cost determination in the impugned order, without prejudice to its rights in the capital cost determination exercise pending before the State Commission.

State Commission (Respondent-1)

5. The learned counsel for the State Commission argued in support of the order of the State Commission.

Findings

6. On the basis of the contentions made by the parties, the following questions would arise:

- i) Is the State Commission correct to assume 100% debt financing and not allowing any return on equity in respect of the existing power projects of the Appellant?
- ii) Is the State Commission correct in directing the recovery of arrears for Baspa Hydro Electric Project by the Appellant over a period of six years by creating a regulatory asset? Even if the regulatory asset has been created whether the State Commission was correct in not allowing the

prevailing market rate of interest on such regulatory asset?

- iii) Whether the State Commission was correct in not considering the impact of the Sixth Pay Commission recommendations on the employees cost?
- iv) Whether the State Commission is right in not creating a Pension and Gratuity Fund for the terminal benefit liabilities of the Appellant?
- v) Whether the State Commission should have considered the submissions of the Appellant and relaxed the Regulations to the extent of reducing the power purchase expenses of one month for calculating the working capital requirements of the Appellant?

7. The first issue is apportionment of the capital cost into debt and equity. According to the learned counsel for the Appellant, the Electricity Board is entitled to 30% of the capital cost to be considered as equity in terms of the Regulations framed by the State Commission.

8. We have examined the impugned order. We find that the State Commission for determining the ARR and tariff of the generation business has divided the hydro power stations owned by the Appellant into two categories, Group-I, comprising of stations that were commissioned pre-1990 and Group-II that were commissioned post-1990. The State Commission has clearly indicated that for the pre-1990 projects the funding is through 100% debt and all debts have been retired as of date. For Post-1990 Projects the Commission has determined the annual fixed charges for each station considering the data made available by the Appellant. The State Commission has allowed 14% return

on equity on some of the Post-1990 projects where the infusion of equity by the Appellant or the State Government was clearly established. Accordingly, the State Commission has allowed Rs. 13.04 crores per annum as return on equity for the Post-1990 projects. The State Commission has given a clear finding that the Board could not give satisfactory data to establish infusion of equity by the Appellant. When the Appellant Electricity Board could not produce any data before the State Commission to establish infusion of equity in its project, the finding of the State Commission could not be found fault with.

9. The learned counsel for the Appellant argued that equity should have been apportioned on normative basis in the ratio of 70:30 as per the Regulations. This is incorrect. The Regulations only provide for a ceiling on equity at 30% subject to actual. Thus, if the actual equity is less than 30%, the actual amount is to be considered as equity for the

purpose of tariff determination. Therefore, the State Commission has correctly apportioned the debt and equity of the Hydro Projects in the absence of supporting data for infusion of equity by the Appellant.

10. The second issue is power purchase cost payable for Baspa Hydro Electricity Project. According to the Appellant, while they have been directed to make payment of arrears to Baspa Hydro Project within three months in the year 2008-09, the recovery of the same has been allowed in a period of 6 years by creating a regulatory asset. Further the interest rate applied on the regulatory asset was only 10% which is not representative of the prevailing market rate of interest. We find that the State Commission has given a clear reasoning for not allowing the entire amount in one single year in the impugned order. The State Commission has noted that recovery in a single year would result into significant increase in the ARR of the Board thereby leading

to significant increase in the retail tariff. Accordingly, the State Commission has decided to create a regulatory asset of this amount which would be amortized in six years with a carrying cost of 10%.

11. The learned counsel for the State Commission has submitted that carrying cost of 10% has been allowed with the assumption that the Board shall be borrowing from the market at around 10% interest rate to pay the Baspa arrears. However, the carrying cost shall be trued up at the end of the control period based on the actual cost incurred by the Board for paying these arrears.

12. While it is prudent that all uncontrollable costs such as power purchase cost should be quickly allowed, in the present case the State Commission has allowed realization of the arrears of power purchase cost from Baspa Project in 6 years and creation of regulatory assets to avoid tariff shock. The Tariff Policy dated 06.01.2006 states that

the Regulatory Asset should be created only as an exception. However, in the impugned order the State Commission has clearly explained the reason for creation of the Regulatory Asset. Thus, we do not find any fault in the methodology adopted by the State Commission in passing on the arrears on account of power purchase cost in respect of Baspa in the ARR as the State Commission has given adequate reason for creating the Regulatory Asset and has also provided for carrying cost. However, we direct the State Commission to allow the actual rate of interest as carrying cost for finances arranged by the Electricity Board for paying these arrears in the true up of financials of the Electricity Board.

13. The third issue is determination of employees cost taking into account the impact of Sixth Pay Commission recommendations. We find that the State Commission has given a clear finding on this issue and has stated in the

impugned order that the process of actual implementation of the Sixth Pay Commission recommendations would take time and may go beyond the control period. The State Commission has however, acknowledged this as a contingent liability for the future and has stated that any impact on employee cost due to the recommendation of Sixth Pay Commission would be duly trueed up as and when it is implemented. The learned counsel for the Appellant has submitted that the Sixth Pay Commission recommendations have been actually implemented. In view of this, the State Commission is directed to consider the impact of the same after the Appellant places the requisite material before the State Commission in the true up proceedings.

14. The fourth issue is the disallowance of Pension and Gratuity Fund. The State Commission in its order has clearly welcomed the proposal of the Appellant but has decided not to provide any provision for creation of the

Gratuity and Pension Fund in the ARR for the following reasons:-

- a) Any future liability of the Board can not be passed onto the consumers now.
- b) The quantum of future liabilities towards terminal benefits is uncertain in view of the unbundling process of the Electricity Board.

15. We do not find any fault with the order of the State Commission for not creating the Gratuity and Pension Fund in the MYT Tariff Order for the period FY 09 to FY 11 in view of the restructuring of the Electricity Board which was in progress. However, we direct the State Commission to consider the proposal of creation of Gratuity and Pension Fund after the restructuring of the Electricity Board as and when proposal in this regard is submitted by the successor companies of the Electricity Board.

16. The fifth issue is working capital requirement of the Appellant. The learned counsel for the Appellant has argued that the State Commission ought not to have reduced the power purchase expenses of the Appellant by one month while determining the working capital requirements after relaxing the Regulations to that extent.

17. The State Commission has determined the working capital requirement for each of the three functions viz. generation, transmission and distribution separately as per MYT Regulations and added up the working capital requirement for all the three functions to determine the total working capital requirement of the Board for the Control Period. The MYT Regulations of the State Commission regarding Working Capital for Retail Supply Business are

reproduced below:

“32. Working Capital for Retail Supply Business

Working capital for retail supply of electricity shall consists of:-

- a) O&M expenses for one month;*
- b) receivables for two months of revenue for sale of electricity;*
- c) maintenance spares @ 40% of the R&M – expense for one month; and*
- d) less: consumer security deposit, if any.*
- e) less: power purchase costs for one month”.*

18. We find that the State Commission has correctly determined the working capital requirements of the Appellant according to its Regulations. There is no substance in the argument of the learned counsel for the Appellant that deduction of one month's power purchase cost should not be done in relaxation of the Regulations. If the Appellant is making payment within one week of raising of bills on its own, it can not be a valid reason for the State Commission to

relax the Regulations. Accordingly, this issue is also decided against the Appellant.

19. The Summary of our findings regarding the issues raised by the Appellant are as under:-

a) **Interest & Finance Charges – Disallowance of equity for the projects of the Appellant.**

The State Commission has given clear findings about the apportionment of debt and equity in the Hydro Projects of the Appellant. The State Commission has clearly indicated that in case of projects commissioned prior to 1990, the funding is through 100% debt and all debts have been retired as of date. For Post-1990 Projects the State Commission has determined the apportionment of debt and equity in the various projects based on the data made available by the Appellant. The State Commission has allowed 14% return on equity on some of the Post-1990 projects where

the infusion of equity by the Appellant or State Government was clearly established. The learned counsel for the Appellant has argued that equity should have been apportioned on normative basis in the ratio of 70:30 as per the Regulations. This is incorrect. The Regulations only provide for a ceiling on equity at 30% subject to actual. Thus, if the actual equity is less than 30%, the actual amount is to be considered for the purpose of tariff determination. Therefore, we do not find any fault with the findings of the State Commission.

b) **Power purchase cost payable for Baspa Hydro Electric Project.**

The State Commission has allowed recovery of the arrears for electricity supplied by Baspa Hydro Electric Project in 6 years by creating a regulatory asset. Carrying cost has also been provided at an interest rate of 10%. While it is prudent that all

uncontrollable costs such as power purchase cost should be quickly allowed and the Tariff Policy dated 6.1.2006 also states that creation of regulatory asset should be done only as an exception, in the present case, the State Commission has given reasons for creating the regulatory asset and also provided for carrying cost. Thus, we do not find any fault in the methodology adopted by the State Commission in passing on the arrears on account of power purchase cost for Baspa. However, we direct the State Commission to allow the actual rate of interest as carrying cost for finances arranged by the Electricity Board for paying these arrears in the true up of financials of the Electricity Board.

c) **Employees cost**

The State Commission has not allowed the impact of Sixth Pay Commission recommendations on the

employees cost as implementation of the recommendations would take time and may go beyond the control period. The State Commission has however, acknowledged this as a contingent liability for the future. The Appellant has now submitted that the Sixth Pay Commission recommendations have been actually implemented. Accordingly, the State Commission is directed to consider the impact of the same after the Appellant places the requisite material before the State Commission in the true up proceedings.

d) **Disallowance of Pension and Gratuity Fund**

The State Commission has not allowed creation of Gratuity and Pension Fund for the reason that future liability of the Board can not be passed on to the consumers now and due to uncertainty about the quantum of future liabilities in view of the unbundling process of the Electricity Board.

We do not find any fault with the order of the State Commission for not creating Gratuity and Pension Fund in the MYT Tariff Year for the period FY 09 to FY11. However, we direct the State Commission to consider the proposal of creation of Gratuity and Pension Fund after the restructuring of the Electricity Board as and when proposed by the successor companies.

e) **Working Capital Requirements of the Appellant**

The State Commission has correctly determined the working capital requirements according to its Regulation. There is no justification of not deducting one month's power projects cost from the working capital in relaxation of the Regulations as argued by the Appellant. Accordingly, this issue is decided against the Appellant.

Conclusion

20. In view of the above, we dismiss the Appeal with the directions to the State Commission as recorded in paras 12, 13 and 15.

21. Pronounced in the open court on this **25th day of January, 2011.**

(Justice P.S. Datta)
Judicial Member

(Rakesh Nath)
Technical Member

REPORTABLE / NON-REPORTABLE

VS