Before the Appellate Tribunal for Electricity
(Appellate Jurisdiction)

Appeal No.137 of 2008, 138 of 2008 and 139 of 2008

Dated: July 15, 2009.

Present:- Hon'ble Mrs. Justice Manju Goel, Judicial Member
Hon'ble Shri H.L. Bajaj, Technical Member

IN THE MATTER OF:

Appeal No. 137 of 2008

The Tata Power Company Limited
Bombay House,
Homi Mody Street, Fort
Mumbai-400001 .....Appellant

v/s

Maharashtra Electricity Regulatory Commission
World Trade Centre
Centre No. 1, 13th floor
Cuffe Parade
Mumbai-400005 .....Respondent

Appeal No. 138 of 2008

The Tata Power Company Limited
Bombay House,
Homi Mody Street, Fort
Mumbai-400001 .....Appellant

v/s

Maharashtra Electricity Regulatory Commission
World Trade Centre
Centre No. 1, 13th floor
Cuffe Parade
Mumbai-400005 .....Respondent

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Appeal No. 139 of 2008

The Tata Power Company Limited
Bombay House,
Homi Mody Street, Fort
Mumbai-400001 .....Appellant
v/s

Maharashtra Electricity Regulatory Commission
World Trade Centre
Centre No. 1, 13th floor
Cuffe Parade
Mumbai-400005 .....Respondent

Counsel for appellant(s): Mr. Amit Kapur
Ms Poonam Verma

Counsel for respondent (s): Mr. Buddy A. Ranganadhan
For Respondent No. 1
Mr. Arijit Maitra

JUDGMENT

Per Hon'ble Mr. H.L. Bajaj, Technical Member

Appeal No. 137 of 2008

This appeal challenges the order dated April 02, 2008 passed by the Maharashtra Electricity Regulatory Commission (MERC or the Commission in short) passed in case No. 68 of 2007 in the matter of Tata Power Company Limited General Business (TPC-G).

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2. The appellant has raised the following issues:-

1. Disallowance of A&G expenses towards Tata Brand Equity expenses.
2. Denial of rightful retention of the difference between the Normative Interest on Working Capital on account of the cost of its internal funds utilized for funding Working Capital.
3. Disallowance of entitlements to gains on account of maintaining O&M expenditure despite significant increase in uncontrollable expenses.
4. Disallowance of Depreciation Expenditure projected for FY 2007-08 and FY 2008-09 for the assets expected to be capitalized during the year.

Appeal No. 138 of 2008

3. This appeal challenges the order dated May 26,2008 passed by the Maharashtra Electricity Regulatory Commission (MERC or

the Commission in short) in case No. 67 of 2007 in the matter of Tata Power Company Limited Transmission Business (TPC-T).

4. The appellant has raised the following issues:-

1. Disallowance of A&G Expenses towards Tata Brand Equity Expenses.
2. Denial of rightful retention of the difference between the Normative Interest on Working Capital and Actual Interest on Working Capital on account of the cost of its internal funds utilized for funding working capital.
3. Disallowance of Depreciation Expenditure projected for FY 2007-08 and FY 2008-09 for the assets expected to be capitalized during the year.

Appeal No. 139 of 2008

5. This appeal challenges the order dated June 04,2008 passed by the Maharashtra Electricity Regulatory Commission (MERC or the Commission in short) in case No. 69 of 2007 in the matter of Tata Power Company Limited Distribution Business (TPC-D).

6. The appellant has raised the following issues:-

1. Disallowance of Brand Equity Component of A&G Expenses during true up for the period FY 2006-07
2. Disallowance of Depreciation Expenditure projected for FY 2007-08 and FY 2008-09 for the assets expected to be capitalized during the year.

7. As the issues raised by the appellant in Appeal Nos. 138 of 2008 and 139 of 2008 are also covered in the issues raised in Appeal No. 137 of 2008, we have taken Appeal No.137 of 2008 to deal with all the issues.

Issue No.1: Disallowances of Administrative and General Expenses towards Tata Brand Equity Expenses.

8. Learned counsel appearing for the appellant submitted that Brand Equity refers to marketing effects or outcomes that accrue to a product with its brand name compared with those that would accrue if the product did not have the brand name.

9. He submitted that payment of royalty is an expenditure incurred as also held by the Hon'ble Supreme Court in Bharat Beedi Works Pvt. Ltd. & Anr vs CIT (1993) 3SCC252. In this context he drew our attention to the following paras of the Hon'ble Supreme Court judgment wherein it has been held that such royalty is an expenditure.

> *"9. The genuineness or validity of the agreement between the assessee company and the firm is not disputed. The factum of payments made on account of royalty in terms of Clause 4(a) of the said agreement is also not disputed. It is also not disputed that in the beedi trade, brand name carried significant business value. It is necessary to keep this factual context in mind while examining the question at issue. Section 49(c) read as follows during the relevant assessment years:*
>
> > *"40. Notwithstanding anything to the contrary in Sections 30 to 39, the following amounts shall not be deducted in computing the income chargeable under the head 'profits and gains of business or profession:-*
> >
> > *(a)* * * *
> >
> > *(b)* * * *
> >
> > *(c) in the case of any company-*

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(i) any expenditure which results directly or indirectly in the provision of any remuneration or benefit or amenity to a director or to a person who has a substantial interest in the company or to a relative of the director or of such person, as the case may be.

(ii) any expenditure or allowance in respect of any assets of the company used by any person referred to in sub-clause (i) either wholly or partly for his own purposes or benefit,

if in the opinion of the Income Tax Officer any such expenditure or allowance as is mentioned in sub clauses (i) and (ii) is excessive or unreasonable having regard to the legitimate business needs of the company and the benefit derived by or accruing to it therefrom, so, however, that the deduction in respect of the aggregate of such expenditure and allowance in respect of any one person referred to in sub-clause (i) shall, in no case, exceed-

(A) where such expenditure or allowance relates to a period exceeding eleven months comprised in the previous year,

the amount of seventy-two thousand rupees;

(B) where such expenditure or allowance relates to a period not exceeding eleven months comprised in the previous year, an amount calculated at the rate of six thousand rupees for each month or part thereof comprised in that period;

Provided that in a case where such person is also an employee of the company for any period comprised in the previous year, expenditure of the nature referred to in clauses (i),(ii),(iii) and (iv) of the second proviso to clause (a) of sub section (5) of Section 40-A shall not be taken into account for the purposes of sub-clause (A) or sub-clause (B), as the case may be;

*(iii) * * **

Explanation:- The provisions of this clause shall apply notwithstanding that any amount not to be allowed under this clause is included in the total income of any person referred to in sub-clause (i)".

13. *That the payments made by the assessee-company to the firm on account of royalty in terms of clause (4)(a) of the agreement fall within the meaning of the expression 'expenditure' in sub-clause (i) of clause (c) is not disputed. The observations in CIT v. Indian Engineering and Commercial Corpn. (P) Ltd. do not say otherwise. That case arose under Section 40-A(5). The payments in question were made to the directors by way of commission on sales. The question was whether the said payments fell within sub-clause (ii) of clause (a) of sub-section (5) of Section 40-A. It was held that they did not. While holding so it was observed that "it is difficult to say that payment of a certain cash amount by way of commission on sales, directly to an employee, can be said to fall within the words 'where the assessee incurs any expenditure which results directly or indirectly'". The said observations were made in response to the Revenue's argument that the said payment constituted 'perquisites within the meaning of sub-clause (ii) of clause (a) of Section 40-A(5). The observations are clearly confined to the said sub-clause and have no relevance to any other provision in the Act. The observations cannot be read dissociated from their context. Coming back to the provisions of Section 40(c) and the facts of the case before us, the only question is whether the royalty payments to the firm fell within clause (c). We assume for the purpose of this argument that in this case, payments to firm were payments to partners. Even so, we think that the said payments did not fall within clause (c). The payments were made in consideration of a valuable right parted by the firm/partners/directors of the assessee-comopany in favour of the assessee. So long as the agreement whereunder the said payments were made is not held to be a mere device or a mere screen, the said*

> *payments cannot be treated as payments made to the directors as directors (qua directors). The payments were made by way of consideration for allowing the assessee to use a valuable right belonging to them viz. the brand name. Such a payment may be liable to be scrutinized under sub-section (2) of Section 40-A but it certainly did not fall within the four corners of Section 40(c)."*

10. Mr. Kapur submitted that the Press Note 9(2000) Series issued by Department of Industrial Policy & Promotion, Ministry of Commerce and Industry, Government of India also recognizes the payment of royalty up to 2% for exports and 1% for domestic sales under automatic and brand name of the foreign collaborator without technology transfer.

11. Mr. Kapur submitted that the 'Brand Equity' extends the name of Tata to Tata Power which confers several benefits to TPC inter alia:-

(i) The Tata Group promotes the appellant through advertisements as part of the group, which leads to brand building for the appellant.

(ii) The group also makes available central services like recruitment, training courses and common procurement services.

(iii) Being recognized as part of such eminent group it facilitates purchases at competitive prices by the company and also provide access to best credit facilities at very competitive rates. For instance, import of goods such as coal has been facilitated many times without Letter of Credit but merely on acceptance of documents.

(iv) The brand due to its positive image also helps the appellant in attracting good human resource talent. This is of immense benefit to the company in the short and long run to carry out its operations to global standards and efficiencies.

(v) The Brand equity subscription is not only paid by appellant but also by other Tata Group of Companies. Moreover, the terms of Brand Equity Brand Promotion (BEBP) Agreement under which appellant enjoys such benefits are the same for all the beneficiaries.

12. He submitted that MERC in its order dated June 11, 2004 passed in case No. 30 of 2003 in the matter of Determination of Annual Revenue Requirement and tariff applicable to various categories of consumers of Tata Power Company Limited for

FY 2003-04 accepted the A&G expenses as projected by TPC which included Tata Brand Equity expense also in the sub head of 'others'. However, contrary to the established past practices and philosophy, MERC has, without any justification, deviated from these practices and has chosen to disregard the appellant's submission and has disallowed the said expenses towards Tata Brand Equity.

Analysis and decision

13. It has been brought to our notice that Tata Group commenced its first business operation in India in 1868 and the power sector business operations started on November 07, 1910. A Tata group Brand Equity initiative was launched in 1998 to initiate a corporate identity programme in order to sustain the power of the Tata Brand, Tata Sons Ltd. being the owner of the Tata main. The Tata Group of Companies, by a High Court order, amalgamated into the Tata Power Company Ltd. in November 2000. It is evident that the Tata Brand Equity entails many benefits to the Tata Power Company such as instilling confidence, attain market leadership through Tata Business Excellence Model

of the Tata Code of Conduct. The Tata Group promotes Tata Power Co. through advertisement, makes available central services like recruitment, training courses and common procurement services. This facilitates purchases at competitive rates, provides access to credit and loan facilities at competitive rates. The Brand name helps in attracting good human resource talent etc.

14. In view of the obvious immense benefits available due to Tata Brand Equity and the expenditure incurred by the Tata Sons Group on promotion of Brand Equity, it is only fair and equitable that Tata Power Company contributes their share for promotion of Tata Brand Equity to the parent company and such expenditure should form part of the A&G expenses. We, therefore, decide that TPC is entitled to Tata Brand Equity Expenses for FY 2006-07, 2007-08 and 2008-09.

Issue No. 2: Difference between Normative Interest on Working Capital and actual interest on Working Capital on account of cost of its internal funds utilized for funding Working Capital.

15. Learned counsel submitted that the Commission approved Rs. 72.68 crores on account of Interest on Working Capital on normative basis. MERC considered the entire approved amount of Rs. 72.68 crores as efficiency gain, a part (1/3rd) of which was to be shared with the Distribution licensees (Rs. 24.22 crores) though TPC-G had submitted that it has funded its Working Capital through internal accruals and has not resorted to external borrowing for funding the Working Capital.

16. He submitted that while computing the gains of Rs. 72.68 crores, MERC has not taken into consideration the cost of the 'internal cash' used for funding the Working Capital and has passed on the entire amount as gain out of which, 1/3rd has to be passed on to the Distribution licensees. Appellant is, therefore, aggrieved by MERC's refusal to acknowledge the financing of its Working Capital through internal funds as a cost leading to erroneous computation of efficiency gains on this account.

17. He submitted that the premise of the MERC's philosophy is, since the appellant has not availed of any loan for funding its Working Capital, the revenue entitlement on this account on normative basis should be construed as a gain part of which should be shared with the Distribution Licensee (1/3rd). Only the balance 2/3rd part was allowed to be retained by TPC-G. He submitted that by doing so, MERC has deprived the appellant of its rightful revenue entitlement to the extent of 1/3rd of the said amount i.e. Rs. 24.22 crores. The findings in the impugned order have resulted in accrual of additional gains and a portion of which has to be passed on to its customers. He submitted that the interest on Working Capital on normative basis does not form a part of the O&M expenses which comprise of employee cost, R&M expenses and A&G expenses only, but the interest on Working Capital is included whilst arriving at the Annual Revenue Requirement. MERC (Terms and Conditions of Tariff) Regulations, 2005, define the methodology for computing the Interest on Working Capital (one of the component of Annual Fixed Charges)

in paras 34.5, 50.6 and 63.6 in respect of the Generation, Transmission and Distribution utilities respectively.

18. He averred that various components of the Annual Fixed Charges as prescribed by the MERC Regulations (Terms and Conditions of Tariff), 2005. The total entitlement on account of the Annual Fixed Charges for a generating station or a utility leads to the determination of the fixed charge component of the tariff for the customers of the utility. The various components are as below:

(i) Return on Equity Capital

(ii) Income Tax

(iii) Interest on Loan Capital or Interest on Debt

(iv) Depreciation

(v) O&M Expenses

(vi) Interest on Working Capital

19. He contended that Interest on Working Capital is a separate expense component entitled to be recovered as part of the Annual Fixed Charges.

Analyses and decision

20. In Appeal No.111/08, in the matter of Reliance Infrastructure v/s MERC and Ors., this Tribunal has dealt the same issue of full admissibility of the normative interest on Working Capital when the Working Capital has been deployed from the internal accruals. Our decision is set out in the following paras of our judgment dated May 28, 2008 in Appeal No. 111 of 2008.

> " 7) *The Commission observed that in actual fact no amount has been paid towards interest. Therefore, the entire interest on Working Capital granted as pass through in tariff has been treated as efficiency gain. It is true that internal funds also deserve interest in as much as the internal fund when employed as Working Capital loses the interest it could have earned by investment elsewhere. Further the licensee can never have any funds which has no cost. The internal accruals are not like some reserve which does not carry any cost. Internal accruals could have been inter corporate deposits, as suggested on behalf of the appellant. In that case the same would also carry the cost of interest. When the Commission observed that the REL had actually not incurred any expenditure towards interest on Working Capital it should have also considered if the*

> *internal accruals had to bear some costs themselves. The Commission could have looked into the source of such internal accruals or funds could be less or more than the normative interest. In arriving at whether there was a gain or loss the Commission was required to take the total picture into consideration which the Commission has not done. It cannot be said that simply because internal accruals were used and there was no outflow of funds by way of interest on Working Capital and hence the entire interest on working capital was gain which could be shared as per Regulation No. 19. Accordingly, the claim of the appellant that it has wrongly been made to share the interest on Working Capital as per Regulation 19 has merit.*
>
> *15. b): The interest on Working Capital, for the year in question, shall not be treated as efficiency gain.*

21. In view of our earlier decision on the same issue we allow the appeal in this regard also.

Issue No. 3: Disallowance of entitlement on gains on account of O&M expenditure despite significant increase in uncontrollable expenses.

22. Mr. Kapoor contended that various uncontrollable factors that have led to the increased O&M expenditure, are statutory or mandatory in nature, such as, increase in Insurance, environment impact studies and ambient air quality monitoring charges etc. Furthermore, inflation and setback of expenses have resulted in

additional expenditure, which could not be envisaged at the time of the previous filing.

23. He contended that MERC has erred in not allowing the sharing of loss/gains in view of the following:-

(i) Regulation 18 inter alia provides that the approved aggregate gain or loss to the Generating Company or licensee on account of uncontrollable factors shall be passed through as an adjustment in the tariff of Generating Company or Licensee.

(ii) Regulation 19 of the Tariff Regulations deals with the mechanism for sharing of gains or losses on account of controllable factors.

(iii) The very concept of the uncontrollable factors means that these factors cannot be controlled and as such are required to be given a treatment as a pass-through in the tariff in terms of Regulation 18 of the Tariff Regulations.

(iv) TPC by adopting prudent and best practices, could control the expenditure to Rs. 260 crores, instead of

Rs. 274 crores and has to be rewarded for its efficiency. He submitted that only Rs. 260 crores were spent against Rs. 274 crores that would have been spent had Tata Power through its prudent practices not controlled the expenditure on account of controllable factors and as such Regulation 19 will apply as a mechanism for sharing of gains on account controllable factors.

Analyses and decision

24. MERC Regulation 18, set out below, provides that approved gain or loss to the licensee on account of uncontrollable factors shall be passed through tariff.

Regulation 18: Mechanism for pass through of gains or losses on account of uncontrollable factors.

18.1 The approved aggregate gain or loss to the Generating Company or Licensee on account of uncontrollable factors shall be passed through as an adjustment in the tariff of the Generating Company or Licensee over such period as may be specified in the order of the Commission passed under Regulation 17.10;

18.2 Nothing contained in this Regulation 18 shall apply in respect of any gain or loss arising out of

> *variations in the price of fuel, which shall be dealt with as specified in Regulation 82.*

25. We find force in the arguments of the appellant that the uncontrollable factors do mean the factor which cannot be controlled and, therefore, any additional expenditure due to uncontrollable factors needs to be deemed as pass through. We therefore, allow the appeal in this view of the matter.

Issue No. 4: Disallowance of depreciation of expenditure projected for FY 2007-08 and FY 2008-09 for the assets expected to be capitalized during the year.

26. Mr. Kapur submitted that MERC approved the depreciation expenditure for FY 2007-08 and FY 2008-09 considering the depreciation on the opening Gross Fixed Asset (GFA) only and not on the assets added during the year. He contended that MERC decision in this regard is arbitrary, without justification and contrary to the third proviso of Tariff Regulation 34.4.1(i) which provides that Accounting Standard-6 shall apply to the extent not inconsistent with the Regulations and that the Accounting

Standard-6 provides that the depreciation is to be charged over the useful life of the assets.

27. He submitted that the useful life of an Asset commences immediately after the capitalization of the Asset and when such asset is actually available for use by the Distribution Licensees and the consumers. Accordingly, the depreciation should also commence from the date of the Capitalization. If the asset is actually used for part of the year, proportionate depreciation should be granted.

28. He further submitted that the provisions of the Companies Act {Notes to Schedule XIV (Rates of depreciation) Companies Act, 1956} also provide that additions have to be taken into account and depreciation of asset shall be calculated on proportionate basis from the date of addition.

Analyses and decision

29. Reference has been made by the appellant to the Tariff Regulations, Accounting Standard-6 of the Institute of Chartered

Accountants of India and the Companies Act. Relevant extracts from these references are set out below:-

(1) **Accounting Standard-6:** Clause 3 defines depreciation, depreciable assets, useful life and depreciable amount as below:

> *3.1 Depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes. Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortization of assets whose useful life is predetermined.*
>
> *3.2 Depreciable assets are assets which*
>
> *(i) are expected to be used during more than one accounting period; and*
>
> *(ii) have a limited useful life and*
>
> *(iii) are held by an enterprise for use in the production or supply of goods and services, for rental to other, or for administrative purposes and not for the purpose of sale in the ordinary course of business.*

> *3.3 Useful life is either (i) the period over which a depreciable asset is expected to be used by the enterprise; or (ii) the number of production or similar units expected to be obtained from the use of the asset by the enterprise.*
>
> *3.4 Depreciable amount of a depreciable asset is its historical cost, or other amount substituted for historical cost in the financial statement, less the estimated residual value.*

(2) **Tariff Regulation 34.4.1** of MERC (Terms and Conditions of Tariff) Regulations, 2005 is extracted below:

> *34.4.1 Depreciation*
>
> *For the purpose of tariff, depreciation shall be computed in the following manner namely:*
>
> *(i) The value base for the purpose of depreciations shall be the original cost of the asset as approved by the Commission in accordance with Regulation 30;*
>
> *(ii) Depreciation shall be calculated annually, based on straight line method at the rates provided in the* ***Annexure-I*** *to the Regulation:*
>
> *Provided that the residual life of the asset shall be considered as 10 per cent and*

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> *depreciation shall be allowed up to maximum of 90 per cent of the original cost of the asset:*
>
> *Provided further that land is not a depreciable asset and its cost shall be excluded from the original cost for the purpose of calculation of depreciation:*
>
> *Provided also that the provisions of the Statements of Accounting Standard (AS-6): Depreciation Accounting of the Institute of Chartered Accountants of India shall apply to the extent not inconsistent with these Regulations.*

(3). **Companies Act:** Note at Serial No. 4 to Schedule XIV of the Companies Act, 1956 reads as under:-

> *" 4. Where, during any financial year, any addition has been made to any asset, or where any asset has been sold, discarded, demolished or destroyed, the depreciation on such assets shall be calculated on a pro rata basis from the date of such addition or as the case may be, up to the date on which such asset has been sold, discarded, demolished or destroyed".*

30. From the aforesaid extracts it is clear that third Proviso to MERC Regulation 34.4.1 (ii) requires that the provisions of the statements of Accounting Standard-6 (AS-6) shall apply. AS-6 provides that depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset. Further, it defines useful life as the period over which the depreciable asset is expected to be used by the enterprises. The Companies Act provides depreciation for a part of the financial year on pro-rata basis when the asset has been put to use during a financial year.

31. In view of the provisions of the Tariff Regulations the Companies Act and the Accounting Standard-6, we find full justification and rationale in the contention of the appellant that proportionate depreciation has to be allowed even for part of the year when the assets have been put to use. The asset once put to use will be exposed to wear and tear which will not wait to depreciate till the start of the new financial year. We, therefore, allow the appeal in this view of the matter also.

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32. We allow the Appeal and direct the Commission to revise the ARR in view of our decisions at paras 14, 21, 25 and 31 of this judgment.

33. Our decision in this judgment will apply *mutatis mutandis* to Appeal No. 138/08 and 139 of 2008 also.

34. No order as to costs.

35. Pronounced in the open court on 15th day of July, 2009

(H.L. Bajaj) Technical Member	(Mrs. Justice Manju Goel) Judicial Member

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