Before the Appellate Tribunal for Electricity
(Appellate Jurisdiction)

Appeal No.60 of 2007

Dated: May 12, 2008.

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

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

Versus

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

2. Mumbai Grahak Panchayat
Sant Dnyaneshwar Marg
Behind Coopoer Hospital Vile Parle

3. Prayas, C/o Amrita Clinic
Athawale Corner, Karve Road
Deccan Gymkhana
Pune-411004

4. Thane Belapur Industries
Plot No. P-14, MIDC
Rabale Village, Post Chansoli
Navi Mumbai 400071

5. Vidharbha Industries Association
Ist floor, Udyog Bhawan, Civil Lines
Nagpur-440001

6. General Manager, BEST Undertaking
BEST Bhavan, BEST Marg
Mumbai-400001

7. Sr. Vice President (Comm)
Reliance Energy Ltd.
Reliance Energy Centre
Santa Cruz (E)
Mumbai-400050 ....Respondents

Counsel for Appellant(s): Mr. Amit Kapur, Advocate
Mr. Mansoor Ali Shoket, Advocate
Ms Shobana Masters, Advocae
Mr. Kunal Rajpal, Advocate
Mr. Avijeet K. Lala,Advocate
Mr. Alok Shankar, Advocate

Counsel for Respondent(s) Mr. Jayant Bhushan, Sr. Advocate
Mr. Buddy A. Ranganadhan and
Mr. Arijit Maitra , Advocates
Mr. Suresh Gehani, Consultant
for MERC

GB
No. of corrections

Judgment

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

1. The Tata Power Company Limited (TPC or Tata Power in short) has filed the present appeal challenging the following two orders passed by Maharashtra Electricity Regulatory Commission (MERC or the Commission in short):-

(a) Order dated October 03, 2006 passed in Case Nos. 12/2005 & 56/2005 re: ARR & Tariff Petitions filed for FY 2005-06 & FY 2006-07 (*Impugned Tariff Order*); and

(b) Order dated March 22, 2007 passed in Case No. 47/2006 re: Review Petition against the Order dated October 03, 2006 passed in Case Nos. 12/2005 & 56/2005 (Impugned Review Order).

2. The present appeal essentially challenges the denial of expenses in respect of nine items given below along with financial impact of each:

Sl. No	Disallowances: Item-wise	Net Impact (Rs. In Crores)			
		FY 2004-05	**FY 2005-06**	**FY 2006-07**	**Total**
1	Depreciation	45	4	-	49
2	Income Tax 25% Disallowance	33	50	-	83
3	Employee Expenditure	-	12	-	12
4	Repair & Maintenance Expenditure	3	-	-	3
5	A&G Expenditure	19	16	-	35
6	Drawal of various statutory reserves and value of investment while drawing from reserves	* 163 for the year FYs 2005 and 2006 * 39 for not considering Diminution in value of investment		62	226
7	Income Tax adjustment in clear profit	10	10	-	20
8	Capital Expenditure	12	37	-	49
9	Departure from Accrual/Mercantile system	-	356	-	356
Aggregate					833

3. TPC has submitted that out of nine heads of claim, some are covered by the judgment of this Tribunal and Hon'ble Supreme Court which are applicable in their case also.

4. We now proceed to deal with each issue one by one.

ISSUE NO. 1: DISALLOWANCE OF DEPRECIATION:

5. TPC is aggrieved by the partial disallowance of depreciation claims in the Financial Years 2004-05 and 2005-06 by MERC who has observed as under:-

> *"Tata Power submitted the actual depreciation expenditure in FY 2004-05 and FY 2005-06, which have been computed partly in accordance with the depreciation rates considered in the Tariff Order. However, in case of plant and machinery under Transmission assets, the actual depreciation costs (Rs 68.54 Crore) for FY 2004-05 as submitted by TPC under Form F3 over Opening Gross fixed Assets (Rs 468.03 Crore) is very high and the depreciation rate works out to 14.65% during FY 2004-05. TPC is directed to submit the Auditor's certificate certifying that the accumulated depreciation for each asset in the asset register has not exceeded 90% of the asset value, as depreciation cannot be claimed beyond 90% of the asset value. ……"*

6. TPC filed a petition seeking review of the above finding while placing on record the Auditor's certificate confirming the fact that TPC has limited its depreciation claim to 90% of the original cost of the assets. Further, TPC made certain submissions on fact and law which have not found favour with MERC which dismissed this claim by holding that:-

(a) The useful life of the transmission assets as stipulated in the Ministry of Power Notification of March 1994 on 'Depreciation Norms for Licensees' would be applicable. The fair life of transmission assets as stipulated in the aforesaid Notification ranges between 25 to 35 years depending upon the voltage. Hence the balance useful life of the asset would be at least 20 years as against the submission of TPC which contended that the remaining useful life of the asset is nil.

(b) Since the Auditors Certificate indicates that the FERV has been capitalized and depreciated to the extent of 100%. Though the principle assets has been depreciated only 90%, the depreciation on the capitalized FERV should also be limited to 90% and as a result of which the extent of depreciation additional allowable would reduce by 3.72 Crores.

(c) As regards the capitalization of the insurance spares and corresponding depreciation, the impact in FY 2004-05 was because of change in accounting policy of the Company, which does not clarify in either mistake or error apparent on the face of record or discover of new and important matters or evidence and as such review of depreciation extendable on account of capitalization of insurance spares was rejected.

7. In its written submission MERC has further explained and substantiated the rejection primarily on the following grounds:

(a) Since TPC had not given the details of assets affected of FERV and the age and balance useful life of the asset, the Commission was not in a position to compute the quantum of FERV in the amount of depreciation allowable in the current years ARR.

(b) Auditors Certificate submitted by TPC indicates that FERV has been capitalized and depreciated to the extent of 100% though the principal asset has been depreciated only 90% in accordance with the regulatory requirements. Hence the depreciation of capitalized FERV also instead limited to 90% as a result of which the extent of depreciation additional allowable would reduce by 3.72 Crores.

(c) For the assets for which repayment is in progress, it will not be proper to consider that the asset has completed its useful life.

(d) As regards the insurance spares, the details in that regard had not been brought to the notice of the Commission and were brought only at the time of Review Petition. Since furnishing of new details would not clarify for review under MERC regulations, the same could not be considered. The relevant Accounting Standards-11 (AS-11) was made applicable from accounting years 2004-05.

According to AS-11 (Revised 2003), forex evaluation on account of repayment of loan solely incurred for the purposes of clearing the asset should no longer be capitalized and be charged to the revenue.

8. TPC submitted that it had provided for and claimed depreciation for the period in question on the basis of the opening asset block of Rs.468.04 Crores based on the a detailed fixed asset register maintained by them, applying a weighted average depreciation rate of 6.73% derived from the applicable rates as notified by the Ministry of Power on March 26, 1994 pursuant to the VI Schedule to the Supply Act. TPC contends that "Plant and Machinery" covers assets which attract deprecation rates ranging from 1.8% to 45% in terms of the Schedule to the 1994 notification which resulted in the weighted average depreciation rate of 6.73%. However, MERC has applied a depreciation rate of 5% for the said block of asset.

9. TPC extensively relied upon the principles, purpose and application of useful life and rate of depreciation as provided for under the Ministry of Power's Notifications of 1992 and 1994 as

laid down in the judgments of this Tribunal dated May 24, 2006 and September 29, 2006 passed in Appeal No. 122 of 2005, and as upheld by the Hon'ble Supreme Court in Delhi Electricity Regulatory Commission vs BSES Yamuna Power Ltd & Others [*(2007) 3 SCC 33*].

10. Per contra learned senior counsel appearing for MERC has contended that the reliance on the judgment of the Hon'ble Supreme Court was limited to the peculiar facts of the five year policy direction based on transition in Delhi from a public utility to a private utility.

11. On the other hand learned counsel Mr. Amit Kapur appearing for the appellant emphasized that the situation for both Delhi and Mumbai are similar since VI Schedule to The Electricity (Supply) Act, 1948 and 1994 notifications are applicable, and that the interpretation of the 1994 notification shall be binding for MERC order in Mumbai also.

12. TPC further submitted that within its depreciation claim is a component of provision for Foreign Exchange Rate Variation (FERV) in service of foreign debt which earlier used to be accounted for under the head 'Write-off of Forex Variation'. TPC contended that this component ought to be allowed since it was on account of adherence to:-

(a) Accounting Standards 11 (2003 revision, at paragraphs 1(a), 8, 9 and 13)

(b) Accounting Standards 6 (paragraphs 5 to 7)

(c) MERC's directive in paragraph 5.7.3 of its earlier tariff order dated 11.06.2004 directing TPC to "*account for the foreign exchange variations in line with Accounting Standard AS 11 for all foreign exchange loans from FY 2004-05 onwards.*"

13. TPC submitted that within its depreciation claim is a component of provision for additional Insurance spares computed on the basis of the existing inventory which ought to be allowed. Taking note of the fact that the useful /depreciable life of the assets in terms of the MOP Notifications had already been exhausted and 90% original book value written down, TPC

capitalized and depreciated the insurance spares in that very year in compliance with Accounting Standards ASI2, whereby TPC examined the inventory existing and even provided for insurance spares. Since the assets were already depreciated, TPC capitalized and depreciated the insurance spares in that very year in compliance with ASI2.

14. TPC further submitted that MERC approved of depreciation to the sum of Rs.200 Crores in the true-up exercise for FY 2004-05, as against the depreciation approved in the Tariff Order was Rs.175 Crores. However, MERC failed to take note of the fact that the actual depreciation for FY 2004-05 was Rs.245 Crores out of which Rs.70 Crore were allocable to the additional provisions made in terms of paragraph (b) and (c) above. As a consequence, MERC erred in treating the claim as excessive and denying to TPC a depreciation claim of Rs.51.62 Crores (Rs.45 Crores plus Rs.6.62 Crores).

ANALYSIS AND DECISION.

15. Schedule VI of The Electricity (Supply) Act, 1948 is applicable both in Mumbai and in Delhi for tariff determination

of the licensees, we find no force in the arguments of the Commission that DERC vs BSES Yamuna judgment pertains to the peculiar facts of five year policy directive of Delhi Government. The judgment of this Tribunal in Appeal No.122 of 2005 which was upheld by the Hon'ble Supreme Court will be applicable to TPC also. In this view of the matter, we decide in favour of the appellant.

16. Insofar as the component for FERV and insurance spares for determination is concerned, it is to be kept in mind that the accounting standards have to be necessarily followed by the appellant and there is no exception to it. In view of this we agree with the contentions of the appellant and decide this issue also in favour of the appellant.

ISSUE NO. 2: INCOME TAX DISALLOWANCE:

17. Learned counsel for the appellant contended that MERC has disallowed 25% of the claim primarily as the Income Tax claim which includes the revenue earned by TPC on several other business viz. IPP business in Belgaon, Delhi distribution

licensees business, the captive power plant at Jojobera, transmission business, power trading etc. and that the tax liability of the other business should not be loaded to the Mumbai licensed area. The consumers of Mumbai licensed area should not subsidize the other businesses of TPC. In the absence of details of actual income tax paid to the Mumbai licensed area, the actual income tax paid by TPC has been apportioned between Mumbai licensed area and other business of TPC which has been assumed as 75:25. Thus, the income tax expenditure allowed for FY 2004-05 and 2005-06 is 104.9 Crores and 110.1 Crores respectively.

ANALYSIS AND DECISION.

18. This issue is exactly covered by our judgment in appeal No. 251 of 2007 in case of REL vs MERC dated April 04, 2007 (2007 APTEL 164). We decide that in this view of the matter the Commission should extend the same regulatory dispensation to TPC as implemented in pursuance of our judgment in case of REL.

ISSUE NO. 3: EMPLOYEE EXPENDITURE.

19. Learned counsel submitted that this claim is also covered by this Tribunal judgment of April 04, 2007 in Appeal No. 251 of 2007 titled REL v/s MERC.

20. Learned counsel appearing for the Commission fairly accepted the plea of TPC and assured that it shall take up this issue subject to prudence check. We order accordingly.

ISSUE NO. 4: REPAIR AND MAINTENANCE.

21. Learned counsel stated that TPC submitted that Commission has allowed only Rs. 111.14 crores against the actual expenditure of Rs. 113.21 crores (for FY 2004-05) and Rs. 115.33 crores against actual expenditure of Rs. 115.95 crores (for FY 2005-06). He further stated that this claim is covered by the judgment dated April 04, 2007 of this Tribunal in Appeal No. 251 of 2007.

ANALYSIS AND DECISION.

22. We direct that the Commission to adopt the principles given in the aforementioned judgment of April 04, 2007 in this view of the matter also.

ISSUE NO. 5: A&G EXPENDITURE:

23. Learned counsel for TPC claimed that MERC in its Tariff Order has :

(i) Allowed Rs.82.85 Crores as against the actual expenditure of 101.96 Crores for FY 2004-05, and

(ii) Allowed Rs.84.86 Crores as against the actual expenditure of 101.82 Crores for FY 2005-06.

24. He contended that there is no justification for disallowing the actual expenditure particularly when all the details and the documents were produced before the MERC. TPC has claimed that MERC rejected its claim on A&G expenditure without any justification and against the principles laid down in the Clause XVII of Schedule VI of the Electricity (Supply) Act, 1948 which inter alia, provides that any expenditure properly incurred on the

distribution and sale of energy by the licensee has to be permitted.

25. Mr. Kapur submitted that the finding of this Tribunal in the aforesaid Judgment are applicable to the facts and circumstances of the case and that the present case is covered by the principles laid down in the aforesaid Judgment.

26. Learned counsel for MERC has submitted that :

(i) A&G expenses have been prudently allowed since the norm of 3% of GFA adopted by MERC is appropriate.

(ii) A&G expenses in the Tariff Order were calculated on the basis of past 5 years of CAGR which came to 2.5% and hence the A&G expenses were allowed with an increase of 2.4%.

(iii) While perusing the details of actual expenses incurred by TPC as submitted in its Review Petition, MERC found out that Rs.21 Crores have been claimed towards payment of one consultant. Out of this amount, MERC has deducted an amount of Rs.19 Crores.

(iv) The consultant's fees is disproportionate to the claimed benefits, and even the claimed benefits do not

appear to be directly correlatable and solely to the work done by or under the advice of the consultant.

27. TPC also filed an Affidavit in January 2008 placing on record the credentials of the consultant and the benefits derived by the distribution undertaking through system improvements from the services rendered by the consultant. They implemented the Speedy, Sustainable and Significant Cost Reduction project. The claimed benefits derived within a financial year was stated to be around Rs.100 crores in a financial year through (a) improvement in heat rate of unit 6, (b) running of unit 5 above 500 MW, (c) increasing the coal firing at Trombay resulting in Rs. 87 crores reduction in fuel cost, (d) other initiatives. TPC submitted that disallowance of A&G expenditure was inappropriate and MERC did not consider various issues raised and material placed on record including the Auditors Certificate. It was also pointed out by TPC that MERC did not prescribe the nature and level of details that were required at the ARR filing, nor did it ask for any further details over and above those filed by TPC before disallowing the same.

28. Mr. Kapur submitted that the justification given by MERC in rejecting the claims towards A&G expenses has been rejected by this Tribunal in its Judgment dated April 04, 2007 passed in Appeal No. 251/2007 wherein at paragraph 25, this Tribunal has held as under:-

> *"25. Concedingly, under the Sixth Schedule, Clause XVII of the Electricity(Supply) Act, 1948 " any expenditure properly incurred" on the distribution and sale of energy by the licensee is to be permitted. In the absence of any norms specified by the Commission, merely allowing 3.3% (being the CAGR) is not correct as this does not factor inflation which has to be necessarily taken into account and cannot be ignored.*
>
> *We are inclined to accept the contentions of the appellant and, therefore, allow the appeal in respect of A&G expenses for FY 2004-05 and FY 2005-06.*

ANALYSIS AND DECISION.

29. In our view any expenditure properly incurred by the licensee has to be permitted. TPC have furnished credentials of the consultants and the benefits they have derived through system improvements from the services rendered by the consultant and the benefits of about Rs.100 crores derived by TPC. It is an accepted international practice that the

remuneration of the consultant depends mainly on the quality of services they deliver and, therefore, no hard and fast rules can be laid for determination of the services of the consultant. Such decisions are normally left to the management of the utilities. Competition can be created amongst consultants of similar standing and repute by proper evaluation process.

30. In view of the aforesaid we allow the appeal on this issue of A&G expenditure.

ISSUE NO.6: DRAWAL OF VARIOUS STATUTORY RESERVES AND VALUE OF INVESTMENT WHILE DSRAWING FROM RESERVES.

31. This claim of TPC issue relates to the draw-down and appropriation of Rs. 226 crores from the Contingency Reserves of TPC to meet the gap between Clear Profits and Reasonable return. Learned counsel for TPC contended that this claim is covered by the judgment dated July 12, 2007 of this Tribunal passed in IA No. 76 of 2006 in Appeal No. 251 of 2007.

ANALYSIS AND DECISION:

32. Since this issue is covered in our judgment above, we direct the Commission to apply the same principles in case of TPC also.

ISSUE NO.7: INCOME TAX ADJUSTMENT IN CLEAR PROFIT.

33. TPC submitted that MERC by its order dated October 03, 2006 disallowed certain expenditure for FY 2004-05 and FY 2005-06 which it had reiterated in its Order dated March 03, 2007 and that MERC erred in not re-computing the Income Tax liability for FY 2004-05 and FY 2005-06 based on expenditure allowed by MERC and the income earned by TPC. He averred that even if the disallowance by MERC were to be taken, profit before taxes would be higher and the corresponding taxes also would be higher and TPC would be entitled for recovery of the same. He submitted that if the higher tax liability is created due to the disallowed expenditure TPC is entitled to recover the same. Any recomputation of profits results in change in the taxable income and hence the Income Tax is required to be recomputed while arriving at 'Clear Profit'.

34. MERC has fairly conceded that if TPC succeeded on other issues, the same will have an impact on those issues and it will automatically be entitled to the claim of tax liability. We order accordingly.

ISSUE NO. 8: CAPITAL EXPENDITURE:

35. TPC submitted that MERC has disallowed the Capital Expenditure on the ground that the various schemes have not been placed before MERC for its approval and/or no details of such schemes were provided by TPC to MERC. TPC submits that non approval of Capital Expenditure is without any justification, arbitrary and unlawful. TPC contends that MERC disapproved Capital Expenditure under Network Development Activity for the FY 2004-05 and FY 2005-06 on the ground that no DPR was submitted. TPC submitted that the expenditure of Rs.70 Crores under the Network Development Activity did not require submissions of DPR in view of the MERC "guidelines for in-principle clearance of proposed investment schemes" which required submission of feasibility report for Licensee for those

capital investment schemes exceeding Rs.10 Crores for "in-principle" approval by MERC. It submitted that only one such scheme exceeded Rs.10 Crores investment and the said scheme was submitted for approval with MERC. Remaining schemes under Network Development Activity worth Rs.70 Crores did not require submissions of feasibility report. Details of these schemes were submitted by TPC to MERC along with the Review Petition and that the MERC has not taken into account of these documents/details of the schemes while passing the In-principle Order. It was further submitted that the disallowance of Capital Expenditure is contrary to the law enunciated by this Tribunal in its judgment dated November 08, 2006 passed in Appeal No.84/2006 titled as *KPCL vs. KRC*.

36. MERC has disallowed and/or refused to allow capitalization of expenditure on various investment schemes during the FY 2005 and 2006 on the ground that the various schemes have not been placed before MERC for its approval and/or no details of such schemes have been provided by the Appellant.

37. TPC has asserted that the non–approval of capital expenditure without any justification and is arbitrary and unlawful in light of the following:-

(i) MERC's *Guidelines for In-Principle Clearance of proposed Investment Scheme* requires submission of Feasibility Reports by licensee for those capital investment schemes exceeding Rs.10 Crores, for "in-principle" approval by the Commission.

(ii) Only one Scheme exceeded the Rs.10 Crores investment and was submitted or approval with MERC. Remaining schemes under 'Network development Activity' worth Rs.70 Crores did not require the submission of Feasibility Report. This has been repeatedly pointed out by TPC to MERC without any avail.

(iii) All the details of the schemes were submitted by TPC along with its review petition.

(iv) Disallowance of the capital expenditure is contrary to the law enunciated by this Tribunal in paragraphs 4, 10,17, 21 and 23 of *judgment dated November 08, 2006 passed in Appeal No. 84/2006 titled KPTCL Vs. KERC*, wherein this Tribunal *inter alia* held as under:

"*We are unable to appreciate the procedure adopted by the Commission in appointing a Committee to examine the proposal or to find out whether it is feasible or not to implement the investment proposal. It is being commented as a day dream on the part of utility. Yet they are within the domain, commercial decision and internal management of the utility and there is time enough for the Commission to undertake prudent check when the utility comes forward to claim return on such investment in its annual revenue requirement and till then the proposal to invest is well within the domain of the utility. It is sufficient if the utility confirms*

its proposal to invest.

Further when the Technical Experts and Engineers, have applied their mind with respect to their proposal and plan it is not for the Commission to examine by appointing another expert Committee. No expert agrees with another expert as presumably either add or comment. By this it shall not be taken that we are commenting upon the expert Committee appointed by Commission. Even the Committee did not opine that the proposed capital investments are not at all required or otherwise not suitable nor an efficient proposal.

All that it is being pointed that it may not be possible to execute. Here again it is with in the domain and control of the utility. Assuming that the utility has a dream, it is expected that it will wake up with determination and act, lest the State which owns the undertaking will not spare and accountability of the utility is unending to the State, State Legislature and audit by The Accountant General. The power demand is increasing by leaps and bounds and quality has to be maintained and this compels the utility to update its transmission system including reduction in transmission loss ordered by the Commission. It is not for the Commission to throw its spanner in the wheels of the utility when it has proposed to invest for the improvement and expansion of system after a study by its Technical Team and when its board has approved the investment proposals.

The further approach that it is obligatory for the Commission to keep the cost of the power at the lowest possible level is not a proper approach. Being a regulator, the Commission has to approach such issues as a regulatory measure and not as if the Commission is there to protect the consumers alone. When the Commission expects the utility to upgrade its system of transmission or distribution or quality of service, it follows automatically that utility has to invest in up gradation, maintenance for providing quality service. This could be by way of balancing and not by approaching the issue as if the consumer has to pay at the lowest rate. When the consumer expects quality service, the consumer should be prepared to pay a reasonable charge and here the role of

Regulator is vital and it has to balance between the two. If timely capital investment is not made to improve the system then the quality of service by the utility cannot be complained either by consumers nor it could be commented by Regulator. The appointment of an expert committee by the regulator at the stage of proposal to invest is neither warranted nor justified as the plan to invest, estimate of investment and the program of up gradation or extension or development of transmission system is exclusively within the domain of transmission utility.

Even if the proposal to invest is over ambitious, the utility might improve itself or act in such an improved speed to execute the work, but that does not mean that the utility or its managers or top brass should not have imagination or over ambitious which target they set up for themselves to achieve in the course of the year. It follows that as and when the project is executed and investment is made, the same will have financial implications on the sector and consumer tariff but that has to be balanced by the first respondent. The regulator is not going to approve the expenditure or approve the financial charges just for asking and the regulator has to satisfy itself by a prudent check with respect to capital investment and in case they contribute for the quality or development or providing better service, the regulator may include and pass on the consequences of such investment to the consumers. Day by day demand increases and number of consumers are also increasing. The utility has to serve a number of metropolitan cities where the need for power is ever increasing. Therefore, the transmission utility has to estimate or at least imagine and estimate the requirements in advance for the future years to serve the consumers.

To decry the utility and its technical experts or engineers is also not called for as it is for them to rise up to their planning and implement it. The expert committee has not stated that the proposed investment is not required at all and none of the proposals have been commented as not called for by the expert committee appointed by the Regulator. The efficiency to implement the projects or

investments, if the utility fails to achieve, then it cannot pass on the consequences of such investment to the consumers. The investment made on the earlier years cannot be a basis to restrict investment for the current year 2007 or the following years. The Commission overlooked the fact that the appellant being transmission utility transmitting power through out the State for the bulk supply as well as distribution as an obligation to maintain the supply as well as quality supply and when the demand increase, either at the level of distribution or at the level of bulk supply it is the transmission licensee who should provide for the supply. This obviously means that the transmission utility has to plan in advance and should be in a position to supply power as demanded from time to time. Section 42, 43 of The Electricity Act 2003 also should not be lost sight of. To meet the ever increasing demand consequent to development and improvement in the status of the consumer public, industrialization, computerization, heavy industries and requirement increases by geometric proportion, it is for the transmission utility or such other utility to estimate the future demands as well, besides improving the quality and standard of maintenance. This is possible only if the utilities have the freedom to plan with respect to their investment, standardization, upgrading of the system. For such a course it is within the domain of those utilities to undertake to plan, invest and execute the projects or schemes of transmission etc. If the view of the Commission is to be sustained, as already pointed out, the same would mean for each and every investment an approval has to be sought by the utility in advance which is not the objective of The Act. The Karnataka Electricity Regulatory Commission has not acted reasonably or fairly in interfering with the internal, commercial, management and domain of the transmission utility with respect to its commercial plan and proposal to invest a substantial sum."

38. Mr. Kapur submitted that this view has also been approved and followed by this Tribunal in its judgment dated November 08, 2006 in Appeal Nos. 181 & 207/2005 and 59/2006.

39. MERC in the beginning, justified its Order by stating that TPC had not submitted details of the schemes and as such MERC was not in a position to discern whether the scheme were actually for amount less than Rs.10 Crores. However, on being shown the details of the schemes and the documents placed on records by the Counsel for TPC MERC conceded that it had not looked into these details.

ANALYSIS AND DECISION:

40. In view of our judgment in case of KPTCL vs KERC cited above and the fact that only such schemes as are more than Rs. 10 crores are to be furnished for MERC approval, we allow the appeal in this view of the matter also.

ISSUENO.9:DEPARTURE FROM ACCRUAL/MERCANTILE SYSTEM.

41. This claim relates to MERC deciding to introduce a "billed-revenue concept of revenue recognition" qua the amount of Fuel

Adjustment Charges (FAC) recoverable from/payable to customers. Consequently, MERC has not allowed TPC to adjust the FAC in the Revenue for Power Supply thereby not following the accrual/mercantile accounting policy followed by the TPC under the Companies Act, 1956.

42. In the above context, TPC submitted that the finding of MERC is contrary to the applicable statutory provisions, relevant Accounting Standards and the settled law as enunciated by the Hon'ble Supreme Court and by this Tribunal, in terms of:-

(a) *The relevant mandatory Accounting Standards, i.e., AS-1 [Para 9, 10(c) & 27] and AS-9 [Para 10 & 11], read with Sections 209 (3) (b) & (5) and 211 (3A) of the Companies Act, 1956.*

(b) *CIT v M/s Shree Goverdhan Ltd Bombay reported at 1968 (2) SCR 731 @ page 737 [e-h], has inter alia held as under: It is however, well-established that the income may accrue to an assessee without actual receipt of the same and if the assessee acquires a right to receive the income, the income can be said to have accrued to him though it may be received later on its being ascertained. The legal position is that a liability depending upon a contingency is not a debt in praesenti or in futuro till the contingency happens. But if it is a debt the fact that the amount has been ascertained does not make it any the less a debt if the liability is certain and what remains is only quantification of the amount: debitum in praesenti, solvendum in futuro"*

(c) Morvi Industries Ltd v CIT reported at 1972 (4) SCC 451, at Para 11 and 12 has inter alia held as under: "The dictionary meaning of the word 'accrue' is to 'come as an accession, increment or produce: to fall to one by way of its advantage: to fall due.' The income can thus be said to accrue when it becomes due. The postponement of the date of payment has a bearing only in so far as the time of payment is concerned, but it does not affect the accrual of income. The moment income accrues, the assessee gets vested with the right to claim that amount even though it may not be immediately. There also arises a corresponding liability of the other party from whom the income becomes due to pay that amount. The further fact that the income is not subsequently received by the assessee would also not detract from or efface the accrual of the income, although the non-receipt may, in appropriate cases, be a valid ground for claiming deductions. The accrual of an income is not to be equated to the receipt of the income… it is well known that the mercantile system of accounting differs substantially form the cash system of book-keeping. Under the cash system, it is only actual cash receipts and actual cash payments that are recorded as credits and debits; whereas under the mercantile system, credit entries are made in respect of amounts due immediately they become legally due and before they are actually received; similarly, the expenditure items for which legal liability has been incurred are immediately disbursed. Where accounts are kept on mercantile basis, the profits or gains are credited though they are not actually realized, and the entries thus made really show nothing more than an accrual or arising of the said profits at the material time."

(d) The authoritative definition and commentary on the subject (mercantile and accrual system of accounting) having been placed on record on 04.01.2008, being

(1) Black's Law Dictionary (6th Edn., 1990)

(2) Relevant extracts from Ramaiya's Guide to the Companies Act (16th Edn.,2006) at pages 1973, 1994-95.

(3) Relevant extracts from Taxmann's book on Accounting Standards and Corporate Accounting Practices (6th Edn., 2003) at page 15.

(e) This Tribunal has held in its judgment dated 08.11.2006 passed in Appeal No. 181/2005, 207/2005 & 59 of 2006 at paragraphs 35 & 37, that:

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

37. Concedingly both appellant and respondent realize that a corpus is required to be created to pay terminal benefits payable on a future date. While we appreciate concern of

the Commission regarding interest payment, we are convinced that once the Accounting Standards-15 are mandatory in nature and accounts are required to be kept on accrual basis , there is no way in which the appellant can deviate from this basic accounting principle. In view of this position we answer this point in favour of the appellant and set aside the directions issued by the Commission in this regard."

(f) Learned counsel submitted that since inception Tata Power has maintained accounts and accounted for revenue from power supply on "Accrual Basis".

(g) He said that it is relevant to note that the FAC in FY 2005-06 is due to the cap introduced by MERC in their order dated 11.06.04. Although representations were made twice to remove the cap, the same were not granted by the MERC in its order dated November 09, 2005. Though it has been considered for truing up, it does not change the nature of the unbilled revenue to be considered as such on the basis of accrual concept. The revenue has been accrued and the same has to be considered against 'billed' revenue.

(h) Under the accrual system, since the fuel costs has been incurred and FAC formula merely defers the recovery of costs incurred, the amount beyond FAC receivable will be relatable to the Financial Year in which it is incurred.

(i) Further, such an exercise defeats the Matching Costs concept whereby fuel and power purchase costs incurred and booked as expenditure should be matched with the revenue of the relevant year.

43. MERC in its written submissions has sought to improve its case in the Impugned Orders by stating that the *issue is really*

whether the un-recovered FAC which has not been billed due to a regulatory cap is to be treated as revenue earned by the licencee for the purposes of the ARR. MERC has erroneously considered the actual billed revenues and reworked the CP-RR gap. The only justification given by MERC is that the unrecovered FAC beyond the 10% cap even if incurred and recoverable under the regulatory regime (tariff orders and FAC formula notified by MERC) the same cannot be said to have accrued to TPC and recoverable since MERC may disallow, or defer the recovery thereof.

ANALYSIS AND DECISION:

44. Before we proceed to analyse, it is necessary for us to understand the accrual accounting method which is defined in Black's Law Dictionary as:

> *" Accounting method that records entries of debits and credits when the liability arises, rather than when the income and expense is received or disbursed.- Also termed accrual basis".*

45. On the other hand cash basis accounting method is defined as follows:

"Cash-basis accounting method. An accounting method that considers only cash actually received as income and cash actually paid out an as expense".

46. In view of the aforesaid succinctly defined terms, it is clear that as soon as the liability arises the same has to be accounted for. One does not have to wait for the receipt of cash in hand or disbursal of expenditure. Companies are required to declare their accounting policies and they are required to adhere to the same. In the present case TPC having declared their accounting policy, they cannot deviate from it. Notwithstanding the 10% cap put by MERC in the Fuel Adjustment Cost (FAC). The moment electricity is sold income corresponding to the entire Fuel Adjustment Cost has accrued and has to be entered into the books of accounts. On the expenditure side the price paid for the fuel (irrespective of 10% cap) has to be paid to the fuel supplier and corresponding entry has to be made in the accounts books. If contention of the Commission was to be accepted there will be a distortion in the books of accounts as expenditure would be shown fully but corresponding income will be truncated limited

by the 10% cap. Such distortion cannot be allowed by accounting standard as the same will result in reduced income. This will further result in lesser payment of Income Tax by the company which may attract penalties.

47. In view of the foregoing discussions we are inclined to agree with the contentions of the appellant and allow the appeal in this view of the matter.

48. In the result the appeal is allowed.

49. We remand the matter to the Commission and direct that the ARR be revised in the light of our directions and its impact taken into account during the next truing up exercise.

50. Appeal and IA disposed of.

No costs.

(Mrs. Justice Manju Goel)
Judicial Member

(Mr. H.L. Bajaj)
Technical Member

GB
No. of corrections