

**KARNATAKA ELECTRICITY REGULATORY COMMISSION,  
BANGALORE-560 001**

**Dated this day the 21<sup>st</sup> February, 2008**

**In the matter of:**

**Annual Revenue Requirement of ESCOMs (Distribution Licensees in Karnataka) and Tariff applicable to them for FY07-Truing up of ARR of ESCOMs in pursuance of Order of the Hon'ble ATE dated 7<sup>th</sup> February 2008 in Appeal No. 250 of 2006.**

<b>Present:</b>	<b>Shri K.P.Pandey</b>	<b>Chairman</b>
	<b>Shri H. S. Subramanya</b>	<b>Member</b>
	<b>Shri S. D. Ukkali</b>	<b>Member</b>

**O R D E R**

The Commission vide its order dated 16<sup>th</sup> October 2006 had approved the revenue requirement and retail supply tariff of the five ESCOMs, namely BESCOM, MESCOM, CESC, HESCOM and GESCOM for 2006-07 (herein after referred to as ESCOMs). The ESCOMs had challenged the said order before the Hon'ble ATE in Appeal No. 250/2006. The ESCOMs had challenged the Commission's order on the following issues:

- (A) Reduction of quantum of power purchase required.
- (B) Disallowance of power purchase cost to Tanir Bhavi.
- (C) Distribution loss calculation
- (D) Interest and finance charges on investment.
- (E) Employees cost
- (F) Charges payable to KPTCL
- (G) Repair and Maintenance Expenses

- (H) Additional reduction in tariff
- (I) Differential industrial tariff.
- (J) Bad Debt Provisions

The Hon'ble ATE in its Order dated 7<sup>th</sup> February 2008 except on items (I) & (J) above has allowed the Appeal on all other issues mentioned above. This Order is being issued in compliance of the directions of the Hon'ble ATE in the above-referred Order as detailed here below:

**(A) Re. Reduction of quantum of power purchase required.**

The decision of the Hon'ble ATE is reproduced below:

"28.The basic issue before us is as to who should estimate the power requirement. It is the responsibility of the appellant to ensure power supply and also give new connections required during the year. The DISCOM have their own planning departments where experts assess the power requirements. This Tribunal in its judgment in Appeal No. 84 of 2006, dated August 29, 2006, in case of KPTCL vs KERC has decided that it is for the utility to estimate the future demands.

Relevant para from our judgment is extracted below:

*"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."*

29. It is not for the Commission to assume day to day duties and responsibilities of the appellant as it is the appellant alone who has to ensure power supply and who should estimate the requirement of power. Any way, at the end of the year the truing up has to be done. The appellants have fairly submitted that in case of any over recoveries they will refund the excess amounts collected by them with interest to the consumers.

30. With regard to 100% metering, it is important and essential that the appellants abide by the provisions of the Act and ensure 100% metering as envisaged in Section 55 of the Act.

31. As far as the IP sets are concerned, the Karnataka Government has taken the decision to postpone the regularization as per their letter dated October 3, 2006, reproduced below:

Government are pleased to accord approval for the following:

- "1) to extend the time limit for regularization of unauthorized IP sets from August 01, 2006 to March 31, 2007;*
- 2) to collect the regularization charges of Rs. 10,000/-per IP set payable by farmers in five monthly equal installments.*
- 3) Regularization charges payable in installments as above by farmers shall be shown distinctly under separate head as "receivable from farmers" in the Revenue Ledger, without merging this with the periodical electricity charges (revenue);*
- 4) To initiate action as per rules apart from disconnecting the unauthorized IP set installations, if any, existing after March 31, 2007."*

32. Once a decision has been taken by the Government it may not be proper to designate the existing connections as unauthorized.

33. In view of the aforesaid discussions and since interest of the consumers is being protected by the appellants, we hold that the Commission should allow the power requirement as estimated by the appellants."

### **Compliance by the Commission**

The Commission notes that the actual power purchase quantum and costs are now available in the audited accounts for FY07. Hence the Commission has allowed the full power purchase quantum and costs as per actuals in this truing

up exercise, considering the decision of the Hon'ble ATE in Appeal No. 100 Of 2007 regarding losses. The power purchase quantum has been allowed with reference to the approved distribution losses. The decision of the Hon'ble ATE in the AppealNo.100 is reproduced below:

*'31. XXXXX Once the target for loss level is fixed, the licensee is expected to make all efforts to achieve the loss level. The consumers should not be made to bear the brunt of losses over and above the fixed target. In the case in hand, during one year, the Commission fixes a loss level of 31%. The cost of 100 units purchased and 69 units (100-31) sold should be considered in the ARR. However, KPTCL could achieve only 35.5% loss level which means that units required to be purchased will be about 107 so that 69 units are available for sale to the consumers. Whereas the Commission has allowed the cost of procurement of power of about 107 units, simultaneously by applying a loss level of 31% to 107 units, it has also assumed that there will be sale of about 5 units over and above the 69 units. This results in recovering from the licensee for the electricity which has not actually been sold because of losses being 35.5% (actuals) against the set target of 31%. The additional imaginary sale of power assumed by the Commission is irrational, unreasonable as this electricity has not even reached the consumer end.*

*We need to balance the interest of the consumer and the licensee by ensuring that the licensee tries his best to achieve the said targets and is deterred to under achieve loss reduction. In the present case to sell 69 units KPTCL will be allowed purchase cost of 100 unit only as per the target of 31% set by the Commission and the licensee will have to pay for the power required over and above 100 units so that 69 units are sold to consumers. We decide that this deterrent of disallowing cost of electricity required over and above 100 units is sufficient and it will not be correct to assume an imaginary sale of electricity when the actual loss level is 35.5% and when the licensee has already been penalized by not allowing it the cost of power procurement over and above 100 units. This will ensure that the licensee functions efficiently. Interest of consumers is not prejudiced because licensee is being allowed only purchase cost of power as per the loss level target set by the Commission.*

*The question before us is how much of power can be deemed to have been sold and what amount should be taken as the revenue from the sale of power. The Commission cannot be allowed to assess the revenue of the licensee on the imaginary sale of power as indicated above. The licensee has borne the*

*burden of extra purchase of power for meeting the T&D loss over and above the target. The revenue of the licensee can be assessed only on the basis of actual sale. We accordingly, uphold the objection of the appellant on this aspect and allow the appeal in respect of issues A&B".*

In accordance with the above decision of the Hon'ble ATE, the quantum of power purchase to be allowed has been worked out based on the actual sales and the approved loss levels. The Computation in respect of BESCO is illustrated below:

Particulars	As Approved	Actuals as per audited accounts	Considered for truing up
1. Actuals of input energy at IF points(MU) for FY07	16222.26	18521.64	18521.64
2. Sales (MU)	12896.70	14126.45	14126.45
3. Loss(MU)	3325.56	4395.19	-
4. Loss (%)	20.50%	23.73%	20.5
5. Power purchase to be allowed considering approved loss (MU)- 14126.45 MU X 100/79.50			17769.12
6. Deviation in Energy Loss (MU) to be borne by the licensee (MU) as per the Orders of the Hon'ble ATE	-	-	752.52
7. Total Power Purchase Cost (Rs. Cr) as per actuals	-	-	4580.58
8. Average power purchase (Rs./kWh) of the energy at IF points	-	-	2.473
9. Deduction in actual power purchases (Rs. Cr.) towards deviation in loss	-	-	186.11
10. PP cost considered for true-up (7-9)	-	-	4394.47

Similar approach has been adopted in respect of the other ESCOMs also for truing up the power purchase cost.

#### **(B) Disallowance of power purchase cost to Tanir Bhavi**

The extract of the decision of the Hon'ble ATE is reproduced below:

*'35. It has been fairly stated by the learned counsel for the Commission that the additional power purchase cost*

*payable to Tanir Bhavi as allowed by this Tribunal in appeal No. 107 of 2006 could not be taken into account as the judgment in appeal No. 107 of 2006 was delivered on October 19, 2006 whereas the Commission had already vide its order dated October 16, 2006 had stated that the order was subject to the judgment of this Tribunal in appeal No. 107 of 2006. We need not say more and expect the Commission brings out this element of additional cost succinctly brought while implementing this order.'*

### **Compliance by the Commission:**

As per the allocation of PPAs made by the Government of Karnataka, the power drawn from Tanir Bavi Power Company (TBPCL) has been allocated to BESCOM and MESCOM. In the ERC for FY07, the Commission, in its Tariff orders dated 16.10.2006, had disallowed a sum of Rs. 105.30 Crs. being fixed charges payable to TPCL in respect of BESCOM and MESCOM. (page 91 of BESCOM Tariff Order and Page 88 of MESCOM Tariff order).

In terms of the directions of the Hon'ble ATE, the said disallowed amount has now been allowed in this truing up exercise. The Commission has now allowed the full power purchase cost, including the full fixed charges payable to TBPCL, as per audited accounts. Since the source-wise power purchase costs for FY07 are not separately indicated in the audited accounts of BESCOM & MESCOM, it is not possible to succinctly indicate the same.

### **(C) Distribution loss calculation**

In regard to distribution loss calculation, the Hon'ble ATE has ordered that:

*"37. We have already held above that the power purchase in respect of IP sets is to be allowed and, therefore, the losses associated with such supply also have to be allowed."*

### **Compliance by the Commission.**

To comply with the above directions, the Commission has considered the total quantum of sales as per audited accounts, which include the consumption of

metered and un-metered sales. The sales to IP sets are included under un-metered category. Since, the Power purchase quantum allowed in this order is based on actual sales [including sales to IP sets] as per audited accounts and the normative loss level approved by the Commission, the total power purchase in respect of IP sets is now allowed including the losses associated with such supply.

**(D) Interest and finance charges on investment.**

In regard to the above, the Hon'ble ATE has ordered that:

“38. This issue has already been decided by this Tribunal in appeal No. 100 of 2007 wherein we have ordered as under:

*“In view of the above judgment of this Tribunal the payments of interest and finance charges, pending final approval of the Commission, are merely provisional payments and, therefore, the Commission need not discontinue its decades old practice of allowing the interest and finance charges to the licensee till capitalization of the assets. If there is any variation in the expenditure made by the appellant and the approval accorded by the Commission, adjustments can always be made. Moreover, if the interest payments are not allowed till capitalization then the Interest During Construction will also form a part of asset base and for the useful life of the asset the return on the equity portion will be allowed to the licensee and this will not be in the interest of the consumer. It will therefore, be just, fair and equitable to continue to allow the interest and finance charges to the appellant as per Commission's well established practice and make required adjustments at the time of capitalization of assets as approved by the Commission.*”

39. We direct that the Commission implement our order in Appeal No. 100 of 2007, mutatis mutandis, in this appeal also."

### Compliance by the Commission:

In its Order dated 16.10.2006, the Commission had not allowed the interest and finance charges on the new loans against capex. The amounts as proposed by the ESCOMs and the amounts as approved in the said order are as follows:

ESCOM	Interest & finance charges AS proposed in the ERC	Interest & finance charges As approved by the Commission in the ERC
BESCOM	131.86	125.09
MESCOM	35.46	41.46
CESC	56.03	31.98
HESCOM	121.96	57.44
GESCOM	33.24	20.41

As against the above amounts, the actual interest & finance charges as per audited accounts are as under:

ESCOM	Interest & finance charges As approved by the Commission in the ERC	Interest & finance charges actually incurred as per audited accounts
BESCOM	125.09	136.83
MESCOM	41.46	41.98
CESC	31.98	39.72
HESCOM	57.44	129.83
GESCOM	20.41	68.09

It is seen from the above that except in HESCOM and GESCOM, the actual interest and finance charges do not significantly vary with the approved figures. However the Commission notes that the actual expenses include the interest paid on belated power purchase payments as indicated below:

BESCOM      Rs. 17.74 Crs.  
 MESCOM      Rs.13.81 Crs.  
 CESC          Rs. 8.36 Crs



HESCOM Rs. 37.97 Crs.

GESCOM Rs. 29.03 Crs.

The Commission, in all its previous orders has not been allowing interest on belated power purchase payments. The Hon'ble ATE in its order dated 4.12.2007 in Appeal No. 100 of 2007, has allowed interest on belated payments incurred by KPTCL for FY07, considering that KPTCL, as a bulk power trader (then) was not a repository of the revenues. As ESCOMs are repositories of revenues, they are expected to collect the revenues and discharge their payment obligations on time. For the non-recovery of revenues and consequent delay/failure in discharging the power purchase payment liabilities, the consumers should not be made liable to pay the extra cost by way of interest and finance charges on belated power purchase payments as the same would give perverse incentives for non-recovery of revenues. Further, if the consumers pay the electricity bills after due date, they are charged interest for belated payment. Hence the interest on power purchase payments is disallowed in this truing up exercise as the payment of interest on belated payment of power purchase costs would result in payment of interest twice by the consumer.

Further ESCOMs have been directed by the Commission to furnish the details of the capital works completed and the benefits derived therefrom to exercise prudence check on the capex. This information has not been submitted by the ESCOMs in full and as a result, the Commission is unable to exercise the prudence check on capex. The Commission takes serious note of non-furnishing of information by ESCOMs and directs them to furnish the information to the Commission, in the prescribed format to enable it to exercise necessary prudence check. As a one-time measure, the Commission hereby allows the actual interest and finance charges on capex. This is without prejudice to the Commission disallowing the interest and finance charges on

capex for FY08-10 (for the first control period), if necessary information is not furnished in the prescribed formats.

**(E) Employees cost:**

As regards the Employee cost, the Hon'ble ATE has ordered as follows:

*“43. We appreciate concern of the Commission regarding employees productivity and its endeavor to increase the same. Increasing the employees productivity will enhance efficient working of the organization, cut costs and improve reliability and quality of supply. We hope that the appellants take up the task of improving the productivity levels in their respective organizations and ensure continued improvements in the productivity levels as expected by the Commission. Having said that, we do not agree with the decision of the Commission not to allow the employees cost as pay revisions take into account factors such as: cost of living, salary levels in similar sectors etc. and are not necessarily linked to employee productivity alone. The Commission has sufficient powers under Section 142 of the Act to enforce its directions regarding improvement of employee productivity. Wage revisions invariably require very long and protracted negotiations and, therefore, we do not find any justification in disallowing arrears of pay revisions to the appellants. In today's industrial environment the appellants cannot postpone the payment of arrears and, therefore, will be exposed to crippling cash flow constraints if the wage related payments are not allowed.*

*44. In view of the aforesaid discussion we hold that all payment of arrears arising as a result of the pay revision should be allowed with carrying cost in the next truing up exercise.”*

**Commission's Compliance:**

For FY07 the Commission has allowed the actual employee expenses as per audited accounts. However, the Commission has not allowed the expenses towards bonus and cost of free/ subsidized power to the employees. This is in line with the principle being followed by the Commission in all its earlier orders and upheld by the Hon'ble ATE in its order dated 29<sup>th</sup> August 2006 in Appeal No. 84 of 2006 filed by KPTCL. ESCOMs have paid the pay revision arrears and the same is accounted during FY06/FY07. The Commission, in its MYT Order, while truing up the ARR for FY06 had disallowed a total amount of Rs.67.92 Crores towards pay revision arrears, which was included in prior period charges. In this order the Commission has allowed Rs.67.92 Crores towards the same.

**(F) Charges payable to KPTCL****The Hon'ble ATE has ordered that:**

*"46. Once a higher authority has taken a decision in judicial hierarchy, it is necessary that these decisions are implemented expeditiously with alacrity. We direct that the Commission expeditiously takes up implementation of this Tribunal's orders as mentioned in the aforesaid para No 45 above during the next truing up."*

**Compliance by the Commission:**

The Commission has been implementing all the decisions of the Hon'ble ATE. The orders of the Hon'ble ATE dated August 29, 2006 in appeal No. 84 of 2006, order dated October 19, 2006 in appeal No. 107 of 2006 and order dated December 04, 2007 in appeal No. 100 of 2007 have been complied with by the Commission expeditiously and with alacrity. In Order dated 7<sup>th</sup> July 2007, the Commission has implemented the Orders of the Hon'ble ATE dated 29<sup>th</sup> August 2006 and Order dated 10<sup>th</sup> October 2006 in Appeals no. 84 of 2006 and 107 of 2006 respectively. The said Orders of the Commission have been challenged in Appeal No. 100 of 2007. The Commission has implemented the Orders of the Hon'ble ATE dated 4<sup>th</sup> December 2007 in Appeal No.100 of 2007 vide Commission's order dated 31<sup>st</sup> December 2007 followed by the Tariff Orders of all the ESCOMs issued during January 2008. The financial outflow on account of implementation of these decisions has been allowed in those Orders. However, the observation of the Hon'ble ATE is again noted for future guidance.

**(G) Repair and Maintenance Expenses****Decision of the Hon'ble ATE:**

*"49. Repair and Maintenance is very important for optimal utilization of machinery and equipment on long term basis. It is important that proper repair, overhaul and maintenance is carried out regularly and wherever replacements are required the same are effected to ensure reliable supply of power and to achieve the fair life of the equipment. Therefore, it should*

*be left to the wisdom of the management of the utility to make cash projections required for R&M. Concedingly, the Commission has fairly stated that the actual for R&M expenses for FY 2006-07 which are already available shall be considered subject to prudence check after the truing up proposals are filed by the appellants. We expect the Commission takes up this exercise expeditiously and allows actual R&M expenses with carrying cost subject to prudence check."*

### **Commission's Compliance**

In this Order, the Commission has allowed the actual expenditure as per audited accounts.

### **(H) Additional reduction in tariff:**

#### **The Hon'ble ATE has ordered as follows:**

*"52. We consider that Rs. 192 crores, by no means, is a small amount to be cut with one stroke. Whether or not, there is a surplus, any reduction of this magnitude has to be explained. We are not probing into the question of surplus which has been contested by the appellants. We do not agree with this ad hoc reduction of Rs. 192 and direct the Commission to restore the same."*

### **Compliance by the Commission:**

The Hon'ble ATE had stayed the operation of the Orders of the Commission dated 16<sup>th</sup> October 2006 (in which the tariff was reduced) vide its order dated 30<sup>th</sup> October 2007. This stay was in operation till 7<sup>th</sup> February 2008, i.e the date of disposal of Appeal No.250 of 2006. Thus the reduction of tariff ordered vide Commission's order dated 16<sup>th</sup> October 2006 has not been actually given effect to by the ESCOMs. The Commission has revised the retail tariff chargeable by ESCOMs in the Orders issued during January 2008, which are yet to be implemented. In this interim period, the tariff as ordered in Tariff Order dated 27<sup>th</sup> September 2005 is in force. Hence the question of restoring the earlier tariff does not arise.

**(I) Differential industrial tariff**

The Hon'ble ATE has upheld the decision of the Commission in introducing differential tariff to urban and rural areas and has observed as hereunder:

"55. At this juncture, it is necessary to advert to sub section 62(3) of the Act extracted below for our reference.

*"The State Commission, while determining the tariff under this Act, shall not show undue preference to any consumer of electricity, but may differentiate according to the consumer's load factor, power factor, total consumption of energy during any specified period or the time at which the supply is required or the geographical position of any area, the nature of supply and the purpose for which the supply is required."*

"56. As per sub Section 62(3) above, the Commission may determine differential tariffs according to the geographical locations of the Consumers. Though promoting rural industry may be in the purview of the policy of the Government yet we cannot find fault with the Commission as long as it has acted in accordance with the Act, and its action may have helped in waning the industrial activity in the Metropolitan area of Bangalore. Accordingly, we uphold the decision of the Commission with regard to the Differential Tariff."

**(J) Bad Debt Provisions**

The Hon'ble ATE has upheld the decision of the Commission in regard to disallowances on bad and doubtful debts as follows:

*" 58. It is normal accounting practice to allow bad debts. The Commission has fairly stated in its order for allowing the same on receipt of full details and, therefore, we need not interfere with the order of the Commission with regard to the provision for bad debts."*

**Compliance by the Commission:**

The Commission has given effect to this decision in the truing up exercise in this Order, pending furnishing of details by the ESCOMs. The Commission would like to further add that in BESCO's audited accounts an amount of Rs. 182.05 Crores has been written off as bad debts against the subsidy receivable from the Government of

Karnataka. This indicates that the surplus amount earned by BESCOM is being utilized to write off subsidy receivable, as bad debt. As the surplus amount belongs to the consumers the Commission cannot allow this provision to wards bad debts. The Commission also directs BESCOM not to appropriate the surplus belonging to consumers to write off bad debts.

In this respect it is worth while to refer to the decision of the Hon'ble ATE in order dated 28<sup>th</sup> January 2008 in Appeal No. 33,24 and 101 of 2007 which is reproduced below:

*"60. In view of the aforesaid discussions we decide that if the Commission determines tariff de hors promise of subsidy, it cannot be held responsible for ensuring that MPECS gets the promised subsidy from the Government of Maharashtra as it is a post tariff fixation subsidy. But as the Commission has factored Rs. 72 crores subsidy element in determination of tariff, it is duty bound as per this Tribunal's judgment dated May 26, 2006 in SEIL vs PSERC case, to require the Government to pay outstanding subsidy. We order accordingly."*

As the Government of Karnataka is duty bound to pay the committed subsidy, ESCOMs cannot adjust the subsidy by setting off a part of the surplus to write off subsidy. Therefore, the ESCOMs are directed to obtain the committed subsidy. In this regard the Government of Karnataka is also directed to release the committed subsidy to the ESCOMs expeditiously.

#### **Net Result of Truing Up:**

The statements indicating truing up of item-wise expenses of each of the ESCOMs are enclosed to this order as Annex 1 to 5. After the truing up exercise, which has been done with reference to the audited accounts, the net amount of surplus/ deficit to be carried forward to the next review of ARR for FY09 is as follows:

ESCOM	Total Revenue including Committed subsidy	Total Expenditure after truing up	Surplus/(Gap)	Carrying Cost @ 12% for 1 year	Total Surplus
BESCOM	5746.17	5000.45	745.72	89.49	835.21
MESCOM	1094.33	839.58	254.75	30.57	285.32
CESC	1155.37	1034.71	120.66	14.48	135.14
HESCOM	1718.39	1621.66	96.73	11.61	108.34
GESCOM	1099.52	1069.88	29.64	3.56	33.20
<b>Total</b>	<b>10813.78</b>	<b>9566.28</b>	<b>1247.5</b>	<b>149.70</b>	<b>1397.20</b>

As a result of the truing up of expenses, the surplus of all the ESCOMs along with carrying cost for one year works out to Rs. 1397.20 Crores. The above surplus represents the amount passed over to consumers in tariff in excess of the revenue requirement.

### Commission's Order

1. This order is issued in compliance of the orders of the Hon'ble ATE dated 7<sup>th</sup> February 2008 in Appeal No.250 of 2006. The Annual Revenue Requirement for FY07 stands corrected as per the figures considered for true up in this order.
2. The surplus/(deficit) as per this order is ordered to be carried forward to the ARR of FY09, during the next filing for Review of Annual Performance.
3. This Order is signed, dated and issued by the Karnataka Electricity Regulatory Commission at Bangalore on this day the 21<sup>st</sup> February 2008.

Sd/-  
**(K.P.Pandey)**  
Chairman

Sd/-  
**(H.S.Subramanya)**  
Member

Sd/-  
**(S.D.Ukkali)**  
Member