CHAPTER – 1

ANNUAL PERFORMANCE REVIEW FOR FY17

1. MSEZL's Application for APR for FY17:

MSEZL has filed its application for Annual Performance Review (APR) for FY17 and Revision of ARR and retail supply tariff for FY19 on 29th November, 2017. MSEZL has sought the approval for its revised ARR as per the Annual Performance Review (APR) for FY17 based on the Audited Accounts.

The Commission in its letter dated 21st December, 2017 had communicated its preliminary observations to the application. MSEZL, in its letter dated 27th December, 2017 has furnished its replies to the preliminary observations of the Commission.

The Commission in its Tariff Order dated 30th March, 2016, had approved the ARR along with Retail Supply Tariff for FY17. The Annual Performance Review of MSEZL for FY17 as per the provisions of the MYT Regulations and based on its audited accounts is discussed in this Chapter.

MSEZL's Submission:

MSEZL has submitted its proposals for revision of ARR for FY17 based on the Audited Accounts as follows:

TABLE – 1

APR for FY17 – MSEZL's Submission

Amount in Rs. Crores

Sl. No	Particulars	As Filed
2	Energy at Interface in MU	18.54
3	Distribution Losses in %	-0.06%
4	Sales in MU	18.60
5	Revenue from sale of power	17.81
	Expenditure	
6	Power Purchase Cost	10.54
7	Employee Cost	
8	Repairs & Maintenance	
9	Admin. & General Expenses	
10	Total O&M Expenses	1.42
11	Depreciation	2.73

12	Interest on Loans	3.81
13	Interest on Working capital	0.00
14	Interest on consumer deposits	0.29
15	Less: Expenses capitalised	0.00
16	Return on Equity	3.02
17	Other Income	0.30
	Net ARR	**21.91**

Considering the revenue of Rs.17.81 Crores against a net ARR of Rs.21.51 Crores, MSEZL has reported a gap in revenue of Rs.3.70 Crores for FY17. The MSEZL in its application has decided to absorb the gap in revenue of Rs.3.70 Crores arrived on account of Rs.3.02 Crores of RoE and Rs.0.68 Crores of normative interest on excess equity investment. Further, MSEZL in its applications has informed that, any increase in revenue gap on account of increase in Power Purchase Cost may be allowed to be passed on and recovered from the consumers during FY19.

2. The item-wise review of revenue and expenditure and the decisions of the Commission thereon are as discussed in the following paragraphs:

i. Sales for FY17:

1) The Commission, in its Tariff Order dated 8th May, 2017, had approved sales of 79.40 MU for FY17 as proposed by the MSEZ. The actual sales as per current filing is 18.60 MU indicating under achievement of sales to an extent of 60.80 MU. MSEZ has stated that the estimated sales to HT industries could not be achieved due to demand constraints and poor off-take by major bulk consumers on account of delayed synchronization of their CPP with KPTCL grid, which occurred in February,2017.

2) The Commission had observed that the reduction in sales is attributed to poor off-take by major bulk consumers. Hence, MSEZ was directed to furnish HT bulk consumer-wise details of estimated sales and actuals for FY17.

3) MSEZ in its replies has furnished the details sought by the Commission. The Commission notes that the under achievement in sales is attributable to one consumer, namely, ONGC Mangalore Petro-Chemicals, which has consumed only 4.33 MU as against estimated sales of 67.01 MU.

4) The Commission having noted the reduction in sales with respect to the approved figures, hereby approves the actual sales of 18.60 MU for FY17.

ii. Distribution Losses for FY17:

MSEZL, in its application has reported the actual negative distribution losses of 0.32% as against the distribution losses of 1.35% approved by the Commission for FY17. MSEZL has stated that, the negative losses are due to meter calibration issues.

The Commission in its, Tariff Order dated 11th April, 2017 had informed MSEZL that, it cannot accept negative loss figures. The distribution system should invariably include technical losses and negative losses if any are, are due to measurements issues. MSEZL in its replies has stated that, the losses are based on the measurements and, the meters at IF points and consumers' locations have since been calibrated.

It is noted that despite the Commission's observations in its Tariff Order dated 11th April, 2017 while approving the APR for FY16, the MSEZL has not taken care to set right the issue.

The Commission, notes that MSEZL has sold energy higher than the energy received from MESCOM at IF points for FY17. MSEZL is required to reconcile the energy data along with MESCOM. The Commission directs MSEZL to set right the issue without any further delay.

iii. Power Purchase for FY17:

MSEZL, in its application has reported that it has purchased 18.54 MU at the IF points of MESCOM at a cost of Rs.10.54 Crores as against the approved power purchase of 83.38 MU at a cost of Rs.45.32 Crores for FY17. As per the actual source-wise power purchase reported by MESCOM under format D-1 and audited accounts, the revised power purchase cost for MSEZL is as detailed below:

TABLE – 2

Revised Power Purchase Cost-FY17

Particulars	Energy in MU	Total Cost Rs.Crores	Cost Per Unit Rs/Unit
5% of procurement of MESCOM	283.442		
95% of Requirement	269.27		
Sourced from BTPS Unit 2	186.31	100.36	5.39
NLC II expansion	27.05	14.24	5.26
RTPS VIII	55.91	27.17	4.86
NCE-Solar Power	14.17	10.59	7.47
Total Power Purchase Cost at 5%	**283.44**	**152.36**	**5.38**
Transmission Charges& SLDC Charges		11.10	0.3917
Total PP & Transmission cost		**163.46**	**5.77**
Trading margin at 5 paise per unit		1.42	0.05
Total Cost	**283.44**	**168.88**	5.82
Power Purchase at IF Points (Transmission Loss at 3.283%)	**274.14**		**6.01**

Based on the above computations, the power purchase cost for the purchase of 18.54 MU by MSEZL from MESCOM IF points at Rs.6.01 per unit works out to Rs.11.15 Crores for FY17. Therefore, MSEZL is required to pay the difference in the power purchase cost of Rs.0.61 Crores to MESCOM for FY17.

Further, the Commission notes that the power purchase quantum reported by MSEZL is lesser than the energy sold to the consumers of MSEZL. MSEZL is directed to reconcile the energy purchase quantum with MESCOM, based on calibration of meters as reported in its application. However, for the present, **the Commission decides to consider the actual power purchase of 18.54 MU at IF points at a cost of Rs.11.15 Crores for the purposes of APR of FY17.** Any revision in the quantum and cost of power purchase for FY17 noticed subsequently shall be factored, in the ensuing year and reported to the Commission.

iv. RPO Compliance:

MSEZ was directed to furnish the status of solar and non-solar RPO compliance for FY17 and also the estimates of RPO to be met in FY19 and the plan of action to meet the same in FY19.

MSEZ in its replies has stated that as per the prevailing Regulations any deemed licensee procuring bulk power supply from ESCOMs is deemed to have complied with RPO to the extent of such procurement from ESCOMs and therefore, a standalone compliance is not required.

The Commission notes that, the Regulations also specify that in case of non-compliance, the onus of meeting the RPO lies with the deemed licensees, as well.

The Commission further, notes that MESCOM from whom MSEZ is procuring power, has met both the Solar & Non-Solar RPO and therefore, MSEZ is deemed to have met both Solar & Non-Solar RPO for FY17.

v. Operation and Maintenance Expenses:

MSEZL in its application has sought the approval for the O&M expenditure of Rs.1.42 Crores for FY17 as detailed below:

TABLE-3

O&M Expenses for FY17–MSEZL submission

Rs. Crores

Repairs & Maintenance	0.65
Employee Expenses	0.49
A&G expenses	0.28
O&M expenses	**1.42**

The Commission in its Tariff Order dated 30th March, 2016 had approved O&M expenses of Rs.1.23 Crores for FY17. The Commission notes that, the overall O&M expenses consist of R&M expenses, Employee cost and A&G expenses.

The Commission, in accordance with the provisions of MYT Regulations and the methodology adopted while approving the O&M expenses for the control period for FY17 to FY19 and for the previous control period and subsequent APRs carried out for distribution licensee, proceeds with the determination of normative O&M expenses based on the 12 Year data of WPI and CPI. Considering the Wholesale Price Index (WPI) as per the data available from the Ministry of Commerce & Industry, Government of India and Consumer Price Index (CPI) as per the data available from the Labour Bureau, Government of India and adopting the methodology followed by the CERC with CPI and WPI in a ratio of 80:20, the allowable annual escalation rate of inflation for FY17 is computed as follows:

TABLE – 4
Computation of Rate of Inflation

Year	WPI	CPI	Composite Series	Yt/Y1=Rt	Ln Rt	Year (t-1)	Product [(t-1)* (LnRt)]
2005	103.37	115.8	113.314				
2006	109.59	122.9	120.238	1.06	0.06	1	0.06
2007	114.94	130.8	127.628	1.13	0.12	2	0.24
2008	124.92	141.7	138.344	1.22	0.20	3	0.60
2009	127.86	157.1	151.252	1.33	0.29	4	1.16
2010	140.08	175.9	168.736	1.49	0.40	5	1.99
2011	153.35	191.5	183.87	1.62	0.48	6	2.90
2012	164.93	209.3	200.426	1.77	0.57	7	3.99
2013	175.35	232.2	220.83	1.95	0.67	8	5.34
2014	182.00	246.90	233.92	2.06	0.72	9	6.52
2015	177.03	261.42	244.542	2.16	0.77	10	7.69
2016	180.6	274.3	255.56	2.26	0.81	11	8.95
A= Sum of the product column							39.44
B= 6 Times of A							236.63
C= (n-1)*n*(2n-1) where n= No of years of data=12							3036.00
D=B/C							0.08
g(Exponential factor)= Exponential (D)-1							0.0811
e=Annual Escalation Rate (%)=g*100							**8.1059**

While determining the normative O & M expenses for FY17, the Commission has considered the following aspects:

a) The actual O & M expenses of the base year as per the audited accounts for FY16.

b) The three year compounded annual growth rate (CAGR) of the number of installations considering the actual number of installations as per the audited accounts up to FY17.

c) The weighted inflation index (WII) at 8.1059% as computed above.

d) Efficiency factor at 0.5% as considered in the earlier two control periods.

Thus the normative O&M expenses for FY17 will be as follows:

Particulars	FY16	FY17
No. of Installations	9	9
Inflation		8.1059%
Base Year O&M Cost(FY15 as per actuals)		
O&M Index= 0&M (t-1)*(1+WII-X)		**1.22**
Actual base year O&M expenses for FY16	**1.13**	**1.22**

The Commission notes that, the O&M expenses for FY17 claimed by MSEZL are more than the Commission approved expenses and directs that, the O&M expenses are controllable expenditure in nature, the MSEZL should take necessary action to minimize these expenditures in future to bring down the O&M expenses within the approved level.

Thus, the Commission decides to allow actual O&M expenses of Rs.1.22 Crores for FY17.

vi. Depreciation:

MSEZL in its application has claimed an amount of Rs.2.73 Crores as depreciation for FY17.

In accordance with the provisions of the KERC (Terms and Conditions for Determination of Tariff) Regulations, 2006 and amendments thereon, allowable depreciation for FY17 has been determined by the Commission duly considering the data of assets as per MSEZL's audited accounts and the details furnished under D-8 format as follows:

TABLE – 5

Allowable Depreciation for FY17

Rs. Crores

Particulars	Opening Balance of Asset as on 01.04.2016	Closing Balance of Asset as on 31.03.2017	Depreciation for FY17
Lease hold assets	6.17	6.17	0.00
Buildings	2.84	2.84	0.09
Civil	-	0.87	0.03
Plant & M/c	21.07	21.18	1.01
Line, Cable Network	33.87	33.89	1.61
Furniture	0.05	0.05	0.00
Office Equipment	0.02	0.02	0.00
Total	**64.90**	**65.03**	**2.73**
Allowable depreciation			**2.73**

The allowable depreciation based on the rates of depreciation as per the prevailing Regulations works out to Rs.2.73 Crores.

Thus, the Commission decides to allow depreciation of Rs.2.73 Crores for FY17.

vii. Interest on Capital loan:

MSEZL in its application has claimed an amount of Rs.3.81Crores towards interest on capital loans. The Commission in its, Tariff Order dated 30th March, 2016 had approved the interest on capital loans at Rs.1.95 Crores for FY17.

As per the bifurcated audited balance sheet of the licensed activity of MSEZL, the opening balance of loans is Rs.27.86 Crores and the closing balance is Rs.25.15 Crores for FY17. As per the D9 (format) and the notes to the audited accounts under the consolidated balance sheet, MSEZL has pre-closed the capital loan availed from IoB Bank and borrowed fresh capital loan from SBI during FY17. Accordingly, the borrowings and the repayment of capital loan is indicated as Rs.25.29 Crores and Rs.28.00 Crores respectively for FY17. Considering the payment of interest on capital loan balance as per the consolidated audited accounts of MSEZL for FY17, the weighted average rate of interest on capital loan works out to 9.7331% which is within the normative rate of interest. The Commission recognizes the same rate of interest for computation of interest on the average capital loan amount for FY17 as detailed below:

TABLE –6

Allowable Interest on Capital Loans for FY17

Rs. Crores

Particulars	FY17
Opening balance of Capital Loans	27.86
New Loans	25.29
Less; Repayments	28.00
Total loan at the end of the year	25.15
Average Capital Loan	26.51
Interest Rate in %	9.7331%
Interest on Capital Loans	**2.58**

The Commission having decided to recognize the opening balance of Gross Fixed Asset (GFA) of the licensed business at Rs.64.90 Crores and Rs.32 Crores as the actual opening net equity as on 1.04.2016 as per the audited accounts for FY17, has considered the equity in excess of 30% of GFA amount as being

used to finance the acquisition of assets of the MSEZ and allowed the interest as per the provisions of Clause 3.6 of the KERC (Terms and Condition for Determination of Tariff for Distribution and Retail sale of Electricity) Regulations, 2006 as under:

Rs. Crores

Opening Gross Fixed Assets as on 1.04.2016	64.90
30% of GFA (Eligible for allowance of RoE)	19.47
70% of GFA (Eligible for loan component)	45.43
Opening balance of net Equity as on 1.04.2016	32.00
Equity in excess of 30% GFA (32.00-19.47) treated as amount of equity used to finance the creation of assets.	12.53
Weighted average rate of interest	9.73%
Interest eligible for allowance for FY18	1.22

Accordingly, the allowable interest on the equity in excess of 30% of GFA is Rs.1.22 Crores for FY17.

Thus, the Commission decides to allow an amount of Rs.3.80 Crores (Rs.2.58 Crores plus Rs.1.22 Crores) towards interest on capital loan for FY17.

viii. Interest on Working Capital:

MSEZL in its application has stated that, it has not incurred any interest on working capital and not claimed any amount of normative interest for the licensed activity in the APR for FY17.

The Commission in its Tariff Order dated 30th March, 2016 has allowed Rs.1.12 Crores as interest on working capital for FY17. As per the KERC (Terms and Conditions for Determination of Tariff) Regulations, 2006 and amendments thereto, the Commission has computed the normative allowable interest on working capital for FY17 as follows:

TABLE – 7

Allowable Interest on Working Capital for FY17

Rs. Crores

Particulars	FY17
One-twelfth of the amount of O&M Expenses	0.10
Opening GFA	64.90
Stores, materials and supplies 1% of Opening balance of GFA	0.65
One-sixth of the Revenue	2.97
Total Working Capital	3.72
Rate of Interest (% p.a.)	11.00%
Normative Interest on Working Capital	0.40
Actual interest on WC as per audited accounts for FY17	0.00
Allowable Interest on Working Capital	0.20

The Commission notes that, the MSEZL in its application has not claimed any normative interest on working capital for its licensed activities for FY17.

Thus, the Commission decides not to allow any amount towards interest on working capital for FY17.

ix. Interest on Consumers' Security Deposits:

MSEZL in its application has claimed an amount of Rs.0.29 Crores towards payment of interest on consumers' security deposits for FY17 at 7.75%.

The Commission takes note of the opening and closing balance of consumers' security deposits as per the audited consolidated balance sheet for FY17. As per the KERC (Interest on Consumers' Security Deposit) Regulations, 2005 the interest on consumer deposits shall be allowed as per the bank rate prevailing as on the 1st of April of the relevant year. Considering, the bank rate 7.75% as on 1st April, 2016, the allowable interest on consumers' security deposits for FY17 is Rs.0.29 Crores only.

Thus, the Commission decides to allow an amount of Rs.0.29 Crores towards interest on consumers' security deposits for FY17.

Thus the allowable interest and finance charges for FY17 are as follows:

TABLE – 8
Allowable Interest and Finance Charges

Rs. Crores

Sl. No.	Particulars	FY17
1.	Interest on Loan capital	3.80
2.	Interest on working capital	0.00
3.	Interest on consumers; security deposits	0.29
	Total interest and finance charges	**4.09**

x. Return on Equity:

MSEZL in its application has claimed Return on Equity of Rs.3.02 Crores for FY17 as detailed below:

TABLE –9

Return on Equity – Submission by MSEZL

Rs. Crores

Particulars	FY17
Opening Equity	19.76
Return on equity at 15.50%	**3.02**

The Commission while approving the ARR for FY17 has computed the return on equity at 15.50% by considering the equity at 30% of the GFA and has allowed RoE of Rs.3.70 Crores. As per the bifurcated audited balance sheet of MSEZL for FY17, the opening share capital for the licensed business is Rs.35.55 Crores and the accumulated deficit is Rs.3.55 Crores. However, as the normative allowable equity of Rs.19.47 Crores based on the 30% of the gross fixed assets is less than the actual net equity of Rs.32.00 Crores as per the bifurcated audited accounts for FY17, the Commission decides to consider the normative equity of Rs.19.47 Crores for computation of return on equity.

As per the provisions of the MYT Regulations, the Commission having recognized Rs.19.47 Crores being the equity of the licensed activity in proportion to the opening GFA of the licensee as per the bifurcated audited accounts of MSEZL, the allowable RoE for FY17 is Rs.3.02 Crores at 15.50% for FY17.

As per the KERC (Terms and Conditions for Determination of Tariff) Regulations, 2006 and amendments thereto, the Commission has computed the allowable Return on Equity at 15.5% without allowing the tax on the equity of Rs.19.47Crores as discussed in the above paras:

TABLE – 10

Allowable Return on Equity

Rs. Crores

Particulars	FY17
Opening balance of Share Capital	35.55
Opening balance of accumulated deficit under Reserves and Surplus	(-)3.55
Opening balance of Net Equity	32.00
Normative Equity at 30% of the GFA (GFA-64.90 Crores)	19.47
Return on equity at 15.50% on 30% of GFA	**3.02**

Thus, the Commission decides to allow Return on Equity of Rs.3.02 Crores for FY17.

xi. Income Tax:

The Commission notes that, the MSEZL being a SEZ developer is enjoying tax holiday under the Section 80.1AB of the Income Tax Act, and has not claimed any tax for FY17.

Thus the Commission decides not to allow any amount of income tax /MAT for FY17.

xii. Other Income:

MSEZL in its application has claimed an amount of Rs.0.30 Crores as other income towards interest from Banks for FY17.

Thus, the Commission decides to allow an amount of Rs.0.30 Crores as other income for FY17.

3. Abstract of Approved ARR for FY17:

As per the above item-wise decisions of the Commission, the consolidated statement of ARR for FY17 is as follows:

TABLE – 11

Approved ARR for FY17 as per APR

Rs. Crores.

Particulars	As approved 30.03.2016	As filed	As per APR
Revenue			
Revenue From Sale of Power	54.83	17.81	17.81
Subsidy from Government	0.00	0.00	0.00
Total Revenue	**54.83**	**17.81**	**17.81**
Expenditure			
Power Purchase Cost	45.32	10.54	11.15
Employee Expenses	0.00	0.00	0.00
R&M Expenses	0.00	0.00	0.00
A&G Expenses	0.00	0.00	0.00
O&M Expenses	**1.23**	**1.42**	**1.22**
Depreciation	1.52	2.73	2.73
Interest on Loan Capital	1.95	3.81	3.80
Interest on Working Capital	1.12	0.00	0.00
Interest on Consumers' security Deposit	0.29	0.29	0.29
Less; Expenses Capitalised	0.00	0.00	0.00
Return on Equity	3.70	3.02	3.02
Other Income	0.30	0.30	0.30
Net ARR	**54.83**	**21.51**	**21.91**

4. Gap in Revenue for FY17:

As against an approved ARR of Rs.54.83 Crores, the Commission after the Annual Performance Review (APR) of MSEZL for FY17 decides to allow the revised ARR of Rs.21.91 Crores for FY17. Considering the revenue from sale of power of Rs.17.81 Crores, the revenue deficit of Rs.4.10 Crores is determined for the year FY17.

MSEZL in its application has stated that, the Management has decided to absorb Rs.3.70 Crores of the gap in revenue on account of Rs.3.02 Crores of RoE and Rs.0.68 Crores of normative interest in its books and does not propose to pass on the same to the consumers. Further, MSEZL has requested the Commission that, any increase in revenue gap on account of increase in power purchase cost may be allowed to be passed on and recovered from the consumers during FY19.

The Commission takes note of the above decision of the Management of the MSEZL on treatment of the deficit in revenue for FY17. Accordingly, the Commission, after having reckoned the absorbed net revenue deficit of Rs.3.70 Crores, decides to carry forward Rs.0.40 Crores being the remaining revenue deficit of FY17 on account of power purchase cost to the proposed ARR for FY19, as discussed in the subsequent Chapter of this Order.