KERALA STATE ELECTRICITY REGULATORY COMMISSION
Thiruvananthapuram

Petition No. TP 20 of 2006 and TP 22 of 2006
November 24, 2007

Present	Shri. C. Balakrishnan, Chairman Shri. C. Abdulla, Member Shri. M.P. Aiyappan, Member
Kerala State Electricity Board	Petitioner

ORDER

The Kerala State Electricity Regulatory Commission having scrutinized the petitions on **Truing up for the years 2003-04 and 2004-05** filed by Kerala State Electricity Board (hereinafter referred to as Licensee) vide letter No.KSEB/ TRAC/A&F/TruingUP 03-04/06/383 dated 22nd June, 2006 and No. KSEB/TRAC/TruingUP 2004-05/06/590 dated 19th October, 2006, admitted as Petition No. TP 20 of 2006 and Petition No. TP 22 of 2006 respectively, considered the written objections filed by the stakeholders, heard the views of stakeholders/ objectors on 23rd October, 2007, considered other documents and materials on record, and passes the following Order to dispose the above petitions in exercise of the powers vested in it under the Electricity Act 2003, on this behalf.

Sd/-	Sd/-	Sd/-
M.P. Aiyappan	C. Abdulla	C. Balakrishnan
Member	Member	Chairman

Background:

Kerala State Electricity Board (KSEB) had submitted the truing up petition for 2003-04 vide their letter No.KSEB/TRAC/A&F/Truing up 03-04/06/383 dated 22-6-2006 citing a revenue gap of Rs.1007.44 Crore. The Commission decided to accept the same in its Proceedings dated 12th July, 2006 and informed KSEB to publish the same as required under section 27(6) of KSERC (Conduct of Business) Regulations 2003. Further on 2-11-2006, KSEB submitted another petition for truing up for the year 2004-05 to accommodate a revenue gap of Rs.342.77 Crore. The Commission accepted the same as petition No TP 22 and communicated to KSEB vide letter No.KSERC.TP22/2006 dated 6th November, 2006 to publish the same and to provide clarifications sought by the Commission on the petition. The Commission forwarded the petition to the Government of Kerala also for obtaining the comments especially regarding the subsidy to be provided by the Government. Further, the Commission sent reminders to KSEB vide letters dated 10-8-2006, 6-11-2006, 12-6-2007 and 20-7-2007 for publishing the petition and providing clarifications on the same.

The Licensee informed the Commission vide its letter No. KSEB/TRAC/Truing Up/P/311 dated 26-7-2007 that, Licensee has published the petition in the following dailies.

- Mangalam Daily - 5-7-2007
- Madhyamam Daily – 6-7-2007
- The Hindu daily – 6-7-2007.

The Commission in its letter No. KSERC/TP/22/2006 dated 3-8-2007 directed the licensee to provide the details of objections received and to furnish the copies of the dailies in which the summary of the petition had appeared and also to provide the clarification sought by the Commission vide letter dated 6-11-2006. However, no communication from the Licensee has been received so far. The Commission issued a press release to inform the public for inviting objections on the petition by 10-10-2007 and fixed the public hearing on 23-10-2007. The HT & EHT Industrial Consumers Association vide their letter dated 3-10-2007 and M/s Binani Zinc limited vide their letter dated 6-10-2007 requested the Commission to extend the date of submission of objections till 20-10-2007. Pursuant to the request, the Commission extended time till 20-10-2007 for submitting the objections. The public hearing was held on 23-10-2007 at the Commission's Office and the list of persons attended the public hearing is enclosed as Annexure. The Commission forwarded the objections filed by HT-EHT Industrial Electricity Consumers' Association to KSEB vide letter on 23-10-2007 itself for obtaining their reply immediately. A reminder for submitting reply was given to KSEB on 3-11-2007 by fax. However, KSEB did not oblige to the reminders of the Commission. Since the Commission is not in a position to wait indefinitely for the action of KSEB, the Commission has taken a view that, KSEB has nothing to offer on the objections filed by the consumers.

The Commission in its maiden order on ARR & ERC of the licensee for 2003-04 had approved total revenue requirement of Rs.3647.83 Crore with Rs.240.37 Crore as non-tariff income and Rs.3141.37 Crore as revenue from tariff leaving a gap of Rs. 556.46 Crore. In order to avoid a steep increase in the tariff, the Commission recommended to the Government to set off the gap in the following pattern:

1. Exemption from payment of Duty under Section 3(1) of KED Act & Allowing duty collected under Section 4 as grant to the Board - Rs.182.56 Crore
2. Amount of subsidy provided in the Budget of GoK - Rs. 175.00 Crore
3. Grant of additional cash subsidy - Rs.200.00 Crore
4. **Total subsidy commitment - Rs.557.56 Crore**

Against this, the Licensee has furnished the audited income and expenses statements, which shows a gross ARR of Rs. 4068.18 Crore and Rs.3060.74 Crore as revenue from sale of power and other income, thereby leaving a revenue gap of Rs.1007.44 Crore. The Government released subsidy of Rs.361.00 Crore and adjusted the guarantee commission and electricity duty to the tune of Rs.195.46 Crore, totaling Rs.556.46 Crore as ordered by the Commission. For the balance of Rs.450.97 Crore, the Licensee requested the Commission to allow in the truing up petition for 2003-04. A comparison of the approved ARR and actual based on audited accounts are as follows:

Particulars	**2003-04**		
	ARR Order	**Actual**	**Difference**
Purchase of power	1775.13	1887.11	111.98
Generation of power	153.32	143.70	-9.62
R&M	66.70	63.79	-2.91
Employee cost	693.64	788.31	94.67
A&G Expenses	55.88	84.74	28.86
Depreciation	334.52	326.19	-8.33

Particulars	2003-04		
	ARR Order	Actual	Difference
Interest and Financing charges	679.26	726.32	47.06
Other expenses	76.28	143.35	67.07
Total	3834.73	4163.51	328.78
Less expense capitalized	119.80	109.05	10.75
Less interest capitalized	108.93	78.11	30.82
Sub Total	228.73	187.16	41.57
Total expenses	3606.00	3976.35	370.35
Surplus	91.83	91.83	0
Total Revenue Requirement	3697.83	4068.18	370.35
Non tariff income	240.37	304.66	64.29
Revenue from tariff	2901.00	2756.09	-144.91
Total revenue	3141.37	3060.75	-80.62
Revenue gap	-556.46	-1007.43	-450.97
Subsidy received/Ordered	556.46	**556.46**	0
Balance revenue gap	**0.00**	**-450.97**	**-450.97**

The ARR & ERC order of the Commission for 2003-04 was issued on December 31, 2003 and most of the items of expenditure were considered as provided by the licensee.

The Licensee has stated that the accounts submitted along with the petition is in accordance with the Annual Accounts Rules 1985 duly audited and certified by the CAG subject to the observations in the audit report and it represents a true and fair view of the state of affairs of the Board. Licensee has stated in the prayer that the cost of borrowing to meet the deficit in excess of the one allowed by the Commission in 2003-04 had already been built into the ARR & ERC and accounts of the Board for the subsequent year 2004-05 hence no claim is made.

In the ARR & ERC order of 2004-05, the Commission has fixed a revenue gap of Rs296.46 Crore, with ARR fixed as Rs.3492 Crore and revenue from charges at Rs.3196 Crore. The Commission proposed to the Government to bridge the revenue gap as follows:

1. Exemption to KSEB from payment of Duty under Section 3(1) - Rs. 34.00 Cr.
2. Adjustment of Duty collected under Section 4 of KED - Rs.166.00 Cr
3. Total Duty to be adjusted - **Rs.200.00 Cr**

The Commission recommended to the Government to pay the balance gap of Rs.96 crore as subsidy in order to avoid an immediate tariff revision.

The Licensee in its truing up Petition TP No. 22, has furnished the summary of the petition as follows.

Particulars	2004-05		
	ARR Order	Actual	Difference
Purchase of power	1605.53	1463.03	-142.50
Generation of power	100.53	81.13	-19.40
R&M	66.70	74.49	7.79
Employee cost	718.47	789.64	71.17
A&G	68.68	95.01	26.33
Depreciation	382.27	374.77	-7.50
Interest and Financing charges	618.30	605.59	-12.71
Other expenses	50.00	117.54	67.54
Total	3609.95	3601.20	-8.75
Less expenses capitalized	123.53	42.88	-80.65
Less interest capitalized	98.96	62.04	-36.92
Sub Total	222.49	104.92	-117.57
Total expenses	3387.46	3496.28	108.82
Surplus	105.00	103.49	-1.51
Total revenue requirements	3492.46	3599.77	107.31
Non tariff income	231.00	339.63	108.63
Revenue from tariff	2965.00	2917.37	-47.63
Total revenue	3196.00	3257.00	61.00
Revenue gap	-296.46	-342.77	-46.31
Subsidy received/Ordered			0.00
Balance revenue gap	**-296.46**	**-342.77**	**-46.31**

Major Objections from stakeholders

In response to the publication of petition and the notice issued by the Commission, The Kerala High Tension and Extra High Tension Industrial Electricity Consumers' Association and M/s.Binani Zinc Limited filed objections before the Commission. However, both the objectors have filed the same objections. The objectors raised the issue that, petitioner Board has not provided any rationale for filing the petition three to four years after the close of accounts for FY 2003-04 and FY 2004-05. The Objectors have also pointed out that, Regulations of the Commission have not provided the mechanism for truing up. The Commission has not set any standards or benchmarks for the performance of the Board due to which, undertaking a truing up exercise will be against the preamble of the Act ie., encourage efficiency and economical use of resources. The objectors have also pointed out that if the Commission is undertaking the truing up exercise simply based on actuals without differentiating the reasonableness, considering the audited accounts as sacrosanct, the whole exercise of truing up would be a futile exercise. They have also pointed out that a judgment of the Hon. Supreme Court signifies the relevance of regulatory approvals or accounts being different from audited accounts.

The Commission after examining the objections conclude that there is little merit in the arguments of the Objectors that there is no regulation issued to deal with truing up. The existence of a regulation is not a condition precedent for allowing truing up. This is the initial instance; a truing up petition is filed before the Commission. ARR & ERC of the licensees are estimates based on the past data. There are number of reasons on which the forecast of the licensee and judgments of the Commission may differ from the actual. This being the case, the Commission firmly feel that, allowing of expenses are based on the sound regulatory principles of prudence and usefulness and also by considering whether the events which lead to changes in income and expenses are under the control of the licensee or not. Further, the Commission cannot ignore limitations of data availability in assessing the prudence of expenses and fixing of benchmarks. The objectors themselves have cited the example of Karnataka, where the principles of truing up have been set out in the Order itself. Hence the Commission does not find any merit in these arguments of the objectors.

In the public hearing, the Licensee has stated that the final accounts are audited by none other than the Accountant General, and all the reasonableness are ensured while auditing is done by the AG. This argument of the Licensee cannot be accepted, where as the Commission finds force in the arguments of the objectors that audited accounts need not be sacrosanct in terms of regulatory approvals. The Commission considers that, as pointed out by the Licensee itself that, audited accounts *'give a true and fair view of the state of affairs of the Board'.* However, this is no way a justification to pass on the entire burden of expenses to the consumer in the form of tariff. As tariff is determined based on the principles envisaged in the Act, the Commission has to consider various other parameters including efficiency and economy of the operations of the Licensee. Further, as per the principles of performance based regulation, the cost saving achieved by the licensees are allowed to be retained with them as incentives and any over expenses are also retained with the licensee as penalty. Hence, regulatory principles may be different from what the audited accounts reflect. A step further, the performance benchmarks fixed by the Commissions, would be the guidelines for AG while auditing the accounts of the licensee once they are brought to his knowledge.

Principles of Truing up

The Commission has mentioned the requirement of truing up of costs, in the first ARR & ERC order issued in December, 2003 itself. The Commission has decided the ARR& ERC based on the provisions of the Electricity Act 2003. However, in the absence of the notification of National Electricity Policy and Tariff Policy as on the date of that Order and in accordance with the transition provisions under Section 172 of the Electricity Act, 2003 the Commission has relied on the principles existed under Electricity (Supply) Act 1948 and ERC Act 1998.

The Commission is of the view that consistency in regulatory principles and policies are required for providing right signals for the Licensees. The present truing up petitions before the Commission would be dealt with in accordance with principles set out in the respective ARR & ERC orders. In addition, the Commission also have the view that, it is a well established regulatory practice that any loss or gain on account of the factors beyond the control of the licensee to be properly reflected in the revenue requirements of the Licensee. Further, efficiency and performance of the licensee is to be rewarded and inefficiency and under-performance shall be kept in the account of the licensee itself. Though the above considerations are vital, the ground realities cannot be completely overlooked. After its establishment, the Commission has strived to improve the availability and quality of data from the Licensees. While considering the ARR & ERC petitions of the Licensee for 2003-04 and 2004-05, the Commission had faced the problem of lack of adequate data, which was amply brought out in those orders. Hence, the Commission is of the view that proper consideration shall also be given to such factors while considering the present petition. **As the availability and quality of data improves, the Commission would consider various factors in detail.** Hence, the Commission considers the following as the basis for the approval of Truing up of Expenses and Revenue.

1. Principles of Performance Based Regulation (PBR) & regulatory consistency
2. Controllable expenses above the approved limit on the account of the licensee and uncontrollable expenses after prudence check allowed to be passed on.
3. Consideration of Performance parameters fixed

4. Due credit to be given to the licensee for change in consumer mix, hydro thermal mix and inflation.

True up of ARR & ERC for 2003-04 and 2004-05

T&D loss:

The Objectors have stated that, only the approved level of T&D loss be passed on to the consumer, and using the methodology adopted in Rajasthan they have claimed that the excess power purchase cost to the tune of Rs.161.13 Crore for 2003-04 and Rs.230.50 Crore for 2004-05 may be disallowed.

In ARR & ERC submitted by the Licensee for 2003-04, the T&D loss committed was 26.5%. In the 2003-04 Order the Commission fixed the total internal energy input as 12120 MU, based on the data made available as on December 2003. The Commission arrived at this after adjusting for normal growth for the balance period based on the past trends, allowing for reduction in consumption in certain categories and T&D loss reduction during 2003-04. The Commission noted that the estimate of T&D loss could not be arrived due to lack of reliable sales data and that, it would undertake a review of sales at the end of the year. In the ARR & ERC exercise for the year 2004-05, the Commission had undertaken the review of sales based on the data upto December 2003 and decided the sales for 2003-04 as 8900 MU. Thus the T&D loss for the year 2003-04 based on approved energy input was 26.6%. As against this, the actual, based on the audited accounts was 27.4%. For the purpose of truing up the Commission considered the approved level of T&D loss. As per the audited accounts of the licensee, the actual energy input was 12281 MU. The energy sales should have been 9018MU to achieve the approved T&D loss of 26.6%. The difference in sales of 108 MU is considered as excess sales that should have been achieved by the licensee, and charged to revenue based on the actual average realization for the year 2003-04.

The Commission stated in the 2003-04 order itself that, for the year 2004-05, the target for loss reduction would be 3%. Thus, the approved level of T&D loss for 2004-05 was 24.5% based on the actual loss of 27.5% in 2003-04. The Licensee could achieve substantially, the loss reduction directed by the Commission for the year 2004-05. As per the audited accounts the T&D loss was 24.95%. By following the same principle as for 2003-04, the excess sales for 2004-05 for achieving the approved loss would be 63 MU. Thus for the purpose of truing up, energy input, sales and losses are considered as follows.

	2003-04			2004-05		
	ARR Order	**Actual**	**True-up**	**ARR Order**	**Actual**	**True-up**
Total energy input (MU)	12120	12281	12281	12310	12505	12505
Energy sales (MU)	8900	8910	8910	9300	9384	9384
Additional Sales (MU)			108			63
Losses	26.6%	27.45%	26.6%	24.5%	24.95%	24.5%

Expenses:

Power purchase cost:

As the Commission has considered the performance parameter of T&D loss at the approved level, the generation and power purchase is considered as actual. The actual internal generation and power purchase cost for 2003-04 as per the audited accounts of the licensee were Rs.143.7 Crore and Rs.1887.11 Crore respectively. For 2004-05, the power purchase cost was lower than the approved. By following the same principle, the Commission considers the total power purchase and internal generation cost as Rs.1463.03 Crore and Rs.81.13 Crore respectively.

	2003-04 (Rs. Crore)			2004-05 (Rs. Crore)		
	ARR Order	**Actual**	**True-up**	**ARR Order**	**Actual**	**True-up**
Purchase of power	1775.13	1887.11	1887.11	1605.53	1463.03	1463.03
Generation of power	153.32	143.70	143.70	100.53	81.13	81.13

The Commission would like to point out that, it is ideal to ensure that while allowing the actual power purchase cost, the licensee has incurred the expenses in a prudent manner. However, in the present circumstances, there is no way the Commission could realistically verify whether the licensee has incurred the expense for generation and power purchase in an optimum manner following strict merit order principle. This will be possible only when independent operation of state load dispatch becomes a reality.

R&M Expenses

In the 2003-04 Order, the Commission had approved the R&M expenses as proposed by the Board to provide adequate attention for reducing the interruptions by the Board. Against the approved R&M expense of Rs.66.70 Crore, the actual was Rs.63.79 Crore. The Commission allowed the provision estimated by KSEB for 2003-04 after considering the actual half yearly expense of Rs.18.33 Crore in 2003-04. The Commission considers that, KSEB has judiciously incurred the expense under this head and overachieved target set by the Commission. Hence for the purpose of truing up the Commission considers the approved level of expenses of Rs.66.70 Crore for 2003-04.

For 2004-05 the Commission had specifically directed that the licensee shall maintain the R&M expenses in the same level as 2003-04, on the basis of actual expense of Rs.51.65 Crore for the first 10 months of 2003-04. As against this, the actual audited expense was Rs.74.49 Crore. In their petition, the licensee could not justify in a quantifiable manner the increase in R&M expenses more than the approved level and could not provide any material before the Commission on the efforts made to limit the R&M in the approved limit. In these circumstances, the Commission consider the approved level of R&M expenses for the purpose of truing-up.

	2003-04 (Rs. Crore)			2004-05 (Rs. Crore)		
	ARR Order	Actual	True UP	ARR Order	Actual	True UP
R&M Expenses	66.70	63.79	66.70	66.70	74.49	66.70

A&G Expenses:

The A&G expenses include among other things the Electricity Duty under Section 3(1) of Kerala Electricity Duty Act, 1963. The Commission had approved the A&G expenses of Rs.55.88 Crore for 2003-04 as suggested by the Licensee. The actual expense was Rs.84.74 Crore. The Licensee has stated that, the increase was mainly on account of increase in the duty payable as per Section 3(1) of Kerala Electricity Duty Act, 1963 to the Government. The Section 3 of the KED, Act, 1963 read as follows:

3. *Levy of electricity duty on certain sales of energy by licensees.-* ***(1)*** *save as other wise provided in sub section (2) every licensee in the State of Kerala shall pay every month to the government in the prescribed manner, a duty calculated at 6 naye paise per unit of energy sold at a price of more than 12 naye paise per unit.*

provided that no duty under subsection shall be payable by the Kerala State electricity Board on the energy sold by it to another licensee.

(2) *where a licensee holds more than one licence, duty shall be calculated and levied under this section separately in respect of each licence*

(3) *The duty under this section on the sales of energy should be borne by the licensee and shall not be passed on to the consumer*

(Emphasis added)

The Licensee is defined in the said Act as

"Licensee" means (i) the Kerala State Electricity Board constituted under Section 5 of the Electricity (Supply) Act 1948

(ii) Any person licensed under part II of the Indian Electricity Act 1910 to supply energy and includes any person who is deemed to have been so licensed and any other person who has obtained the sanction of the Government under Section 28 of the said Act and

(iii) the Government when it is engaged in the business of supplying energy;

The Licensee has never brought to the notice of the Commission the above provision of the Act. Objectors have also overlooked such provisions in the Act. Sub Section 3(3) of KED Act, clearly provides that duty paid under this section has to be borne by the Licensee and shall not be passed on to the consumer. It appears that Legislature in its wisdom had given such a provision that Licensee under Section 3(1) and Consumer under section 4 have to pay duty separately. Fairly so, consumer need not bear the burden of both the provisions of the Act. In such an event of clear statutory provision of retaining the burden of duty under Section 3(1) with the licensee, passing the same to the consumer would amount to violation of the provisions of the KED Act, 1963. Hence in the light of the clear statutory provision the Commission is not in a position to allow the duty under Section 3(i).

In the approved A&G expenses for 2003-04, the expenses other than electricity duty was placed at Rs.34.01 Crore. As against this, the A&G expenses as per audited accounts, without Electricity duty were Rs.33.21 Crore. Though the approved level is higher, the Commission considers the approved level for truing up considering the fact the A&G expense is a controllable item of expenses and the Licensee has curtailed the expenses under this head and as an incentive, excess provision is allowed to be retained with the Licensee.

Similarly, for 2004-05, the Commission had approved A&G expenses of Rs.68.68 Crore, keeping all except insurance and electricity duty at the 2003-04 level. The approved level of A&G expenses without duty was Rs.34.30 Crore, the Commission considers the same to be passed on to the tariff against the actual expenses of Rs.40.03 Crore. The excess expenses over the approved level shall be on the account of the licensee.

	2003-04 (Rs. Crore)			**2004-05 (Rs. Crore)**		
	ARR Order	**Actual**	**True UP**	**ARR Order**	**Actual**	**True UP**
A&G Expenses (without Electricity Duty under Section 3(1), of KEDA	55.88	84.74	34.01	68.68	95.01	34.30

Depreciation:

Depreciation approved for 2003-04 was based on the norms as existed then. The Hon. ATE has endorsed such a stand in the appeal No 84 of 2006 between KPTCL Vs KERC and others. Depreciation was charged based on NFA at the beginning of the year. The Commission approved the depreciation based on the provisions under the Electricity supply Act 1948, as the National Tariff Policy and National Electricity Policy became effective later only on 6-1-2006 and 12-2-2005 respectively. Depreciation is an accounting item and considering the present data inadequacy and limitations of estimated depreciation at the time of filing ARR & ERC may differ from that of actual accounts. The actual depreciation may be known only when accounts are finalised. Considering this, the Commission allows the depreciation as given in the audited accounts for the year 2003-04 and 2004-05 of Rs.326.19 Crore and Rs.374.77 Crore respectively.

	2003-04 (Rs. Crore)			**2004-05 (Rs. Crore)**		
	ARR Order	**Actual**	**True UP**	**ARR Order**	**Actual**	**True UP**
Depreciation	334.52	326.19	326.19	382.27	374.77	374.77

Interest and financing charges:

The Commission approved the interest and financing charges for the year 2003-04 considering the factors such as capital investment, swapping of loans, interest on working capital etc. In the Order, the Commission disallowed a few items of unreasonable provisions such as interest on borrowing to meet the revenue deficit and regulatory asset etc,. The expenses as per audited accounts for 2003-04 was Rs.726.32 Crore against the approved level of Rs.679.26 Crore. The details are shown below.

	ARR	SERC Order	Actual
Interest charges for various loans	612.00	612.00	622.16
Borrowing for capital projects	30.00	19.42	0.00
Interest for working capital	15.00	15.00	11.03
Other charges	64.54	32.84	61.23
Premium for swapping of loans	0.00	0.00	31.90
Total	**721.54**	**679.26**	**726.32**

The Objectors have pointed out that cost of allowing delay in subsidy should not be passed on to the consumers. The Objector also submitted that, huge funds in the form of People's plan fund, MP fund, MLA fund etc., provided to the licensee has not been utilized and the same is deposited in the bank. Hence, the interest accrued is to be passed on to the consumers in truing up.

The Commission has considered the submission of KSEB and the objectors. While approving the interest charges for 2003-04, the Commission had considered the arguments of KSEB and allowed Rs.612 Crore towards interest charges, Rs.19.42 Crore towards interest for borrowing for capital projects, Rs.15.00 Crore for interest on working capital, and other charges Rs. 32.84 Crore totaling 679.26 Crore. However, the actual was Rs.694.42 Crore. The Commission allows the approved cost for truing up. It is to be mentioned here that KSEB has taken substantial efforts to reduce the interest burden by swapping high cost loans. The Commission is of the opinion that due credit to be given to the Board on this and the hence Commission allows the premium paid on swapping of loans as claimed by the Board as pass through considering the fact that the same is a genuine item of expense.

In the ARR & ERC Order for 2003-04, the Commission had requested the Government to release subsidy to the tune of Rs. 361 Crore to bridge the revenue gap. The Licensee in their petition has stated that, the subsidy ordered by the

Commission for 2003-04 was released by the Government only during 2004-05 in the following manner.

4/2004	Rs.105.80 Crore
5/2004	Rs. 50.00 Crore
6/2004	Rs.81.17 Crore
7/2004	Rs.12.06 Crore
8/2004	Rs.26.46 Crore
9/2004	Rs.10.32 Crore
10/2004	Rs.23.67 Crore
2/2005	Rs.29.22 Crore
3/2005	Rs.22.30 Crore
Total	**Rs.361.00 Crore**

Since the Government has delayed the payment of subsidy, the Commission feels that Licensee is eligible for the carrying cost of the Subsidy for one year. The objectors have pointed out that carrying cost need not be allowed. However, it may be noted that, the ARR & ERC order for 2003-04 was issued at the fag end of the year. It will also be fair on the part of the Government to release the subsidy from the next financial year as the same has to be included in the budget. Under these special circumstances, it is fair on the part of the Commission to allow carrying cost to the Licensee. Based on this, average carrying cost of 8% would work out to Rs.14.44 Crore (as the payments were staggered, the average borrowing of Rs.180.50 Croes (Rs.361/2) at 8% interest for one year). The same may be added to the allowed expense of Rs. 711.16 Crore, and hence the true up expense under interest and financial charges for 2003-04 shall be Rs.725.60 Crore against the actual of Rs.726.32 Crore.

The approved expenses under interest and financial expenses for the year 2004-05 was Rs.618.30 Crore, whereas the actual was only Rs.605.59 Crore. Licensee could over achieve the targets fixed by the Commission on this count by the swapping of loans and through other measures. Hence, Commission allows the approved expense of Rs. 618.30 Crore under this head against the actual expense of Rs.605.59 Crore for 2004-05 as an incentive.

	2003-04 (Rs. Crore)			**2004-05 (Rs. Crore)**		
	ARR Order	**Actual**	**True UP**	**ARR Order**	**Actual**	**True UP**
Interest and Financing charges	679.26	726.32	725.60	618.30	605.59	618.30

Employee expenses:

The objectors have pointed out that in the previous order the Commission had raised concern over the increasing employee costs. They argued that only approved level of expense be passed on to the tariff and contented that the licensee has failed to provide information regarding the productivity levels of employees and hence excess cost need not be passed on to the consumers.

The Commission approved the employee cost for 2003-04 as projected by the Licensee (Rs.693.64 Crore). The actual employee cost based on the audited accounts reported by the Licensee in the True up petition was Rs.788.31 Crore. The increase was Rs.94.67 Crore. Licensee has stated that the increase was on account of release of 5 installments of DA (16%) at one go to the employees and the increase in the quantum of terminal benefits.

In 2004-05, the actual expense was Rs.789.64 Crore against the approved level of Rs.718.47 Crore. While approving the employee cost for 2004-05, the Commission allowed 3% increase in Wages and 5% increase in terminal expenses keeping other items of expenses at the same level of 2003-04.

The Licensee has stated that payment of DA and terminal benefits to the Board employees are determined periodically in line with the policy of GoK and hence Licensee cannot limit such benefits. However, similar claims made by Boards/Licensees elsewhere were rejected by various Commissions and Appellate courts. With supporting judgments from Hon Supreme Court, Hon Appellate Tribunal for Electricity, in Appeal No 4 of 2005 dated 26 May 2006, M/s Siel Limited Vs PSERC, PSEB and Others, has ruled that "

> *" The main plank on which the Board has assailed the impugned orders of the Commission with regard to employees' cost++, is that the Commission has overlooked the fact that Board cannot substantially reduce employees due to certain obligations cast upon it under law.*
>
> *…………………………. It is significant to note that in so far as the increase in DA and merger of DA with DP of the employees of the Board is concerned on the own showing of the Board, the benefits have been extended in order to maintain parity with the employees of*

the State Government. These benefits have been extended on the ostensible ground that when the electricity undertaking was transferred to the Board, it was stipulated that the salary, allowances etc of the transferred employees were not to be less favourable than the Government employees. It appears to us that this condition applied only to the salary and allowances etc, which were in vogue on the date of the transfer. This stipulation does not in any manner guarantee same salary, allowances for the PSEB employees as may be admissible to the employees of the State Government in comparable posts. <u>There is no obligation on the part of the Board to extend same salary and allowances to the employees of the Board as are payable to the employees of the State Government. The process of reforms which has been triggered by the Act of1998 and the Act of 2003 will lose its momentum in case salaries/ incentives are not linked to the performance of the employees. There is nothing on record to show that there has been improvement in the performance of the employees of the Board. Benefit should be made available for rewarding efficiency in performance. Automatic availability of benefits generates inefficiency and indolence</u>". (Emphasis added)

In another decision, in appeal no. 84 of 2006, KPTCL Vs KERC and others, ATE has ruled that <u>there is no illegality or error on the disallowance of a portion of the labour cost such a bonus/ exgratia, cost of supplying electricity to its employees to pass through the tariff</u>. Hence is it is clear that, benefits extended to the employees need not be automatic and has to be judged based on performance.

The Commission feels that employee cost is a controllable item, provided genuine steps are taken to improve productivity. However, the variations due to inflation are beyond the control of the licensee and may be allowed to pass on to the tariff. Hence the Commission as a principle allows the variation due to DA which is linked to inflation. However, this decision of the Commission is no way a blanket approval for sanctioning approval of such costs in future, which may be strictly in accordance with the merit and precedents in similar cases elsewhere. With these remarks, the claim of Licensee on variation of employee costs is allowed as follows:

The approved expenses for 2003-04 except terminal benefits was Rs.324.84Crores (Rs.693.64 Crore - Rs. 368.80 Crores). The licensee has stated in the petition that the actual level of DA for 2003-04 for the employees was 59% which is Rs.151.75 Crores, where as DA projected at the time of ARR was Rs.88.55 Crores. Thus the increase in DA would be:

Increase due to DA for employees =

Rs.151.75 Cr (DA @ 59%) – Rs.88.55 Cr (DA @ 38%) = **Rs.63.20 Cr**

The Commission is inclined to accept the additional expenses towards DA. Hence, the employee cost except terminal benefits would be Rs.388.04 Crore (Rs. 324.84 Crore + Rs.63.20 Crore) after truing up. The actual terminal benefits were Rs.402.20 Crore as against the approved expenses of Rs.368.80. In this situation the Commission considers the fact that, the ARR & ERC order for 2003-04 was finalised in the month of December 2003, which practically constrained the licensee to make any effort for cost reduction in terminal benefits. Considering this fact, the Commission is of the view that terminal benefits may be allowed in full for 2003-04 as a special case. In such case the total employee expenses after true up would be Rs.790.24 Crore which is higher than the actual Rs.788.31 Crore. Considering the generous provisions allowed, the true up allowed for 2003-04 is limited to the actual expense of Rs.788.31 Crore. The Commission would like to reiterate that, the special allowances provided in the present truing up exercise cannot be construed as a general case in future.

For 2004-05, the Commission has allowed Pay and DA to the tune of Rs. 313.0 Crore which was inclusive of 43% DA (Pay = Rs. 218.88 Cr, DA = 94.12 Crore). Based on this, Pay and DA @ 59% would be Rs. 348.02 Crore.

Hence, the excess expense to be allowed =

Rs.348.02 Crore. – Rs.313 Crore. = Rs. 35.02 Cr

The terminal benefits for the year 2004-05 approved by the Commission were Rs.361 Crore and the actual was Rs.342.98 Crore. Hence no adjustment is made. So the total amount admitted is Rs.753.47 Crore against the actual of Rs. 789.64 Crore.

	2003-04 (Rs. Crore)			**2004-05 (Rs. Crore)**		
	ARR Order	**Actual**	**True UP**	**ARR Order**	**Actual**	**True UP**
Employee cost	693.64	788.31	788.31	718.47	789.64	753.47

It is pertinent to point out that, invariably in all public hearings on ARR & ERC, many of stakeholders expressed their concern over skyrocketing of employee costs of the Licensee and the need to curtail it through rational measures. The Licensee has stated in the petition that during 2003-04, licensee had made sincere efforts to reduce the staff costs and A&G expenses through measures such as improving productivity of existing employees, drastic reduction of payment of over time charges, abolition of redundant posts of staff and officers, limiting the increase in the officers' salary to the end of the pay scale, redeployment of employees to vacant posts, and cutting down of certain allowances such as leave surrender and holiday wages. Though the licensee could not substantiate the claims of reduction in employee costs based on data, the Commission appreciates the genuine efforts taken in this direction. The Commission also notes that in the subsequent ARR & ERC many of the benefits earlier denied were released to the employees, proving that the action taken earlier were only cosmetic in nature. Thus, it time and again proved that adhoc measures cannot be sustained in the long run. The Commission is of the view that cutting down employee costs based on such short term and ad-hoc measures is not sustainable and may give wrong signals to the employees. The licensee has to take genuine efforts to substantially enhance the productivity of employees through proper incentive-disincentive mechanism. It is a fact that, the employee cost of the licensee is no way comparable to neighbouring states or any productivity indices available at present. The Commission would like to point out the fact that, already alarming signals are visible as the terminal liabilities have overstepped (now it is more than the employee costs). Hence it is needles to emphasize that it is high time, the Licensee should take genuine long term steps to arrest the increase in employee costs. Also, the increase in DA due to inflation has to be allowed to KSEB employees as and when it becomes due and shall not be permitted to accrue.

Other expenses:

The other expense consists of other debits and prior period credits/charges. For 2003-04, Other debits approved by the Commission was Rs.17.41 Crore against the actual as per audited accounts of Rs.22.72 Crore. For the purpose of true up only approved level is allowed and the excess provision would be on the account of the licensee, which cannot be passed on to the consumers. The objectors have also expressed similar opinions. According to them provision of bad debts should be allowed only if the Licensee takes immediate action to identify the bad debts and furnish full information on such write-off.

The Commission approved Rs.58.87 Crore under net prior period charges for 2003-04. As per the audited accounts, the prior period credits were Rs. 271.07 Crore and expenses were Rs.391.70 Crore. However, major items of charges was on employee cost due to DA increase for previous years Rs. 79.47 Crore, short provision of Depreciation as per AG's observation Rs.68.19 Crore, and Rs.218.61 Crore on account of short provision of electricity Duty. The Commission allows these provisions as they pertain to the period before the Commission came into existence. Hence the net prior period charges at actual of Rs.120.63 Crore are allowed. The total allowable expenses under this head would be Rs. 138.04 Crore (Rs.17.41Cr. + Rs. 120.63 Cr).

For the year 2004-05, the other debits approved by the Commission were Rs.23.69 Crore against Rs.36.50 Crore as per audited accounts. For the true-up the Commission allows only the approved level of expenses for 2004-05.

In the ARR and ERC order for 2004-05, the Commission provided Rs.50 Crore under net prior period charges. However, as per audited accounts, it was Rs.81.05 Crore. The major item of charges was Rs. 240.69 Crore on account of short provision of duty for previous years and Rs.45.42 Crore on account of payment due on power purchase from central stations. Based on the principles listed above, the same is allowed. Hence the amount to be passed on would be Rs.104.74 Crore (Rs.23.69 Cr + 81.05 Cr).

	2003-04 (Rs. Crore)			**2004-05 (Rs. Crore)**		
	ARR Order	**Actual**	**True UP**	**ARR Order**	**Actual**	**True UP**
Other expenses	76.28	143.35	138.04	50.00	117.54	104.74

Regarding prior periods and charges, the Commission wishes to point out that, prior period credits and charges are due to short/excess accounting of income and expenses relating to previous years. The Commission has mentioned in the earlier orders that this head ideally cancel with each other. Prior period credits/charges arises due to many factors, such as disputes, omissions, and other statutory directions. In the various ARR & ERCs, the Commission has allowed the claims of prior period credits with limits considering the limitations of data and inability of the licensee to project the different expenses/income in a reasonable manner. However for each year the Commission approves the expenses based on the principles mentioned in the Electricity Act, 2003. <u>It is assumed that the approved expenses are full claims allowed for each year, against which the Licensee may</u>

account the same based on the accounting principles. In such a situation, claiming both the approved expenses and prior period credits, amounts to double counting in terms of regulatory approvals. Hence, the present approval should not be taken as a policy of approval for future.

Statutory returns:

The Commission allows the actual returns as per 3% of NFA for both years as per the audited accounts for truing up for 2003-04 and 2004-05. Accordingly the statutory return for 2003-04 would be Rs. 91.83 Crore and Rs.103.49 Crore for 2004-05.

	2003-04 (Rs. Crore)			**2004-05 (Rs. Crore)**		
	ARR Order	**Actual**	**True UP**	**ARR Order**	**Actual**	**True UP**
Statutory Surplus	91.83	91.83	91.83	105.00	103.49	103.49

Expenses capitalized:

The Commission seeks to allow the actual capitalization of expenses as per the Annual Accounts Rules claimed by the Licensee.

	2003-04 (Rs. Crore)			**2004-05 (Rs. Crore)**		
	ARR Order	**Actual**	**True UP**	**ARR Order**	**Actual**	**True UP**
Expenses capitalised	119.80	109.05	109.05	123.53	42.88	42.88
Interest capitalised	108.93	78.11	78.11	98.96	62.04	62.04
Sub Total	**228.73**	**187.16**	**187.16**	**222.49**	**104.92**	**104.92**

Non- Tariff Income

The Commission seeks to allow the actual level of Non-tariff income as per audited accounts for both years.

Revenue from Tariff:

Based on the principles mentioned earlier, the Commission considers the actual level of income from tariff. However, the Commission considers the additional revenue due to non-achievement of T&D loss in the revenue from tariff for both years. This would work out to be Rs.33.48 Cr for 2003-04 and Rs.19.53 Crore for 2004-05 at an average actual realization of Rs.3.09/kWh and Rs.3.11/kWh respectively based on the audited accounts. Hence the true up level of income would be as follows:

	2003-04 (Rs. Crore)			2004-05 (Rs. Crore)		
	ARR Order	**Actual**	**True UP**	**ARR Order**	**Actual**	**True UP**
Non tariff Income	**240.37**	**304.66**	**304.66**	**231.00**	**339.63**	**339.63**
Revenue from tariff	2901.00	2756.09	2756.09	2965.00	2917.37	2917.37
Additional revenue on account of additional sales at Average realization	0.00	0.00	33.48	0.00	0.00	19.53
Total revenue from Tariff	**2901.00**	**2756.09**	**2789.57**	**2965.00**	**2917.37**	**2936.90**

Subsidy from Government of Kerala

In response to the Orders of the Commission regarding release of subsidy by the Government to KSEB, Principal Secretary to the Government (Finance) in his letter dated 2-11-2005 had stated that it is possible to "set off" the subsidy due from the Government against the Duty to be payable by KSEB, provided the Commission has firmed up the amount due. The Government has also pointed out that *'KSEB in any case has not been paying its dues voluntarily to the Government of Kerala (since according to them there are other accounts to be settled)*'. The Commission considers the observation of the Government, and is of the view that, as the duty payable by the licensee has not been transferred to the Government, there is no requirement of providing financing cost for the portion of subsidy adjustable/set off against the duty.

Total Revenue Gap for 2003-04 and 2004-05 after true up

As against the revenue gap of Rs.1007.43 Crore filed by the Licensee, the Commission allows Rs. 920.10 Crore for 2003-04. Of this, the Government already allowed Rs.556.46 Crore as subsidy/adjustments on Electricity Duty. Hence the net gap for the year would be Rs. 363.64 Crore against Rs.450.97 Crore projected by the Licensee.

For 2004-05, the approved revenue gap was Rs. 296.46 Crore against which the gap as per audited accounts was Rs.342.77 Crore. In the ARR & ERC Order for 2004-05, the Commission, in order to avoid a tariff increase had, recommended to the Government that of the Rs. 296.46 Crore, Rs.200 Crore was to be adjusted against the duty payable to the government (Rs.34 Crore against the exemption of

Sec 3(1) duty and Rs.166 Crore against Section 4 duty). The balance of Rs.96 Crore would be met as additional subsidy to be payable by the Government to avoid the tariff shock.

	2003-04 (Rs. Crore)			2004-05 (Rs. Crore)		
	ARR Order	Actual	True UP	ARR Order	Actual	True UP
Purchase of power	1775.13	1887.11	1887.11	1605.53	1463.03	1463.03
Generation of power	153.32	143.70	143.70	100.53	81.13	81.13
R&M Expenses	66.70	63.79	66.70	66.70	74.49	66.70
Employee cost	693.64	788.31	788.31	718.47	789.64	753.47
A&G Expenses	55.88	84.74	34.01	68.68	95.01	34.30
Depreciation	334.52	326.19	326.19	382.27	374.77	374.77
Interest & Financing charges	679.26	726.32	725.60	618.30	605.59	618.30
Other expenses	76.28	143.35	138.04	50.00	117.54	104.74
Total	3834.73	4163.51	4109.66	3609.95	3601.20	3496.44
Less expenses capitalized	119.80	109.05	109.05	123.53	42.88	42.88
Less interest capitalized	108.93	78.11	78.11	98.96	62.04	62.04
Sub Total	228.73	187.16	187.16	222.49	104.92	104.92
Total expenses	**3606.00**	**3976.35**	**3922.50**	**3387.46**	**3496.28**	**3391.52**
Surplus	91.83	91.83	91.83	105.00	103.49	103.49
Total revenue requirements	**3697.83**	**4068.18**	**4014.33**	**3492.46**	**3599.77**	**3495.01**
Non tariff income	240.37	304.66	304.66	231.00	339.63	339.63
Revenue from tariff	2901.00	2756.09	2789.57	2965.00	2917.37	2936.90
Total revenue	3141.37	3060.75	3094.23	3196.00	3257.00	3276.53
Revenue gap	**-556.46**	**-1007.43**	**-920.10**	**-296.46**	**-342.77**	**-218.48**
Subsidy received/Ordered	556.46	556.46	556.46	200.00	0.00	222.06
Balance revenue gap/Surplus	0.00	-450.97	-363.64	-96.46	-342.77	3.58

The licensee in its Petition mentioned that the revenue gap is Rs. 342.77 Crore as per audited accounts for 2004-05. The licensee further submitted that, the Commission may recommend to the Government to bear the total revenue gap of Rs.342.77 Crore by way of waiver of duty to the tune of Rs.200 Crore as recommended by the Commission in the Order for 2004-05, and release the balance Rs. 142.77 Crore as cash subsidy (ie., Rs.96 Crore + additional Rs.46.31 Crore). In case the Government declines to allow the additional claim of Rs.46.31 Crore, the same as to be treated as either regulatory asset or tariff increase. The licensee has also requested to allow interest on the subsidy of Rs. 96 Crore as recommended by the Commission.

As mentioned in the previous para, Commission recognizes the gap after true up as Rs. 218.48 Crore for 2004-05. However, based on the audited accounts submitted by the Licensee, the actual Section 3(1) duty was Rs. 54.98 Crore and

Section 4 duty was Rs.167.08 Crore. Thus the actual duty available for adjustment would be Rs.222.06 Crore for 2004-05. The Commission has already recommended to the Government for adjustment of duty for the year 2004-05. Hence the total additional revenue requirement for 2003-04 and 2004-05 would be as follows;

	Rs. Crore
Revenue gap for 2003-04 after True up	920.10
Revenue gap for 2004-05 after True up	218.48
Total Revenue gap after True up	**1138.58**
Subsidy/adjustment already made by the Govt. for 2003-04	556.46
Subsidy adjustment of duty for 2004-05 (Revised)	222.06
Net Gap to be passed on to consumers	**360.06**

The Commission recognizes that an amount of Rs.360.06 Crore as the total revenue gap for the years 2003-04 and 2004-05. The same is allowed to be carried in the ARR & ERC of the licensee for the year 2007-08 and orders accordingly.

Sd/-	Sd/-	Sd/-
M.P. Aiyappan	C. Abdulla	C. Balakrishnan
Member	Member	Chairman

By the Order of the Commission

Sd/-
Secretary

ANNEXURE

List of persons attended the Public hearing on Truing up petition for 2003-04 and 2004-05 held at Commission's Office dated 23-10-2007

1. Shri. George Thomas, President, HT-EHT Industrial Consumers association
2. Shri. G. Hari, HT-EHT Industrial Consumers Association
3. Shri. S. Jayathilakan, Vijaya Ele-Tech Private Limited
4. Shri. A.R Satheesh, Carborandum Universal Limited
5. Shri. Madhavan Nair, Carborandum Universal Limited
6. Shri. P. Sabumohan, Banani Zinc Limited
7. Shri. V.Arunagireeswara Iyer, FA, KSEB
8. Shri. Johnson Jacob, CE, KSEB
9. Shri. V. Ramesh Babu, Dy.CE, KSEB
10. Shri. P.V Siva Prasad, EE, KSEB