THE KERALA STATE ELECTRICITY REGULATORY COMMISSION

THIRUVANANTHAPURAM

PRESENT: Shri. K.J.Mathew, Chairman
Shri. C. Abdulla, Member
Shri. M.P.Aiyappan, Member

May 15, 2010

Petition No. TP 20 of 2006 and TP 22 of 2006	Kerala State Electricity Board, Vydhyuthi Bhavanam, Thiruvananthapuram 695004	Petitioner

In the matter of
Truingup of Accounts of Kerala State Electricity Board for the year 2003-04&2004-05 as per the Order of Appellate Tribunal in Appeal No.94 of 2008

ORDER

Background

1. Kerala State Electricity Board has approached Appellate Tribunal for Electricity (APTEL for short) New Delhi against the Order of the Commission dated 24-11-2007 on the Truing up for 2003-04 and 2004-05. The Tribunal has remanded the truing up of the financials in respect of the T&D loss, R&M expenses, A&G expenses other than electricity duty, employee expenses and also bad debts for 2004-05 after affording another opportunity of hearing to KSEB. All other matters raised in the appeal were dismissed.

2. Accordingly, KSEB through its letter dated 3-12-2009 approached the Commission for re-consideration of the matter as per the APTEL Order. Mean time KSEB also filed a review petition before the APTEL for re-consideration of the matters which were dismissed in the original order. However APTEL in its order dated 15-1-2010 declined the demands and rejected the review petition. Based on this premise the Commission as per the order of the APTEL has taken up the matters remanded to the Commission.

3. In order to afford an opportunity to the Board, the Commission scheduled a hearing on 17-2-2010 and also sought details on the remanded issues especially for providing supporting reasons for expenses over the approved level and also the steps taken by the Board to limit the R&M expenses, employee costs and

A&G expenses to the approved level after the issue of the ARR& ERC order for 2004-05.

4. Though it has been held by the Hon. Supreme Court and APTEL that the Commission is not bound by audited accounts, KSEB in its reply dated 18-2-2010 requested for admitting the expenses as per audited accounts. On the question of R&M expenses, KSEB stated that due to the severe financial crunch, R&M expenses were curtailed in 2002-03 and 2003-04, whereas in 2004-05 financial position improved and hence the R&M expenses increased by Rs.7.78 Crore from the approved level. GFA of the Board in 2003-04 has increased by Rs.968.51 Crore and the inflation rate approved by CERC is 4% during that year. About 91% of the R&M expenses are for transmission and distribution. Considering the complexities and large number of T&D assets, it is difficult to estimate the requirements of R&M expenses, hence the Board argued that the actual R&M expenses should be allowed.

5. Regarding A&G expenses KSEB sought to justify the inclusion of Section 3(1) duty and by quoting Section 59 of Electricity (Supply) Act 1948 stated that if the duty is not admitted the stipulated return on NFA as per the Act will not be achieved. According to KSEB, the A&G expenses are directly linked to the business volume and could not be limited to the level of the previous year. As in the case of R&M expenses, the Board argued that the A&G expenses were curtailed in the previous year which cannot be taken as a basis. The number of consumers increased by 4.99 lakhs and energy sales increased by 5.3% and inflation was 5.72%. The A&G expense was Rs.40.07 crore in 1999-00 and Rs.46 crore in 2000-01. Considering these factors, KSEB requested to allow the expenditure as per actuals.

6. In the case of Employee expenses, due to reduction in the number of employees basic salary had reduced to Rs.205.35 crore in 2004-05 compared to Rs.212.94crore in 2003-04. However provision of Rs.27.16 crore was given in 2004-05 for wage revision which was due in July 2003. Similarly, DA was Rs.153.91 Crore, which included the arrears due. At the time of filing ARR&ERC for 2004-05 DA was 43% of base salary. But additional release of 16% DA (due from 1-7-2001 to 1-7-2003) was made during September and October 2004, which was not included in the ARR&ERC since it was released after the submission of ARR&ERC. The Commission in the initial order on True up allowed 59% DA, but no provision for arrears was made for the DA released retrospectively. The Board further made a provision of Rs.16.04 Crore for pay revision as part of DA. As against 1734 employees who retired in 2003-04, 1442

employees retired in 2004-05, hence the total terminal benefits came down from Rs.390.79 Crore in 2003-04 to Rs.349.92 crore in 2004-05. In the case of other debits additional details were submitted. A provision of 5% of receivable of Rs.1225.27 crore was provided as bad debts in 2004-05. Already provision of Rs.51.91 Crore was provided earlier years and balance of Rs.9.36 crore was booked in 2003-04. The other expenses booked in 2004-05 was Rs.36.49 crore. Of this Rs.23.9 crore was bad debts written off (withdrawl of prior period credits to revenue account due to Government orders Rs.10.58 Crore and Rs.13.32 crore as provision for doubtful debts to meet 5% of the receivables). The miscellaneous losses reported were Rs.12.49 crore of which Rs.6.23 crore is on account of exchange rate variation.

Hearing on the Matter

7. The Commission held a hearing in the matter on 23-2-2010. In the hearing representatives of M/s Binani Zinc Limited and the Kerala HT EHT Industrial Electricity Consumers' Association were present. The Commission allowed them to file written objections if any within one week. The HT-EHT Association vide letter dated 1-3-2010 filed their objections, which were forwarded to the Board for comments. In their objections, they have stated that as per the order of APTEL, the Commission is not bound by the audited financial statements. Further, the T&D loss disincentive should be as per the Order No. 100/07 of APTEL. Since KSEB did not provide any additional material on R&M expenses, A&G expenses and employee costs, no additional expenses should be allowed. According to them all additional claims on R&M, A&G, employee cost, bad debts etc. should be rejected as no proof was submitted to explain additional expenses. M/s Binani Zinc limited vide their letter dated 2-3-2010 requested that decision should not be taken on the submissions of KSEB, till the disposal of the review petition filed by M/s.Binani Zinc Limited before APTEL in the same matter. The Commission has forwarded the objections to KSEB, but no reply was filed so far.

Decision of the Commission

8. While considering the truing up petitions for 2003-04 and 2004-05 initially, the Commission had sought clarifications on various issues and also sent number of reminders. The Commission also sought reply on the objections raised by the public, which was also not provided by the Board even after repeated reminders. Hence the Commission was constrained to take decision without the opportunity of having necessary details on number of items then. During the present proceedings, KSEB vide letter dated 18-2-2010 stated that the Commission has

specified the principles of truing up only in the order dated 24-11-2007. KSEB was not aware of the principles to be followed by the Commission and felt that the Commission would approve the accounts as per the audited accounts. According to the Board, adopting a different methodology while approving the truing up is against natural justice. However, the Commission is of the view that the contentions are unfounded and have no merits. It is well known that approval of ARR&ERC is for giving targets for licensee for expenses and performance. The pertinent issue is how far the licensee take efforts to achieve those targets on expenses as well as performance. KSEB could not produce any materials in support of the efforts taken to limit the expenses to the approved level or properly substantiate that additional expenses were beyond their reasonable control even after proper restraints. The Commission has not adopted a different methodology in truing up since the basis of truing up is the approved level of expenses in the ARR&ERC and any deviations from the approved levels to be explained properly. Further the benefit of changes due to inflation and uncontrollable factors to be properly accounted. The argument of KSEB that actual expenses will be allowed allowed in the truing up is in fact against the natural justice to the consumers as ruled by the Hon. Supreme Court and it render the whole regulatory process of approval of ARR&ERC infructuous.

9. The Commission notes that the Hon. APTEL has not granted any stay on the petition filed by M/s Binani Zinc limited on the proceedings before the Commission in the present matter. In its absence the Commission feels that there is no legal bar in re-considering the matter as ordered by APTEL. However, this order will be subject to the final order issued by the Hon. APTEL in the instant case. Based on the additional details provided by KSEB, objections of the stakeholders and the observations and directions in the Order dated 12-11-2009 of APTEL, the Commission's views and the discussions are given below.

In the Order dated 12-11-2009, the Hon. APTEL has ordered as follows:

> *"37) Accordingly, we allow the appeal in part and remand the truing-up of the financials of the appellant for the year 2004-05 in respect of effect of under achievement of transmission and distribution loss in the light of our observations in paragraphs 21, 22 & 23 and re-determine the R&M expenses, the A&G expenses other than Electricity duty, employees expenses as also bad debts for 2004-05 after affording the appellant another opportunity of hearing. The appeal on other issues is dismissed"*

10. Accordingly, the Commission proceeds to re-examine the disallowance of excess T&D loss for 2003-04 and 2004-05 in accordance with the observation made vide para 21,22 & 23 and R&M expenses, A&G expenses (except electricity duty), employee costs and bad debts for 2004-05.

T&D loss

11. The actual T&D loss in 2003-04 was 27.4% instead of 26.6% approved by the Commission. In 2004-05 the actual T&D loss was 24.95% instead of 24.5% approved. The excess losses in 2003-04 was 0.85% and 0.45% in 2004-05 The directions in para 21, 22 & 23 of the Order of APTEL, is reproduced as below.

> *"21) Our view is also stated in our judgment in appeal No. 9 of 2008. Appeal No. 9 of 2008 challenged the order of Karnataka Electricity Regulatory Commission which was passed pursuant to our judgment in appeal No. 100 of 2007. Our view was expressed in the following language:*
>
> > *"36. … While arriving at the quantum of power purchase to be allowed for revenue requirement, KERC should first reduce the disallowed T&D losses from the quantum of power purchase entered in the audited accounts of KPTCL. From the figure so arrived, the Commission has to reduce the allowed T&D losses which will give the quantum of power available for sale yielding revenue. …"*
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> *22) The power purchase cost is a reality. So are the actual sales. The appellant has actually not earned any revenue by sale of the units which it should have been able to sell with T&D target at 26.5%.* ***In our view it is more reasonable to disallow the cost incurred for purchasing the additional units of energy on account of failure to meet the target for T&D loss*** *reduction than to penalize the distribution licensee by adding assumed revenue from the sale of the additional units of power purchased.*
>
> *23) The appellant itself had offered to contain the T&D loss at 6.5% and accordingly it will be appropriate to accept that as the target fixed by the Commission. For 2004-05 the target fixed was 3% below the loss level of 2003-04. The loss level achieved for 2003-04 was 27.4% and hence the target fixed was 24.5%. The same principle as above should be followed for failure to meet the T&D loss level target in 2004-05. The Commission should disallow* ***the additional cost for purchase of additional power***

rather than adding on the revenue side the amount which could be earned by achieving the T&D loss target (Emphasis extra).

12. Accordingly the excess power purchase of 104 MU for 2003-04 and 56MU for 2004-05 is disallowed based on the pooled power purchase cost as shown below:

	2003-04			2004-05		
	ARR Order	**Actual**	**Revised True-up**	**ARR Order**	**Actual**	**Revised True-up**
Total energy input (MU)	12120	12281	12281	12310	12505	12505
Energy sales (MU)	8900	8910	8910	9300	9384	9384
Losses (%)	26.60%	27.45%	26.60%	24.50%	24.95%	24.50%
Excess losses (%)			0.85%			0.45%
Excess loss (MU)			104			56
Power Purchase (MU)		8015.55			6390.0	
Power purchase cost (Rs. Crore)		1717.12			1292.8	
Average Power Purchase Cost (Rs./kWh)			2.14			2.02
Power purchase cost disallowed (Rs. Crore)			**22.26**			**11.31**

13. As shown above power purchase cost of Rs.22.26 Crore in 2003-04 and Rs.11.31Crore in 2004-05 is disallowed on account of excess T&D loss over the approved level as per the Order of APTEL. Accordingly, the additional revenue accounted in 2003-04 of Rs.33.48 Crore in 2003-04 and Rs.19.53 crore in 2004-05 in the Order dated 24-11-2007 is reversed.

R&M Expenses

14. As additional clarification, the Commission has sought specific details with supporting documents on the steps taken by the Board to limit the R&M expenses, employee costs and A&G expenses to the approved level (such as field level instructions, order etc.,) after the issue of ARR&ERC order for the respective years and the follow up action taken up by the Board. The Board did not provide any such supporting details. The Board argued that considering the complexities and large number of transmission and distribution assets, it is difficult to estimate the requirements of R&M expenses in advance. However, the Commission cannot accept the contentions of the Board that estimates cannot be made on R&M due to the complexities, since all utilities practice planning and budgeting of various expenses. The Board is not at liberty to spend at their will without any planning and control. The Commission also sought the addition to GFA proposed in the ARR and the actuals so as to correlate the reason for increase in R&M expenses. In the reply the Board could not provide any additional information other than what is available in the Audited report. It is also

clear from the stand of the Board that no steps were taken or internal mechanism created to limit the expenses at the approved level. The Board argued that the R&M expenses in the previous years cannot be taken as a benchmark since the expenses were curtailed due to financial crunch. The Commission also notes that while approving the R&M expenses the Commission had considered the addition to GFA proposed by the Board as Rs.707.84 Crore, where as the actual was only Rs.501.42 in 2004-05. Hence the reasons given by the Board are neither sufficient nor convincing to provide the actual R&M expenses. The actual R&M expense was Rs. 74.49 crore, which is about 16.7% higher than the actual R&M expenses for 2003-04. The average inflation reported by KSEB is 5.72% only. The gross addition to GFA is about 7.7% in 2004-05, which is lower than what was projected by the Board and accepted in the ARR for 2004-05. The R&M expense is a controllable item, the Board should have taken steps to control it at the approved levels. Not withstanding above noted facts, as a special case, the Commission allows the R&M expenses for the year 2004-05 at 5.72% above approved level for 2003-04, which may not be construed as precedent in any future proceedings.. Thus the R&M expense for 2004-05 after truing up is Rs.70.52 Crore.

A&G expenses

15. As in the case of R&M expenses, the Board could not explain the relation between business volume and A&G expenses and the reason for excess A&G expenses over the approved level. In the reply of the Board no mention was made on steps taken by the Board to limit the expenses to the approved level. The increase over the approved level of expenses in 2004-05 is about Rs.5.7 Crore. The Board has given a statement of A&G expenses other than electricity duty in the past from 1998-99 as shown below:

Year	A&G expenses other than Sec 3(1) duty
1998-99	35.28
1999-00	40.07
2000-01	46.00
2001-02	38.07
2002-03	30.31
2003-04	33.21
2004-05	40.03

16. The A&G expense is also a controllable item as has been revealed from the above table. KSEB could curtail the expenses substantially down in between 20001-02 to 2003-04. The increase in A&G expenses is 20.5% from 2003-04 to

2004-05, which is very much high by any standards. Compared to the approved level, increase in expenses was on account of ‘other A&G expenses’ to the tune of Rs.6.81 crore. The Commission could not arrive at the rationale since the breakup of expenses was not available in the original ARR for 2004-05 as well as in the approved level. Hence the reason for increase attributed to a specific item of expenses cannot be ascertained. Since it is a controllable item, and no rationale is provided by KSEB in effectively substantiating the additional increase is due to increase in number of consumers or business growth. Hence the Commission is in a position only to allow the increase as per the inflation rate of 5.72% as communicated by the Board over the approved A&G expenses for 2003-04. Hence, the A&G expenses for 2004-05 allowed after truing up is Rs.35.95 Crore, which is 8.2% more than the actual A&G expenses in 2003-04 and 5.72% more than the approved rate for 2004-05.

Employee costs

17. The Commission approved an employee cost of Rs.718.47 crore for the year 2004-05 against which the actual was Rs.759.84 crore. According to the Board the total number of employees decreased by 312 due to retirement in 2004-05 and the base salary was reduced to Rs.205.35 crore against Rs.212.94 crore in 2003-04. KSEB has included Rs.43.20 crore towards wage revision which was due in July 2003 in the actuals.

18. The Commission notes that based on the information submitted by KSEB, the major difference between approved amount and actual is in salary and DA to the tune of Rs.89.46 crore. Out of which, Rs.43.20crore was on account of provision made for salary revision. As against the approved amount of salary &DA of Rs.313 Crore, the actual booked was Rs.402.45 crore. On principle, the Commission allows the salary and DA at actuals. On the earlier occasion of truing up the Board had failed to submit all the relevant details which had led to the approval of a lesser amount compared to the actuals.

Employee cost allowed for 2004-05

Sl.No	Particulars	2003-04	2004-05			
			Approved	Accounts		True up
1	Salaries	212.94	313.00		**232.51**	**232.51**
	Base salary			205.35		
	Provision for pay revision			27.16		
2	DA	151.75			**169.95**	**169.95**
	Base DA			153.91		
	Provision for pay revision			16.04		
3	**Sub total 1 to 2**	**364.69**	**313.00**		**402.46**	**402.46**

Sl.No	Particulars	2003-04	2004-05			
			Approved	Accounts		True up
4	Earned Leave encashment	-	23.00		22.78	22.78
5	Overtime	0.12	0.13		0.07	0.07
6	Other Allowances	16.47	21.34	16.65	19.20	
7	Bonus	2.51		2.55		
8	Medical expenses reimbursement	1.90			1.80	
9	Workmen's compensation	0.32			0.35	
10	Staff Welfare expenses	0.10			0.06	
11	**Sub-total 4 to 10**	**21.42**	**44.47**		**44.26**	**44.26**
12	**Terminal benefits (including terminal Surrender)**	**402.20**	**361.00**		**342.92**	**342.92**
14	**Grand total (3+11+12)**	**788.31**	**718.47**		**789.64**	**789.64**

Bad debts

19. In the ARR&ERC order for 2004-05, the Commission has stated as follows:

While issuing the order on ARR & ERC for 2003-04, the Commission had directed the Board to take immediate steps to identify bad debts and furnish full information on the write offs in respect of this item. However, this information has not been furnished by the Board. The Commission is also not aware whether the provision of Rs.17.41 crores made towards bad debts during 2003-04 has been utilized by the Board. The Commission is inclined to agree to the views expressed by the objectors that the inefficiency of the Board in collecting the outstanding dues should not be passed on to the consumers, as it is not only inequitable but provides the Board with little incentive to improve upon its efficiency and might result in easing of efforts to bill and collect in an efficient manner. The Commission is of the view that there should not be any financial burden on genuine consumers due to inefficiency of the Board and undue advantage taken by the unauthorized or illegal consumers. Therefore, in the absence of a detailed analysis regarding bad debts, the Commission seeks to disallow the provision for bad debts during 2004-05.

20 In the letter dated 18-2-2010, the Board seeks to justify the other debits to the tune of Rs.36.49 crore for the year 2004-05. Total bad debt written off/provided for was Rs.23.9 crore of which Rs.10.58 crore was on account of withdrawl of revenue due to Government Orders and balance Rs.13.32 crore towards provision for bad debts being the difference in the amount to

arrive at 5% of outstanding at the year end over the provisions already made. The miscellaneous write off as per the accounts was Rs.12.49 crore, of which major item was loss due to exchange rate variation (Rs.6.23 Crore) and sundry debtors outstanding for more than 10 years written off (Rs.4.28 crore). As per the accounting practice a small portion of outstanding receivable against sale can be allowed to provide for bad debts. Accordingly, the provision Rs.13.32 crore is allowed. The Commission is not informed about the withdrawl of prior period credits to revenue account due to government orders. The Commission provisionally allows them pending details to be submitted by the Board. The miscellaneous losses written off to the tune of Rs.12.49 crore is also allowed since the major portion is on account of foreign exchange rate variation. The Commission was not provided with these relevant details earlier.

21. Accordingly, following adjustments are made in the Order dated 24-11-2007 as per the order of the Hon. APTEL dated 12-11-2009 in appeal no. 94 of 2008.

- For 2003-04 the adjustment of T&D loss, the revenue gap will be increased by Rs.11.22 Crore (Rs.33.48 Crore – Rs.22.26crore).
- For 2004-05, the revenue gap will increase by Rs.62.65 Crore as per following adjustments.

Particulars	2004-05 (Rs. Crore)		
	True up Order dated 24-11-2007	Adjustments	Allowed after True up
Power purchase Cost	1,463.03	(11.31)	1,451.72
R&M Expenses	66.70	3.82	70.52
A&G Expenses	34.30	1.65	35.95
Employee costs	753.47	36.17	789.64
Bad debts	23.69	12.80	36.49
Other items	1,153.82		1,153.82
Total	**3,495.01**	**43.12**	**3,538.13**
Non tariff income	339.63		339.63
Revenue from Tariff	2,936.90	19.53	2,917.37
Total Revenue	3,276.53		3,257.00
Revenue gap	**(218.48)**	**62.65**	**(281.13)**

- The additional revenue gap of Rs.73.87 Crore (Rs.62.65 crore + Rs.11.22Crore) for 2003-04 and 2004-05 will be adjusted against the revenue surplus/gap arrived at in the truing up of accounts from 2006-07 onwards.

22. Before ending, the Commission wishes to points out that it is clear from the submissions of KSEB, since the regulatory regime was in place, KSEB has not effectively taken up any steps to limit the expenses to the approved levels. It is regretfully noted that there is no internal mechanism formulated to adjust or recast the budgets based on the approved level of expenses and keep the expenses at the approved level. This is evident in the case of all controllable expenses as no explanation could be given by KSEB for the steps taken to limit the expenses. No one can agree to the statements of KSEB that due to the *'complexities and large number of transmission and distribution assets it is difficult to estimate the level of expenses'*. Such statements are clear pointers on the failure to adopt and emulate the best practices in the domain of providing electricity service. KSEB is carrying out the business for more than 5 decades or so, so also other similar entities in the country. According to the Commission, there is no need to reinvent the wheel. Well established planning process and management procedures are to be institutionalised by KSEB especially in a situation of rapid changes in the sector. It has been widely accepted that there is no incentive in the cost plus regime to control expenses to the optimum level since any expenses made can be transferred to the consumers, without affecting the margins of the operator especially in a regulatory regime. Hence 'prudency' and 'used & useful' tests are insisted on to pass on the expenses. Disallowance of expenses should be viewed in that perspective. Any effort to control and reduce expense would directly reflect into lower price of electricity to the public. Considering the peculiar advantages of Kerala, KSEB as a public entity, should act as model to other similar entities by providing electricity at lowest possible cost. Any efforts to control expenses by introduction of technology or through other measures or incentive mechanisms have to be explored and instituted. The disallowance of expenses shall be viewed not as a penal measure, but as a means for institutionalising proper planning and control mechanisms. KSEB should be proactive in this direction rather than giving illogical and unsubstantiated statements to support inaction.

Sd/-	**Sd/-**	**Sd/-**
M.P.Aiyappan **Member**	**C. Abdulla** **Member**	**K.J. Mathew** **Chairman**

Approved for Issue

Secretary