

THE KERALA STATE ELECTRICITY REGULATORY COMMISSION

THIRUVANANTHAPURAM

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

May 14, 2010

Petition No OP 15/2010	Kerala State Electricity Board, Vydyhyuthi Bhavanam, Thiruvananthapuram 695004	Petitioner
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In the matter of
Truing up of Accounts of Kerala State Electricity Board for the year
2006-07

ORDER

Background

1. In the Order on ARR & ERC for 2009-10 of the Kerala State Electricity Board (*hereinafter referred to as KSEB or the Board*), the Commission provisionally arrived at a revenue gap of Rs.335.30 Crore. Against this, the surplus of Rs.181.36 Crore arrived at by the Commission after the truing up exercise for the year 2005-06 was adjusted. In order to fillup the balance revenue gap of Rs.153.94 Crore, Board had filed tariff rationalisation proposals. The Commission in its order dated 2-12-2009 disposed of the tariff petition without allowing tariff increase and directed KSEB to file truing up petitions for the rest of the years i.e., 2006-07 to 2008-09. KSEB accordingly filed the truing up petition for 2006-07 on 22-1-2010. However, petitions for 2007-08 and 2008-09 are yet to be filed.
2. The Commission admitted the petition for truing up for 2006-07 as OP 15 of 2010 and directed KSEB to publish the abstract of the petition for inviting objections from the public as per KSERC (Conduct of Business) Regulations 2003 giving sufficient time for filing objections. The public hearing was scheduled on 11-3-2010 at the Commission's Office. The Commission also sought clarifications

from the Board on the petition vide its letter dated 6-2-2010. The Board has given its reply on 9-3-2010.

3. In the petition, KSEB has presented a revenue gap of Rs.142.23 Crore as against the revenue surplus of Rs.184.63 Crore arrived at by the Commission in the Order on ARR&ERC for 2006-07, as shown below:

Comparison of Approved and Actual ARR &ERC for 2006-07

Sl.No.	Particulars	2006-07 (Rs. Crore)		
		Proposed in ARR	ARR Order	Audited Accounts
1	Generation of Power	43.09	43.09	111.84
2	Purchase of power	1,646.02	1,646.02	1,629.30
3	Interest & Finance Charges	529.76	513.64	429.34
4	Depreciation	424.32	247.43	405.98
5	Employee Cost	882.20	823.45	898.09
6	Repairs & Maintenance	96.50	90.00	110.99
7	Administration & General Expenses	108.85	105.00	135.10
8	Other Expenses	146.75	91.78	698.66
9	Gross Expenditure	3,877.49	3,560.41	4,419.30
10	Less : Expenses Capitalized	(43.90)	(43.90)	(43.19)
11	Less : Interest Capitalized	(53.50)	(53.50)	(35.13)
12	Total Expenditure	3,780.09	3,463.01	4,340.98
13	Return on Equity/Statutory Surplus	217.42	217.42	217.42
A	ARR (12 + 13)	3,997.51	3,680.43	4,558.40
	Revenue from Charges			
14	Revenue from energy sale within the State	3393.42	3424.55	3476.35
15	Revenue from non-tariff income	301.31	290.51	406.46
16	Revenue from export of power		150.00	98.49
17	Revenue from sale of power to Traders			434.87
B	Total (14+15+16+17)	3694.73	3865.06	4416.17
	Revenue Surplus/(gap) (B-A)	(302.78)	184.63	(142.23)

4. In the petition, KSEB stated that though the Electricity (Supply) Act, 1948 stands repealed, the rules made under section 69(1) of the said Act shall continue to have effect until such rules are rescinded or modified. Accordingly the Electricity (Supply) (Annual Accounts) Rules (ESAAR) 1985, are in force, and the Board is bound to follow the rules and the annual accounts are prepared in accordance with the above rules, which are certified and audited by Comptroller and Auditor General of India.

Public hearing on the petition

5. In the public hearing held on 11-3-2010, representatives of Kerala HT-EHT Industrial Consumers Association, M/s Binani Zinc Limited and M/s TCC Limited among others were present. The list of persons who attended the public hearing is annexed. In the public hearing, the Association argued that in the ARR&ERC Order for 2006-07, the Commission had arrived at a revenue surplus of Rs.184.63 Crore and directed KSEB to file tariff rationalization proposals by 30-4-2006. The Board failed to comply with the directions of the Commission. The Association alleged that the Board however, in the petition has misled the Commission by stating that the Commission had allowed the Board to continue the tariff without mentioning the direction issued by the Commission for filing the rationalisation proposal. By giving the extracts of the judgment of APTEL, in Appeal No. 94 of 2008, KSEB Vs KSERC, the Association has argued that the Commission is not bound by the Audited Accounts of the Board. APTEL has remarked that the *“Commission has to allow only as much expenditure as pass through as meet the targets set by it or is found to be prudent and necessary”*. Further the Hon. Supreme Court in WBERC Vs CESC (2002)(8) SCC 715 also had ruled that audited accounts are not *ipso facto* binding on the Commission. Hence as per the provision of the Electricity Act 2003, only expenditure which is reasonable and prudent needs to be passed on to the consumers. The detailed arguments on each of the items are given separately while discussing the individual items.

6. KSEB continuously pressed for allowing expenses as per the accounts which are prepared as per ESAAR 1985 and audited by C&AG. However there are no two opinions on the preparation of accounts as per ESAAR 1985, but the pertinent issue is how far such expenses booked can be passed on to the consumers reasonably. The Commission can allow only such expenses which are prudently incurred for providing supply to the consumers as has been held by the Hon. Supreme Court in WBERC Vs CESC. The Commission has stated the principles of truing up in its first order on truing up for KSEB, dated 24-11-2007. The Commission would follow the same principles for disposing of this petition. The analysis of each item of expenditure is given in the following paragraphs.

Energy Sales:

7. In the order on ARR&ERC, the Commission had approved energy sales of 10860MU, but the actual energy sale within the State during 2006-07 reported by the Board was 11331MU. The detailed energy sales statement is as follows:

Energy sale for 2006-2007 (MU)

Category	ARR Order	As per audited accounts
LT Domestic	5002	5213.2
Industrial	863	933.9
Commercial & Non Domestic	1165	1245.8
Irrigation	205	220.2
Public Lighting	205	228.7
Sub total LT	7440	7841.9
HT Industrial	1460	1436.4
Non-Industrial	141	134.7
Commercial & Non Domestic	400	431.1
Others (Irrigation)	10	9.5
Subtotal HT	2011	2011.7
EHT 66KV	314	309.3
110 KV	720	760.8
Railways	61	72.2
Subtotal EHT	1095	1142.2
Bulk Supply	314	335.4
Total	10860	11331.1

8. The Board has reported that there was considerable increase in the energy consumption of LT consumers over the approved level. In most of the HT-EHT categories also sale was higher than the approved level. The Commission for the purpose of truing up allows the actual energy sales as reported by the Board.

T&D Loss

9. The Board has stated in the petition that the actual energy loss for 2006-07 was 21.47%. The loss figure was arrived at as follows.

Particulars	Unit	Actual 2006-07
1. Net Generation and Power Purchase	(MU)	15,475
2. Surplus energy sale outside the State through displacement mode	(MU)	1,047
3. Net Energy input into the KSEB system = (1) -(2)	(MU)	14,428
4. Energy sales within the State	(MU)	11,331
5. Internal T&D Losses (3) - (4)	(MU)	3,097
T&D Loss as percentage of total energy input	(%)	21.47

10. According to the Board, the actual internal T&D loss for the year 2006-07 was 21.47% against the target of 21.12% approved by the Commission. Though the loss level approved by the Commission for the year was 20.45%, the Board arrived at a loss level of 21.12% presumably by accounting 500MU as sale to other States. Hence, according to the Board the actual loss reduction was 0.35% less than the target fixed by the Commission. The Board also stated that from 2001-02 to 2006-07, the loss reduction achieved by the Board was 9.29% which leads to a saving of power purchase cost to the tune of Rs.580.78 Crore. Board argued that after considering the transmission loss of 5%, the distribution loss in the system would be about 17.33%. This loss level in 2006-07 is better compared to other States in India except Tamil Nadu and Andhra Pradesh, where the loss is 14.27% and 15.51% respectively. According to the Board, the achievement of Andhra and Tamil Nadu is doubtful considering the fact that 25% to 45% of the total sales are unmetered in comparison with Kerala where metering is 100%. Considering this, KSEB requested that penalty for underachievement of loss target by 0.35% shall not be imposed. The Board also requested that 50% of the cost saving through continuous T&D loss reduction achieved by the Board since 2001-02 be allowed to be retained with the Board as an incentive for further loss reduction.

11. The arguments of the Board was severely opposed by the objectors. According to them the arguments of the Board that loss reduction to the tune of more than 9% over the years is false since, in 2001-02 the Board jacked up the loss figures from 17.21% to 30.76% by manipulating the data. They have also quoted the response of the Board recorded in the Order on ARR&ERC for 2003-04 on this issue. If the manipulation of the Board is left out, the losses have been increased to a level of 21.47% from 17.21% in 2001-02. Based on this, they

argued that the claim of the licensee for incentives for performance is totally irrational and objectionable. They also objected to the statement of the Board that the loss level approved by the Commission is 21.12% instead of 20.45%. As per the estimates of the objectors, 185 MU shall be disallowed from the power purchase for non-achievement of the loss target by the Board. Accordingly Rs.41.83 Crore should be disallowed from the power purchase by considering the average power purchase cost of Rs.2.26/kWh.

12. The Commission analysed the claims of the Board as well as the objections. The Objectors have pointed out the deceptive efforts of the Board in showing the achievement in loss reduction. The Commission in the ARR&ERC for 2006-07 had approved a loss reduction target of 2.5% after considering the proposals of the Board in detail. In the ARR for 2006-07, the Board had proposed several steps for loss reduction such as replacement of faulty meters (4 lakh nos), intensification of theft detection and commissioning of a number of T&D schemes, including implementation of projects under APDRP and RGGVY schemes. The Board also had envisaged a Transmission and Distribution work programme during 2006-07 which would contribute towards loss reduction. Considering these programmes, the Commission fixed the loss reduction target at 2.5% for the year 2006-07. However, it can be seen that the programmes proposed by the Board were not completed as planned. Thus, the failure on the part of the Board to complete the projects in time could have contributed to the non-achievement of the loss target. The progress of capital works reported by the Board is as shown below.

Performance of the Board on capital projects

Year	2005-06		2006-07	
	Proposed	Actual achievement	Proposed	Actual achievement
Substations (Nos)				
220kV	3	1	4	0
110 kV	8	4	10	2
66kV	7	4	3	3
33kV	30	10	71	10
Lines (Km)				
220kV	33.25	56.00	52.10	--
110 kV	108.26	55.00	49.00	30.00
66kV	62.77	13.00	--	15.00

Year	2005-06		2006-07	
	Proposed	Actual achievement	Proposed	Actual achievement
33kV	527.80	131.00	--	95.00
11 kV lines	4000	1062	6000	1820
LT lines	13000	7441	17000	8229
Distribution Transformers (Nos)	8500	1751	8500	2124
Faulty meter replacement (No. in lakhs)	8.50	6.38	4.00	2.69

13. Further, the capital expenditure proposed by the Board for 2006-07 was also not achieved as shown below:

	Proposed in the ARR (Rs. Crore)			
	2003-04	2004-05	2005-06	2006-07
Capital Expenditure	453.40	459.01	695.21	662.60
IDC capitalized	115.45	115.73	99.51	53.30
Other expenses capitalized	119.25	123.53	158.95	43.90
Total capital expenses	688.10	698.27	953.67	759.80
Expenses transferred to Gross asset	924.65	707.84	905.68	603.33
	Actuals (Rs. Crore)			
	2003-04	2004-05	2005-06	2006-07
Capital Expenditure	621.93	357.00	407.82	459.13
IDC capitalized	78.11	62.04	48.50	35.13
Other expenses capitalized	109.05	42.88	43.61	43.19
Total capital expenses	809.09	461.92	499.93	537.45
Expenses transferred to Gross asset	968.51	501.42	651.65	505.23

14. It is quite obvious that as has been the case generally with capital expenditure for the improvement of the system, the Board had not taken the implementation of capital expenditure programme seriously. The indifference and inefficiency shown cannot go unnoticed. Even with low progress achieved in the completion of projects, the Board has achieved loss reduction of 1.5% in 2006-07. The Commission is of the view that if the projects were completed on time or at least to the extent of 75% of the targets, including the proposed replacement of faulty meters, the Board could have achieved the loss target set by the Commission. In the petition as well as in the subsequent hearing, the Board could not furnish the reasons for non-achievement of targets, but justified the non-performance by comparing it with other SEBs which are not in the same situation. Many other

areas of achievement of other SEBs are not seen noticed. The Commission also notes that the Board in the past also did not achieve to the loss reduction targets approved by the Commission or proposed by the Board themselves. Loss reduction proposed by the Board, approved by the Commission and the actuals are given in the table below.

Comparison of loss reduction targets and achievement by the Board

Year	Proposed in the ARR (%)	Approved by the Commission (%)	Actual achieved by KSEB (%)
2004-05	2.33	3.00	2.50
2005-06	2.72	2.72	1.99
2006-07	1.76	2.50	1.50
2007-08	1.83	2.00	1.45
2008-09	1.63	1.63	1.32
2009-10	1.27	1.00	

T&D Loss targets proposed, approved and actuals

Year	Proposed in the ARR	Approved level	Actual
	(%)	(%)	(%)
2003-04	26.60	26.60	27.45
2004-05	24.77	24.50	24.95
2005-06	22.59	21.89	22.96
2006-07	21.58	20.45	21.47
2007-08	19.72	19.55	20.02
2008-09	18.49	17.92	
2009-10	17.43	16.92	

15. Based on the principle followed by the Commission in the previous orders and also in the light of the order of APTEL in 94 of 2008, the Commission allows the loss reduction target of 2.5% approved in the ARR&ERC Order for 2006-07 for the purpose of truing up. The Commission had fixed the loss reduction target of 2.5% for 2006-07. Accordingly, the loss target for 2006-07 would be 20.46% (Actual T&D loss for 2005-06 less loss target i.e., 22.96%-2.5%) instead of the loss level of 20.45% approved for the year 2006-07.

	2006-07		
	ARR Order	Actual as per Audited accounts	Allowed in True UP
T&D Loss	20.45%	21.47%	20.46%

16. As shown in the table below, for meeting the internal sale of 11331MU, at an allowed T&D loss of 20.46%, the energy requirement would be 14246MU. As per the data furnished by KSEB, at the interface point 14428MU was used for internal sales due to the higher loss of 21.47%. The excess energy requirement was 182MU (14428MU -14246MU). The cost of additional energy purchase due to non achievement of T&D loss to the tune 182MU has to be deducted from the power purchase cost, as has been done in the previous years in line with the Orders of APTEL

	ARR Order	Actual as per Audited accounts	True up
Net available/required at interface (MU)	13652	14428	14246
Sale within the state (MU)	10860	11331	11331
T&D loss (%)	20.45%	21.47%	20.46%
Excess power purchase (MU)			182

Generation and Power purchase

17. The Commission in the ARR order for 2006-07 had approved hydel generation of 7255.50MU considering excess storage available in the reservoirs. KSEB could generate 7463.76 MU from hydel stations thanks to the good monsoon in 2006-07. From the liquid fuel stations, as against the approved quantity of 42.92 MU from BDPP and 64.39 MU from KDPP, the actual generation was 81MU and 157.20MU respectively. The increase in generation from liquid fuel stations was mainly for meeting the peak hour requirement as well as to sell off-peak surplus energy. Accordingly the actual fuel cost for BDPP and KDPP was Rs.39.07 Crore and Rs.72.33 Crore respectively against Rs.17.56 Crore and Rs.24.92 Crore approved in the ARR.

18. The actual cost of power from Central Generating Stations (CGS) including UI, was Rs.1098.68 Crore in 2006-07. KSEB had a net export of UI about 170.02MU at a rate of Rs.6.12/kWh. Though originally no generation from BSES/RGCCPP/KPCL was proposed, later for exporting power, these stations were scheduled and the power was sold by realising comfort charges and variable costs.
19. The objectors did not accept the arguments of KSEB on excess power purchase. They have pointed out the provisions in the Tariff Policy on the treatment of excess power purchase on account of non-achievement of T&D loss. According to them KSEB has purchased excess quantity of 185MU which needs to be disallowed by considering the average power purchase cost of Rs.2.25/kWh ie., Rs.41.83 Crore should be disallowed from the power purchase cost.
20. As per the submissions of KSEB, 2006-07 was a good year considering the rainfall and availability of power from CGS. KSEB was able to generate 208MU of excess hydro power. Excess availability of power from CGS was about 644MU. Similarly KSEB also generated more from internal Diesel stations and IPPs, thereby they were able to export a total of 1047MU through displacement mode and had a net UI export of 170MU.
21. As per the methodology adopted by the APTEL, the Commission shall disallow the additional cost for purchase of additional power due to non-achievement of the loss target. Accordingly the average power purchase cost is worked out as follows:

Source	Energy (MU)	Cost (Rs.Crore)
Thalcher - II	3,393.94	463.78
NLC-II - Stage-1	312.74	47.36
NTPC- RSTPS	2,586.90	397.22
NLCII - Stage II	569.25	94.11
NLC - Exp	486.63	103.11
MAPS	131.92	26.12
Kaiga	266.33	71.04
KPCL	23.70	25.39
BSES	183.01	203.82
Total	7,954.42	1,431.95
Average Power Purchase cost (Rs./kWh)		1.80

22. Based on the above, the average power purchase cost works out to be Rs.1.80/kWh. Hence the total disallowance of power purchase cost for **182MU is Rs.32.76 Crore.**

23. The Commission approved the transmission charges for the CTU as Rs.232.72 Crore for 2006-07 based on the projections of KSEB. The actual transmission charges paid by KSEB was Rs.202.08 Crore in 2006-07. Since, KSEB has to pay the charges as per the rates ordered by CERC, the Commission has considered the actual transmission charges paid by KSEB for the truing up purpose. Accordingly, the total generation and power purchase cost allowed for truing up would be Rs.1708.38 Crore as against the Rs.1741.13 Crore as per actual accounts

	2006-07 (Rs. Crore)		
	ARR Order	Actual as per Audited accounts	Allowed in True UP
Internal Generation Cost	43.10	111.84	111.84
Power Purchase Cost	1,453.15	1,427.22	1,427.22
Less power purchase cost disallowed			(32.76)
Transmission Charges	192.87	202.08	202.08
Total Generation & Power Purchase Cost	1,689.12	1,741.14	1,708.38

Interest and finance charges

24. According to the Board the actual interest and financing charges was Rs.429.33 Crore for 2006-07. KSEB could reduce the interest on bonds and loans to the tune of Rs.93.76 Crore over the approved amount. The total repayment was Rs.1256.19 Crore, which is inclusive of write off of loans from GoK (Rs.377.69 Crore). In addition to repayments, capital expenditure of Rs.537.45 Crore was also made in the year 2006-07. Thus the total capital payment during the year was Rs.1415.95 Crore, but the additional borrowing resorted was only Rs.41 Crore. According to KSEB this is a unique achievement. KSEB also stated that as per the norms of CERC, the Board can limit the loan repayment to the extent of depreciation claimed. The depreciation claimed in the audited accounts was Rs.405.98 Crore where as the total repayment was Rs.878.50 Crore. Thus KSEB

made repayment in excess of depreciation to the tune of Rs.472.52Crore from own resources. KSEB also stated that it can borrow 70% of the total investment of Rs.537.45Crore made in 2006-07 ie., Rs.376.22 Crore and claim 14% RoE on the balance 30% ie., Rs.161.23 Crore. However, the loan availed was Rs.41.09 Crore only and the balance Rs.496.36 Crore was invested from internal sources.

- 25.The interest on security deposits was Rs.37.44 Crore against the approved amount of Rs.32.73 Crore. The interest on working capital claimed is limited to the actual short term borrowings only. The other financing charges such as the bank charges, guarantee commission, etc. was Rs.26.17 Crore. KSEB allowed a rebate of Rs.9.80 Crore for M/s NVVN and PTC for prompt payment of bills at the rate of 2% as per CERC norms. Hence the total other interest & financing charges were Rs.73.40 Crore as against the approved level of Rs.68.66 Crore.
- 26.The objectors claimed that KSEB shall only be allowed the actual interest incurred. According to them large portion of the reduction of interest is on account of netting off of dues between KSEB and the Government and not by the sincere and dedicated efforts as claimed by the Board. As against the statement of KSEB that netting off proposal was not admitted by the Commission yet and the Commission declined the proposal of loading Rs.2002 Crore on the consumers through write off. They also pointed out that KSEB has violated the Government orders on conversion of equity. They demanded that the Commission should appoint a suitably qualified professional auditor to conduct a forensic audit of the Board's accounts to determine the true nature of its operations and profitability. According to the objectors, the claim of 70:30 norm for investments is applicable only if project wise details are provided. In the event of continued refusal of the Board to provide the project wise information, the corresponding claim as per norms cannot be allowed.
- 27.The Commission had allowed Rs.513.64 Crore as the interest and finance charges for the year 2006-07 after considering the petition of the Board and the additional details submitted by the Board. The actual interest cost as per the audited accounts is Rs.429.33 Crore as shown below:

Sl No.	Particulars	Approved as per ARR (Rs. Cr)	Actual (Rs. Cr)
I	Interest on outstanding Loans and Bonds	412.25	318.49
II	Interest on Security Deposit	32.73	37.44
III	Other Interest and Finance Charges		
	a) Interest on borrowings for working capital	7.50	3.10
	b) Discount to consumers for timely payment of Charges	0.70	1.36
	c) Interest on PF	36.13	32.77
	d) Other Interest charges	0.01	0.00
	e) Cost of raising finance	1.00	0.19
	f) Guarantee Commission	14.32	
	g) Bank Charges	9.00	26.18
	h) Rebate accrued for prompt payment to NVVN	0.00	9.80
	Total of III	68.66	73.40
	Grand Total (1+2+3)	513.64	429.33

28. Regarding the interest on outstanding loans and bonds, as against the approved level of Rs.412.25 Crore, the actual was Rs.318.49 Crore. The difference was mainly on account of removal of government loans through netting off and also on account of the repayments made by the Board. Further as against the approved level of borrowing of Rs.375.25 Crore, the actual borrowing was only Rs.41.09 Crore in 2006-07. If the claims of the Board are true, the efforts made by the Board in reducing the outstanding liabilities needs to be appreciated. In order to examine the claim the Commission analysed the additional efforts made by KSEB in mopping up the internal resources. The Board has claimed that investments and repayments were made with own resources of about Rs.971.58 Crore. Based on the data furnished by the Board, the source of funds is as shown below:

Use of funds	Rs. Crore
Redemption/repayment	878.50
Capital expenditure	537.45
Less Interest & expenses capitalised	-78.32
Less borrowing resorted	-41.09
Total funds employed	1296.54

Source of funds	
Contribution for cost of capital assets	216.14
Electricity duty (Sec4) & other levies retained with Board	208.44
Increase in Provident Funds balance	52.68
Increase in security deposits from consumers	100.22
Depreciation	230.67
Provisions made in revenue expenses (Employee cost, interest etc.)	218.60
Short term deposits with Bank (2005-06)	186.32
Total	1213.07

29. The net funds requirements for capital expenditure and repayment is about Rs.1300 Crore, of which about Rs.1213 Crore is easily available from sources such as electricity duty, provisions, security deposits, contribution for capital assets etc., These are without considering the funds available through export of power, statutory return, and other provisions. The Commission notes that the Board has Rs.782.78Crore Security Deposit balance as on 31-3-2007. Hence, the above table shows that without much effort, many sources are available with the Board (carrying cost for some of the amounts are provided in the tariff) for making investment and repayment. According to the Commission there is no extra effort or potential increase in performance which warrant additional incentives over the actual level. Accordingly the Commission allows only the actual interest charges for existing loans and bonds which is Rs.318.49 Crore for the year 2006-07 in the true up.
30. The Board stated that interest shall be allowed as per CERC norms in the ratio of 70:30 on capital investment. The Commission is of the view that the claim of the Board for CERC norms cannot be accepted in a situation where borrowing is not identified for specific projects. The 30% equity norm is applicable when own resources are actually invested in the regulated business. Such practices are not being followed by the Board probably because many of the funding requirements are met out of surplus available internally.
31. Regarding other interest charges, KSEB claimed Rs.37.44 Crore towards interest on security deposits as against the approved level of Rs.32.73 Crore. In an earlier proceedings, KSEB clarified that the actual disbursement of interest on security deposits is only Rs.22.85 Crore in 2006-07. The Commission again

sought the clarification for which Board has provided reply vide letter dated 9-3-2010. The Board stated that as per the Electricity (Supply) Annual Accounting Rules (ESAAR) 1985, accrual based accounting is being followed by the Board and as per the balance security deposit existed as on 1-4-2005 the interest accrued is Rs.37.44 Crore, though the actual disbursement to consumers was only Rs.22.85 Crore. KSEB has to pay the balance amount as and when the consumers claim interest with retrospective effect. Thus KSEB requested to allow the provision as per the audited accounts. The Commission in the Truing up for 2005-06 disallowed the portion of interest on security deposit which was not paid to the consumers. According to the Commission, interest on security deposit paid to the consumers is fully passed on to the tariff. If any portion of the interest is not paid to the consumers, there is no responsibility for the consumers to share such burden. The Board cannot profit on this provision. The Commission cannot agree with the Board that the consumer should claim interest for their deposits which is unheard of. Provision regarding payment of security deposit as per Kerala Electricity Supply Code is clear in this respect. The Board every year shall adjust the interest on security deposit against the electricity bill of the respective consumers. The practice of creating provision and not paying the same to the consumers is not acceptable. If such practice is allowed, it will create an undesirable incentive to the Board for non-payment of interest to the consumers. It is the failure on the part of the Board to properly credit the interest on security deposit in the accounts of the Consumers from time to time. The Commission is also aware that billing computerisation is not complete in all respects and accounts are yet to be integrated. Hence it is difficult for the Board to pay interest on security deposits to the consumers with retrospective effect. In case the Board pays the arrear interest due to any consumer, the same can be accounted through prior period expenses, which can be allowed in the year it is paid. Hence the Commission allows only actual amount paid as interest on security deposit in the truing up. It is pertinent to state here that the Commission is in no way against booking the interest as per the accrual principle in the books of accounts. However, if the same is to be passed on to the consumers it has to be prudently established that it has actually been paid.

32. The Board has claimed Rs.9.80 Crore for paying rebate to traders for prompt payment at the rate of 2%. According to KSEB such provision for payment to traders is as per CERC norms. In the clarifications provided, Board could not provide the provision in the CERC norms that is applicable to traders for selling

power. Though the Commission is fully convinced that no such provisions are available in the CERC Norms for providing 2% rebate on prompt payment for power sales by the traders, the Commission allows the same considering the fact it is a mutual commercial contract which is equally applicable for purchase and sales. The Commission had allowed Rs.7.50 Crore as interest on working capital. However, the actual interest is only Rs.3.10Crore. Considering the better management of working capital, the Commission allows to retain the excess provision. The Commission notes that the Board has written off the government loans and the netting off proposal is still not logically concluded. As and when the process is completed in line with the provisions of the Act & the regulations and following fair accounting procedures, the Commission shall properly consider the same. Till such time, interest on Government loans are not provided since, the Board is anyway not paying the same to the Government. Accordingly interest and financing charges allowed for the purpose of truing up is as follows:

Particulars	ARR Order	Actual as per Audited accounts	True up
	(Rs. Cr)	(Rs. Cr)	(Rs. Cr)
I. Interest on outstanding Loans and Bonds	412.25	318.49	318.49
II. Interest on Security Deposit	32.73	37.44	22.85
III. Other Interest and Finance Charges			
a) Interest on borrowings for working capital	7.50	3.10	7.50
b) Discount to consumers for timely payment of Charges	0.70	1.36	1.36
c) Interest on PF	36.13	32.77	32.77
d) Other Interest charges	0.01	0.00	0.00
e) Cost of raising finance	1.00	0.19	0.19
f) Guarantee Commission & Bank charges	23.32	26.18	26.18
g) Rebate accrued for prompt payment to NVVN	0.00	9.80	9.80
Total of III	68.66	73.40	77.80
Grand Total (I+II+III)	513.64	429.33	419.14

Depreciation

33. In the truing up petition, the Board has stated that depreciation is a source of funds for replacement of assets and the same is provided at normal rates as prescribed by the Ministry of Power Government of India. According to the

Board, though in the ARR, the Commission allowed depreciation of Rs.247.44 Crore as per the CERC Norms, the Board is compelled to account the depreciation as per Electricity Supply and Annual Accounts Rules (ESSAR) 1985. The Board has stated that as per the annual accounts approved by C&AG depreciation is Rs.405.98 Crore. Board has given several arguments for accounting depreciation as per Government of India 1994 norms. The Board has stated that as per the agreement between Government of Kerala and Government of India, KSEB is continuing as a STU and a licensee during the year 2006-07 and performing the duties and functions envisaged under the Electricity Act 2003 as a generating company, STU and a distribution licensee. Hence, Board claimed that there is no change in the duties and functions as well as accounting system adopted in the Board after the enactment of Electricity Act 2003. According to KSEB, as per section 185(2)(d) of the Electricity Act 2003, the ESSAR is saved for preparation of annual accounts of the Board and statutory authority of C&AG has not been altered by the Electricity Act 2003. Hence, according to the Board, KSEB is still functioning as the State Electricity Board under the provisions of Electricity Act 2003. As per section 68 of the Electricity (Supply) Act, 1948 the Board shall provide depreciation, such sum calculated in accordance with the principles as Central Government may after consultation with the Authority by notification in the official Gazette, lay down from time to time. Board further argued that there is vast difference between CERC norms and ESAAR 1985. CERC depreciation rates have provisions only for generation and transmission and no provision for distribution assets. According to the Board since C&AG has audited the accounts as per Annual Accounting Rules, 1985, the Board has to follow the accounting norms as per Annual accounting rules 1985, until the same is replaced. The Board also supported the arguments with the orders of APERC and TNERC, which provided depreciation on 1994 Gol norms.

34. The objectors have argued that the Commission in the previous orders have specifically addressed the issue of depreciation. In the light of the clarification of Forum of Regulators, the issue regarding depreciation for distribution is resolved. Hence, the Board shall only be allowed depreciation rates as per CERC norms.
35. The Board requested for considering the depreciation as per the Government of India notification 1994. The Commission in its order on ARR&ERC for the year 2008-09 had in detail deliberated the issue of depreciation and decided that as per the clause 5.3(c) of Tariff Policy and the subsequent decision of Forum of

Regulators communicated vide letter No. 1/20(6)/2006-Tariff Policy/CERC dated 23-06-2006, depreciation shall be as per the CERC (Terms and conditions of Tariff) Regulations, 2004. The Commission vide letter dated 6-2-2010 had directed KSEB to estimate the depreciation as per the CERC regulations 2004. However, the Board has communicated its inability to arrive at the depreciation as per CERC norms, stating the reason that since the Government of Kerala has issued policy directions under Section 108 in which para (ix) states that depreciation shall be done as per annual accounts rules 1985. Further the Government vide letter dated 15-7-2008 requested the Commission to allow KSEB to account depreciation as per the rates notified vide gazette dated 29-3-1994. The Commission disagrees with the stand taken by KSEB in this respect. It is to be pointed out that as per the provisions of Section 108 of the Act, policy directions are issued on the functioning of the Commission and the Board cannot take shelter under the directions issued to the Commission. The Commission is of the view that depreciation is a component in tariff determination hence, the direction under Section 108 on depreciation shall be applicable only if the difference between depreciation calculated based on the methodology adopted by the Commission and the methodology suggested by Government of Kerala is provided by the Government in the form of subsidy in a manner as directed by the Commission under Section 65 of the Electricity Act, 2003. Further the letter dated 15-7-2008 of the Government is not binding on the Commission and is only a suggestion for allowing the KSEB to Account depreciation as per GoI norms. The Commission has communicated its stand to the Government on this issue. The Board is free to account the depreciation as suggested by the Government in their books so long the audit principles and statutory Audit permit the same. However, whether such provisions are to be passed on to the consumers is entirely a matter to be decided by the Commission as per the provisions of the Act. The Commission has specifically sought from the Board the provision in the ESAAR, 1985 which provides for depreciation rates as per the Government of India norms. The Board in its letter dated 9-3-2010 has replied that Section 68 of the Electricity (Supply) Act 1948 provides as follows:

“68: Charging of depreciation by Board

The Board shall provide each year for depreciation such sum calculated in accordance with such principle as the Central Government may after consultation with the Authority by notification in the Official Gazette, lay down from time to time“

36. Further the attention was invited to the para 2.60 of the Annexure III and para 1.23 and 1.24 of Annexure V on the procedural matters related to accounting transaction of ESAAR 1985, which is given below:

“General Framework for charging depreciation

1.24 The general framework for charging depreciation is outlined below:

- (1) the existing practice of charging depreciation on straight line method shall continue*
- (2) 90% of the cost of a fixed asset shall be depreciated over the estimated useful life of the Asset*
- (3) “Estimated useful life of the asset” shall be:*
 - As prescribed by the Central Government in consultation with Central Electricity Authority*
 - As prescribed by the State Government in respect of Assets where the Central Government has not prescribed any period.*
- (4) No depreciation shall be provided on an asset in the year in which it is first put to use by the Board*
- (5) Depreciation shall be charged on an asset even if during the year it permanently ceases to be used by the Board.*

37. The Commission is of the view that the above provisions do not support the contentions of the Board. The Board had claimed that as per the provisions of Section 172 of the Act, through Electricity (Supply) Act 1948 is repealed, the Board is still functioning as a State Electricity Board. However, the relevant provision of the Act does not accord such a status to the Board. The Electricity (Supply) Act, 1948 is repealed by the Electricity Act 2003. As per the General Clauses Act 1897, the effect of repeal is follows:

Effect of repeal.- Where this Act, or any [Central Act] or Regulation made after the commencement of this Act, repeals any enactment hitherto made or hereafter to be made, then, unless a different intention appears, the repeal shall not-- (a) revive anything not in force or existing at the time at which the repeal takes effect;

38. Thus the repeal of the Electricity (Supply) Act, 1948 does not revive any provisions of the said Act. Thus, Section 68 in which depreciation is provided is not in existence as on date. Further the transitional provision under Section 172 of Electricity Act is as follows:

*Section 172. (Transitional provisions):
Notwithstanding anything to the contrary contained in this Act,-*

(a) a State Electricity Board constituted under the repealed laws shall be deemed to be the State Transmission Utility and a licensee under the provisions of this Act for a period of one year from the appointed date or such earlier date as the State Government may notify, and shall perform the duties and functions of the State Transmission Utility and a licensee in accordance with the provisions of this Act and rules and regulations made thereunder:

Provided that the State Government may, by notification, authorise the State Electricity Board to continue to function as the State Transmission Utility or a licensee for such further period beyond the said period of one year as may be mutually decided by the Central Government and the State Government;

39. The above provision states that Board as an entity created under the provisions of the Act is transformed to a STU and a licensee, and is entrusted with duties and functions of STU and a Licensee in accordance with the provisions of Electricity Act 2003 for a period of one year and for subsequent periods with the mutual agreement of State Government and Central Government. Hence the contention that Electricity Board is still in existence is not legally sustainable. Further, depreciation is one component in tariff determination. Further proviso to Section 61 of Electricity Act 2003 is as follows:

“Provided that the terms and conditions for determination of tariff under the Electricity (Supply) Act, 1948, the Electricity Regulatory Commission Act, 1998 and the enactments specified in the Schedule as they stood immediately before the appointed date, shall continue to apply for a period of one year or until the terms and conditions for tariff are specified under this section, whichever is earlier.”

40. As per the above proviso, provisions of Electricity (Supply) Act is valid for a maximum of one year from the appointed date. As per the contentions of the Board, Section 68 of the Electricity (Supply) Act 1948 provides for the way in which depreciation is calculated i.e., by way of notification in the official gazette by the Government. Since the said provision was repealed, it is not applicable. There is no provision in the ESAAR 1985 (which is saved in the Electricity Act, 2003), specifying the rate of depreciation. In this context it is to be pointed out that even if the contention of the Board is accepted for argument sake, the provision of the Act and Rules (ESAAR 1.24(2)) provides that depreciation rates shall be as per the stipulated useful life of the Asset. However, Government of India has made significant deviation in the 1994 notification. There are two notifications on the depreciation rates in the 1990 i.e., S.O.93(E) dated 23-1-

1192 and S.O.266(E) dated 29-3-1994. Prior to 1992 the notified fair life ranged from 100 years for dams and 5 years for temporary structures and the depreciation rates ranged from 0.9% to 18%. In 1992, the maximum fair life was reduced to 50 years and the depreciation rate was increased to 1.95% and 21.55% for various assets. However in 1994, Government of India by keeping the fair life of assets unchanged, increased depreciation rates further. Though Section 68 of Electricity (Supply) Act provides that depreciation is to be based on useful life, it was delinked in the 1994 notification. Regarding the Supreme Court Order in DERC Vs BSES produced before the Commission by the Board in support of their claims, the Commission is of the view that it is not applicable to this case as had been mentioned in the Order on ARR&ERC for 2008-09. The argument of the Board that it is difficult to estimate depreciation as per the revised CERC norms since the rate of depreciation is different in the two methods is also not valid since there is no difference between asset classification in the 1994 notification and CERC regulations. It is important to note the comment of the C&AG which is reported in para 1.2.4.1 of the Audit report. The Audit note goes against the contentions of the Board that C&AG has approved the depreciation as estimated by the Board in the audited accounts. According to C&AG, the depreciation is overstated by Rs.175.31 Crore, by not following the Regulations issued by the Commission.

41. The Board also stated that Advance Against Depreciation (AAD) is applicable in case depreciation is as per CERC Norms. AAD is provided to meet the difference between depreciation and repayment of loans for specific projects. In the case of the Board such provisions are not applicable since borrowing and repayment are generally not project specific. Further as per the judgment of Hon. Supreme Court in DERC Vs BSES, depreciation shall not be linked to repayment.
42. It is pertinent to point out the inconsistencies in the contentions of the Board. Though on the one side, the Board argued that CERC regulations are not applicable in the case of depreciation, the same contention is not applied in the case of Return on Equity, for which Board has provided for 14% of Equity as per the CERC norms even when such provisions are not available either in the Electricity (Supply) Act 1948 or in the ESAAR, 1985. Further, even if the ESAAR 1985 is not repealed/rescinded/modified, in the ARR for 2010-11, the Board has adopted CERC norms for estimating depreciation apparently due to the fact that the rates provided are higher. The criterion appears to be greater advantage

only. In the above circumstances, the argument of the Board that depreciation for the purpose of tariff determination is to be as per Government of India Notification 1994 is not acceptable.

43. The Commission vide letter dated 6-2-2010 had directed KSEB to provide depreciation as per CERC norms. However the Board declined to provide the same. In the absence of the estimation from the Board, the Commission accepts the estimate given by the C&AG in the Audit report for the purpose of truing up. As per the estimation of C&AG the depreciation is overstated by Rs.175.31 Crore. Hence the depreciation to be allowed to the Board shall be Rs.230.67 Crore (Rs.405.98 Crore – Rs.175.31 Crore).

	2006-07 (Rs. Crore)		
	ARR Order	Actual as per Audited accounts	Allowed in True UP
Depreciation	247.44	405.98	230.67

44. It has been brought to the Commission's notice by the objectors that the Board is not entitled to claim depreciation for assets created through consumer contribution, government grants etc., As the Commission notes that depreciation in such cases is disallowed by many Commissions and it might lead to double payments for the consumers. The Commission intends to look into this separately collecting the details and giving sufficient opportunity to the Board and the stakeholders, the above provision for depreciation will be treated as provisional.

Employee cost

45. In the ARR&ERC order, the Commission has approved Rs.823.45 Crore as employee cost for 2006-07. Against this, the actual employee cost as per the accounts is Rs.898.09 Crore, which is about Rs.74.64 Crore over the approved level. The major increase was on account of salaries (Rs.54.06 Crore) and terminal benefits (Rs 20.95 Crore). According to the Board the increase is justifiable since in 2006-07, 4.18 lakh new consumers were added to the system and energy sale increased by 13.5%. Despite this, number of

employees were reduced from 26301 as on 1-1-2006 to 25117 on 31-3-2007 ie., by 914 employees. However, this reduction in employees did not reflect in the employee costs since the provision given for wage revision is to the tune of Rs.95 Crore in 2006-07. The wage revision was due from July 2003, which was effected during 2007-08. The actual disbursement of arrears was Rs.280.96 Crore against the total provision of Rs.279.20 Crore created over the years. Thus the provision given in the earlier years avoided lumpsum impact on employee cost. The actual employee costs is as follows:

Particulars	2005-06	2006-2007	
	Actual	ARR Order	Actual
Salaries	251.82	243.70	297.76
DA	183.73	200.00	195.31
Overtime, other allowances, Bonus.	22.02	22.00	21.57
Earned Leave encashment, medical expenses reimbursement, staff Welfare expenses, payment under works men compensation,	30.06	22.75	27.50
Terminal benefits (including terminal Surrender)	374.89	335.00	355.95
Grand total	862.52	823.45	898.09

46. According to the Board, during the financial year 2006-07, 999 employees retired from service. The pension liabilities for the year was Rs.355.95 Crore against Rs.335 Crore approved by the Commission.

Particulars	2005-06	2006-07
Pension	257.81	253.16
Gratuity	43.05	32.87
Provision for pension revision	30.00	30.00
Commutation	42.60	38.52
Others (medical claims etc)	1.43	1.40
Total	374.89	355.95

47. Objectors have stated that the Commission had given clear directions for management of employee costs in 2006-07. The Commission had suggested to have manpower studies to enhance the employee productivity. The Board did not conduct the study. According to the objectors, for a normal company, the

cost of funding terminal benefits would be about 17% of the basic salary and DA of serving employees. In the case of the Board, it is 85%, which is clearly at unsustainable levels and loading such huge expenses on the consumers is against the principles of fair play. Since the employee cost is a controllable item, only approved limits should be allowed to the Board.

48. The Commission in the ARR order had allowed employee cost of Rs.823.45 Crore. The Commission has expressed concern over the mounting pension liabilities, which is difficult to fund from current tariffs. The Commission had suggested that Board may review and evaluate alternate options to move towards a funded system of pension payments. The Commission had also suggested to form an inhouse team to study and propose HR budget with proper norms, development of multi-skill competence and productivity ratios. The Commission views with concern that till now no such efforts have been taken by the Board on this issue. The Board has not mentioned any such measures in the truing up petition to support the increase in employee cost.
49. The Board has provided Rs.125 Crore for pay revision and Rs.74.34 Crore for revision in DA. The Board has stated that actual disbursement of arrears as on 31-3-2007 is Rs.280.96 Crore against the provision created to the tune of Rs.279.20 Crore. The excess expenditure reported by the Board is on account of salaries, other allowance and terminal benefits. Since Pay and DA are admissible, Commission allows the expenses at actuals for the purpose of truing up. However the Commission has limited the medical reimbursements etc., at Rs.2.74 Crore. The actual expenses was Rs.3.04. Accordingly the total employee expenses for the purpose of truing up is as follows:

Employee costs	2006-07 (Rs. Crore)		
	ARR Order	Actual as per Audited accounts	Allowed in True UP
Salary	243.70	297.76	297.76
DA	200.00	195.31	195.31
Overtime etc	22.00	21.57	21.57
Earned leave encashment.	20.00	24.46	24.46
Medical reimbursement etc.,	2.74	3.04	2.74
Terminal benefits	377.39	355.95	355.95
Total	882.21	898.09	897.79

Repair and maintenance Expenses

50. As against Rs.90 Crore approved by the Commission, the actual R&M expenses was Rs.110.99 Crore, which is about 23.3% above the approved level. According to the Board the R&M expenses is only 1.44% of the Gross Block. In terms of percentage of GFA, generation 0.19%, transmission 1.56% and distribution 2.84%. According to the Board, in order to reduce interruptions and to provide quality power, KSEB had to give adequate attention to transmission and distribution. In the previous years, due to financial stringency, the Board had made lower allocation for R&M expenses.
51. According to the objectors, in the ARR order for 2006-07, the Commission has sought breakup of R&M expenses under scheduled/ periodic maintenance and break down maintenance and details of total productive maintenance programme if any including data on performance monitoring. The Commission also sought O&M practices with cost details, which was not provided by the Board. The Board did not give justification for increase in R&M cost.
52. As has been mentioned in the order on ARR&ERC for 2006-07, the Commission is not in a position to estimate the exact requirements of R&M expenses. The actual R&M expenses is Rs.20.99 Crore more than the allowed expenses and about Rs.15 Crore more than the projections of the Board. However the Board could not provide the exact reason for the increase in R&M expenses other than saying that due to financial constraints the R&M expenses was earlier curtailed. In the clarification, the Board has stated that RMU wise details are available. However, the Commission would like to know the exact requirements of R&M expenses with reasons for overstepping the R&M expenses over the approved level. In its absence the Commission could not arrive at reasonable expenses to be allowed in the ARR. Hence Commission is of the view that R&M expenses for the year 2006-07, may be provided at actual pending detailed examination on the requirements on the R&M expenses.

	2006-07 (Rs. Crore)		
	ARR Order	Actual as per Audited accounts	Allowed in True UP
R&M Expenses	90.00	110.99	110.99

Administration and General Expenses

53. The Board has provided the A&G expenses including electricity duty under section 3(1), which is Rs.135.10 Crore for the year 2006-07 against the approved level of Rs.105 Crore. Out of this, the A&G expenses approved was Rs.42.15 Crore against which the actual expense was Rs. 63.32 Crore which is Rs.21.17 Crore more than the approved level. The main reason for increase was on account of increase in legal charges (Rs.17.94 Crore), conveyance & vehicle hire charges (Rs.11.57 Crore) and purchase related expenses (Rs.2.87 Crore). The Board clarified that increase in legal charges is due to wrong classification made by the legal wing ie., in 2006-07, Rs.13.83 Crore made by the Board as deposit before Regional Joint Labour Commissioners, Kollam, Kozhikode and Kochi based on the orders of the District Labour Officer to pay the gratuity to pensioners under the provisions of Gratuity Act 1972, which was wrongly classified as legal charges. This entry was rectified subsequently and the amount is accounted as prior period income for the year 2007-08. Hence the actual legal expenses is only Rs.4.11 Crore. The increase in travel expenses was due to increase in fuel prices and other cost escalation on hire charges for the hired vehicles in the field offices. The Board has also given the split up of purchase related expenses. However no explanation was given on the efforts to limit the expenses at the approved level.
54. Objectors have stated that A&G expenses to be allowed at the approved level and under no circumstances electricity duty under Section 3(1) to be a pass through since APTEL has upheld the decision of the Commission.
55. The A&G expenses as per the audited accounts is Rs.21.17 Crore more than the approved level of Rs.42.15 Crore. Of this Rs.21.17 Crore, Rs.13.83 Crore is due to the wrong classification of legal expenses. Other major difference is due to the conveyance and vehicle hire charges. According to the Board it is due to increase in fuel prices. The Board has also booked section 3(1) duty as part of the A&G expenses. The Commission has always disallowed this item as a pass through in the tariff as per the provisions of Kerala Electricity Duty Act. The order of the APTEL in 94 of 2008 had endorsed the stand taken by the Commission. After considering the reasons provided by the Board, the Commission allows the A&G expenses as given below:

	2006-07 (Rs. Crore)		
	ARR Order	Actual as per Audited accounts	Allowed in True UP
A&G expenses other than Electricity duty	42.15	63.32	63.32
Less excess provision of legal charges			13.83
Net A&G expenses allowed			49.49

Other expenses

56. The other expenses include other debits and net prior period charges. The Board has booked Rs.698.67 Crore under other debits, against the approved level of Rs.49 Crore. Major component is miscellaneous write off (Rs.401.84 Crore) and provision for bad debts (Rs.281.32 Crore). According to the Board, C&AG has remarked that the provision made for bad debts is inadequate and 100% provision has to be made in respect of outstanding for more than 5 years. Though KSEB did not completely accept the comments of C&AG, method of providing for bad debts was changed from 2005-06 to a more scientific method based on agewise analysis of dues. Accordingly the provision required was Rs.477.17 Crore out of which Rs.195.85 Crore was already provided and the balance Rs.281.32 Crore was provided this year. In addition as decided in the meeting held of 25-11-2009 the net receivable from the Government of Rs.2002.30 crore was to be written off at Rs.400 Crore each year as miscellaneous write offs. Thus Rs.400 Crore was provided under miscellaneous write off. The actual prior period charges for 2006-07 as per audited accounts is Rs.15.20 Crore as against Rs.42.78 Crore allowed by the Commission.

57. Objectors have strongly opposed to writing off of dues from the Government. According to them subsidy from the Government shall only be in accordance with Section 65. Further the writing off of dues is against natural justice and it is like 'robbing Peter to pay Paul'. Regarding provision of bad debts, objectors have pointed out the Supreme Court Judgement that audited accounts are not binding on the Commission for determination of tariffs. Further they have argued that providing for bad debts in ARR which is recovered from tariff creates a moral hazard as it allows the licensee to adopt a lenient and lazy approach towards recovery of dues. According to them Rs.877 Crore should be disallowed from this provision and it should be an income of Rs.179 Crore under other expenses.

58. The net prior period charges for the year as per audited accounts is Rs.15.20 Crore. The Commission allows the actual net prior period charges as per the audited accounts.

59. The Board has provided Rs.281.32 Crore under provision for bad debts and Rs.401.84 Crore under miscellaneous write off. The Board has estimated total provision for bad debts as Rs.477.17 Crore, which is about 26.82% of the total receivables (Rs.1778.76 Crore). The estimation of provision for write off based on the agewise details on debtors is given in the petition as follows:

Age of debtors	Amount Due (Rs. Crore)	Provision (%)	Amount (Rs. Crore)
More than 5 years	411.93	50%	205.97
3 to 5 years	288.97	30%	86.69
1 to 3 years	298.60	15%	44.79
6 months to 1 year	135.36	5%	6.77
less than 6 months	76.90	0%	-
Others	488.70	10%	48.87
TNEB etc	78.30	100%	78.30
Irrecoverable losses			5.79
Total	1,778.76		477.17
Less already provided			195.85
Balance to be provided			281.32

However, the method given in 2005-06 was much different from what is adopted in 2006-07. In 2005-06, the methodology used by the Board is as follows:

Age of debtors	Amount Due (Rs. Crore)	Provision (%)	Amount (Rs. Crore)
More than 5 years	327.23	25%	81.81
3 to 5 years	274.48	20%	54.90
1 to 3 years	310.18	10%	31.02
6 months to 1 year	129.07	5%	6.45
less than 6 months	433.56	5%	21.68
Total	1,474.52		195.85
Less already provided			74.58
Balance to be provided			121.27

The above information shows that the reasons given by the Board are completely contradictory. According to the Board, the bad debts were provided based on

the comments of C&AG, though Board did not completely accept the views of C&AG. The Commission has sought the details of audit references on the same. However, there is no reference on specific rate suggested in the Audit Remarks for write off. Provision for write off is generally made by commercial entities for a portion of the credit sales, which is expected to become bad and uncollectable. Generally the provision would be 1 to 2% of the receivables. In the present case it comes to nearly 16.2% of the receivables. It is also to be noted as per the accounting principles, provision is an estimate, which is charged against profits. Provision for bad debt is a part of profit set apart to meet the receivable turning bad. In an unregulated regime, higher provisions will reduce the profit available to the organisation. In the present case, the Board is a regulated entity earning predetermined rate of profit. The provisions are passed on to the tariff, without affecting the profits, which is against the principles especially in a situation of such irrational provisions. If the Board like any other commercial entity is earmarking the bad debt provision from the profit, the same can be allowed. So long as the burden is passed on to the tariff the admissibility and prudence of such provisions have to be looked into. The Commission in the Truing up order for 2005-06 also clearly mentioned its stand. The Board could not convincingly support the higher claim in the truing up petition. There is substantial difference in the stand taken by the Board in 2005-06 and in 2006-07 regarding the estimation of the provision as shown above. The Commission has sought the specific clause under ESAAR 1985 for write off. As per para 4.2 of Annexure V, procedural matters relating to provision for doubtful dues from consumers is as follows:

“4.2 A fixed percentage of dues from consumers (except for a slight variation in the case of large consumers discussed later) shall be maintained as a provision for meeting debts which turn bad. This will eliminate the need for case wise investigation at the time of creating provision. Such investigation can be conducted independently and in depth at the time of actually writing off a debt. A detailed study should be conducted periodically to ascertain the approximate percentage for each Board and to update the percentage for each Board and to update the percentage so determined. One exception to the above rule is the case of high tension large supply consumers. In such cases individual bad debts can some time be large enough to affect any overall percentage. Doubtfulness of balances due from such consumers should be reviewed case wise and if the doubtful amount exceeds the fixed percentage, the

amount of such excess should be additionally provided for. However if the doubtful amount so determined is less than the fixed percentage fixed percentage should be nevertheless provided as a measure of conservatism”

60. Thus there is clear provision available for provision for bad debts. However as the table below reveals, the Board neither conducted a study nor adopted a uniform policy for write off.

Year	Provision for bad debts	Provision for doubtful debts from consumers*	Bad debts as a % of Receivable against sale of power from consumers*
	Rs. Crore	Rs. Crore	Rs. Crore
2000-01	31.60	8.93	1.8%
2001-02	11.86	8.09	1.3%
2002-03	15.15	11.58	1.4%
2003-04	14.17	9.35	1.0%
2004-05	23.89	13.32	1.2%
2005-06	129.56	121.27	10.3%
2006-07	281.32	275.52	22.73%

*Taken from Schedule 26(b) of audited Accounts

61. The Commission in the previous proceedings has noted that allowing high provisions under write off of bad debts will reduce the incentive of the licensee to collect the accumulated arrears. To make this clear, the Commission has sought the details of collection of arrears especially in a situation where it is not affecting the profits. As observed from the Audit Para on the functioning of the Board (sub para 6(iv) sundry debtors of Audited Annual accounts for 2006-07), the receivable is 29.56% of revenue from sale of power. The Board replied to the C&AG that a task force was constituted under the chairman KSEB for intensifying the collection vide Board order dated 7-5-2004. In the reply provided to the Commission on the functioning of the Task Force, Board stated that the task force has been wound up and now Chief Engineer (commercial & Tariff) is dealing with arrears. Thus it is clear that there is no concerted effort on the part of the Board to realise the arrears. Considering all the above, the Commission is not in a position to allow higher provision for bad debts without adhering to any principles. Hence, the Commission can allow for trueup, only

what is approved in the ARR & ERC order for 2006-07. Higher provision than what is allowed can be considered only if the Board convincingly substantiates the necessity for such a provision. Hon Appellate Tribunal for Electricity has taken a similar stand in the Appeal No.250/2006. Hence, the Commission allows Rs.49 Crore under other debits as shown below.

	2006-07 (Rs. Crore)		
	ARR Order	Actual as per Audited accounts	Allowed in True UP
Other debits			
Research and Development Expenses	0.00	0.13	0.13
Sale of store	0.00	0.18	0.18
Provision for Bad and Doubtful debts	49.00	281.32	49.00
Miscellaneous Losses and write-offs	0.00	401.84	
Net prior period charges	42.78	15.20	15.20
Total	91.78	698.67	64.51

Expense capitalised

62. The actual expenses capitalised as per the audited accounts is Rs.43.19 Crore and interest capitalised is Rs.35.13 Crore. As per the principle adopted in the first true up order, the Commission approves the provision as per the audited accounts.

Return on equity

63. The Board has stated that Rs.217.42 Crore has been provided as return on equity at the rate of 14%, which C&AG has audited and approved. To substantiate the claim the Board has stated that it has to find adequate resources for various investments. According to KSEB, they are eligible to earn return on 30% of the capital investment made in each year since as per CERC norms such allowances are allowable.

64. The objectors have stated that as per the C&AG report and Government Order, there is no equity in the accounts of Electricity Board. They requested the Commission to go into the root of this issue since this is an issue of serious concern.

65. The Commission is not in a position to accept the contentions of the Board that they are eligible to earn return on 30% of the capital investment made in the each year and also the free reserve since the contentions are not consistent with any of the statutory provisions available. Further, Board is not in agreement with the same CERC Norms for depreciation. The Commission views seriously the remarks of the C&AG on the equity of the Board. According to the observation of C&AG, the claimed equity capital of Rs.1553.00 Crore of the Board represents the loans and interest due to Government as on 31-3-1998, which was converted into equity as per G.O. No.27/98/ED dated 14-9-1998. But, the Government subsequently through order No. G.O.(MS) No.25/02/PD dated 9-10-2002 modified the earlier order and converted the loan and interest as grant. However, the Board continued to show the same as equity in the books. The C&AG remark was significant in the sense that the important legal requirement for conversion of equity was not fulfilled by the Government i.e., the concept of equity shall be applicable only if the State Government issues notification under section 12A (1) of the Electricity (Supply) Act 1948 directing the Board to be a body corporate with a capital not exceeding Rs.10 Crore. Hence, according to C&AG the equity capital accounted is against the provisions of Electricity (Supply) Act 1948 and in contravention of the Government Order dated 9-10-2002. Further, the representation of Rs.142.33 Crore as regulatory asset/revenue gap under schedule 4(a) of Annual Accounts does not show fair view of the accounts of the Board. The Commission has sought explanation on the above issue. However, the Board could not provide any convincing reply on this. The Board has repeated the justification on netting off dues with the Government.
66. The Commission notes that, the Government has so far not accepted the contentions of the Board nor issued amended orders in support of the claim of the Board. Since the Board does not have any equity in the balance sheet, the Commission is not in a position to give return on equity at the rate of 14% on the claimed equity of Rs.1553 crore. Besides returns at 14% without linking the returns with performance cannot be taken for granted. Considering the source of funds available with the Board, hundreds of crores provision for write off and the amount of actual borrowing, it amount be said that Board is short of own capital to attract funds. However, considering the incentive aspect of having a reasonable return, the Commission as an adhoc measure of incentive provides Rs.50 Crore. The actual return for equity if any will be allowed as and when a

case is presented by the Board, based on a study on Board's capital funding by a reputed firm or agency.

Non Tariff income:

67. The total non-tariff income for the year 2006-07 is Rs.406.47 Crore, which is inclusive of Meter rent/service line rental (Rs.132.59 Crore), rebate received (Rs.66.57 Crore), interest from banks (Rs.23.53 Crore), service connection, penalty, recovery for theft of energy, etc., (Rs.124.60 Crore). The Board also stated that Rs.19 Crore was received as comfort charges for selling power from RGCCPP through M/s NVVN at the rate of Rs.0.46/ kWh. Further rebate from CPSUs was also received for prompt payment of dues to the tune of Rs.66.57 Crore. The Commission for the purpose of truing up allows the non-tariff income as per the audited accounts as Rs.406.47 Crore.

Revenue from tariffs

68. The total revenue from sale of power within the State is Rs.3476.35 Crore for 11331MU. In addition, through sale of off-peak surplus power out side the state the Board earned Rs.402.15 Crore. The Board also sold 174.68MU to Tamil Nadu from BSES plant realising comfort charges and actual variable costs thereby realising a total of Rs.15.25 Crore. Similarly by selling power from RGCCP to Tamil Nadu for the month of April 2007, the Board earned Rs.8.01 Crore through comfort charges and variable chares. Thus in total, additional revenue of Rs.402.15 Crore was earned through the export of 872.21 MU. KSEB requested to retain 50% of the additional income as incentive. The Revenue gap of Rs.142.23 Crore is accounted as Regulatory Asset under schedule 29(b) of the C&AG audited accounts.

69. Board in its prayer has requested to adjust the actual accounts and also requested for incentive for the efficient operation such as Rs.290.39 Crore for loss reduction, Rs.93.76 Crore for reducing interest and financing charges and Rs.212.71 Crore for selling surplus power, totalling Rs. 596.86 Crore, which would result in net revenue gap of Rs. 739.09 Crore.

70. The Board has earned Rs.533.36 crore through export of power, which resulted in net reduction in ARR. The Commission is of the view this shows an efficient

practice which has to be encouraged and accordingly allows the Board to retain Rs.50 crore from the revenue as an incentive.

71 As per the audited accounts the income received from sale of energy within the state is Rs.3476.35 Crore. The Commission notes that the Board has withdrawn the demand to the tune of Rs.122.33 Crore on account of 20 paise rebate extended to LTI(A) and LTVII(A) & LTVII(B) consumers. The Commission sought the details of this entry. The Board has stated that Government did not provide the subsidy and declined to make good the loss sustained on the account of reduction in tariff vide G.O(Ms)22/06PD dated 16-12-2006. Board has further stated that as a Government Utility, Board was not in a position to withdraw the rebate allowed on the reason of non-receipt of Government subsidy in advance. KSEB as a distribution licensee could not reverse the reduction in Tariff allowed on its own motion until the Commission revised the tariff on 26-11-2007. The Board has further stated that the Account Rendering Units booked a sum of Rs.122.33 Crore towards subsidy receivable on account of reduction including revenue from sale of power. Subsequently, in the light of the Government Order dated 16-12-2006, the revenue recognised at field offices was reversed.

72. The Commission is not in a position to accept the explanation of the Board in this regard. The action of the Board is completely in violation of the provisions of the Act and the orders of the Commission. The entire episode on providing rebate to consumers was started with the petition of the Board dated 2-1-06 proposing a reduction of tariff in respect of LT-1 (a) Domestic and LT-VII (A) & (B) Commercial category of consumers, as per the direction of Government of Kerala. Government of Kerala vide its letter No.101/A1/06/PD dated 4-1-06 had expressed their willingness to release the subsidy as required for reducing the tariff as mentioned above. The Commission vide its conditional order dated 5-1-2006 approved a rebate of 20 paise/kWh for domestic and commercial consumers as per the provisions of Section 65 of the Electricity Act, 2005. The Commission in its order had specifically mentioned that :

*“The attention of KSEB / Government is drawn to the provision under section 65 of the Electricity Act 2003, which reads as follows to deal with the non payment of subsidy **“Provided that no such direction of the State Government shall be operative if the payment is not made in accordance with the provisions contained in this section***

and the tariff fixed by the State Commission shall be applicable from the date of issue of orders by the Commission in this regard.”

73. The Commission is not in a position to accept the stand of the Board that it cannot on its own motion stop subsidy. As per the order of the Commission, the rebate shall be extended only if subsidy is received in advance. Hence it amounts to express violation of the provisions of the Act and the Orders of the Commission, which is a fit case for action under Section 142 of the Act.

74. In the light of the clear provisions of the Act and the Order dated 5-1-2006 issued by the Commission, the Board should have extended the rebate to the consumers only if subsidy in advance in lump or on a monthly basis was received from the Government. Since the benefit was extended to the consumers, it cannot again be realised from the consumers after a considerable lapse of time. This principle has been upheld by the Apex Court. Hon. Supreme Court in UPPCL and Others Vs NTPC Limited in (2009) 6 SCC 235 has ruled that additional costs shall not be passed on to the new tariff since some persons who are consumers during the tariff year in question may not continue to be consumers and some new consumers might have added to the system and no reason they should bear the brunt. Hon. Supreme Court has noted as follows:

“63. Further more the direction of the Tribunal that the additional costs may be absorbed in the new tariff, in our opinion was not correct. Some persons who are consumers during the tariff year in question may not continue to be the consumers of the appellant. Some new consumers might have come in. There is no reason as to why they should bear the brunt.....”

Further the consumers are not responsible for the violation of the Act by the Board. Hence, the short fall in revenue shall not be passed on to the consumers as it was on account of a clear violation of the provisions of the Act and the orders of the Commission. In this circumstances, the Commission can treat the short fall in revenue due to non-payment of subsidy as part of the revenue from tariff only. The Board may take necessary steps to realize the amount from the Government as subsidy.

75. According to the Board, shortfall in revenue due to the rebate of Rs.0.20/kWh amounted to Rs.122.33 Crore for 2006-07. Hence total revenue from tariff for the year 2006-07 would increase by Rs.122.33 Crore for the purpose of truing up.

76. The Commission for the purpose of truing up allows the income from sale of surplus power to neighbouring states (Rs.98.49 Crore) and sale to traders NVVN and PTC (Rs.434.87 Crore) as per the audited accounts. Hence the total revenue from tariff shall be as follows for the purpose of truing up.

	2006-07 (Rs. Crore)		
	ARR Order	Actual as per Audited accounts	Allowed in True UP
Revenue from sale of power with in the State	3,424.55	3,476.35	3,476.35
Revenue from sale of power to other States	150.00	98.49	98.49
Revenue from sale of power to Traders		434.87	434.87
Add short fall in revenue due to 20 paise rebate			122.33
Revenue from Non- Tariff income	290.51	406.46	406.46
Total Revenue	3,865.06	4,416.17	4,538.50

77. The Commission has noted the audit observation on the transfer of land from the Brahmapuram project. The Board has not obtained permission from the Commission on this. The relevant provision of the Act is as follows:

Section 17. (Licensee not to do certain things): (3) *No licensee shall at any time assign his licence or transfer his utility, or any part thereof, by sale, lease, exchange or otherwise without the prior approval of the Appropriate Commission.*

(4) *Any agreement, relating to any transaction specified in sub-section (1) or sub-section (3), unless made with the prior approval of the Appropriate Commission, shall be void. (Emphasis extra)*

78. Further to the provisions of the Act, the Commission also notes that considering the market value of the land the consideration of value is highly underestimated. **The Board shall provide explanation on the violation of the above provision of the Act within one month from the date of this Order.**

Total Revenue gap/Surplus after Truing up:

79. As per the ARR & ERC order for 2006-07, the total revenue surplus approved was Rs.184.63 Crore, against which the revenue gap reported by the Board as per the audited accounts was Rs.142.23 Crore. As explained in the previous

paragraphs, the Commission has arrived at a revenue surplus of Rs.1035.55 Crore for 2006-07 after the Truing up, as shown below.

	Particulars	2006-07 (Rs. Crore)		
		ARR Order	Actual as per Audited Accounts	True up
1	Generation of Power	43.09	111.84	111.84
2	Purchase of power	1,646.02	1,629.30	1,596.54
3	Interest & Finance Charges	513.64	429.34	419.14
4	Depreciation	247.43	405.98	230.67
5	Employee Cost	823.45	898.09	897.79
6	Repairs & Maintenance	90.00	110.99	110.99
7	Administration & General Expenses	105.00	135.10	49.49
8	Other Expenses	91.78	698.66	64.51
9	Gross Expenditure	3,560.41	4,419.30	3,480.97
10	Less : Expenses Capitalized	(43.90)	(43.19)	(43.19)
11	Less : Interest Capitalized	(53.50)	(35.13)	(35.13)
12	Total Expenditure	3,463.01	4,340.98	3,402.65
13	Return on Equity/Statutory Surplus	217.42	217.42	50.00
14	ARR (12 + 13)	3,680.43	4,558.40	3,452.65
15	Revenue from Charges			
16	Revenue from energy sale within the State	3,424.55	3,476.35	3,476.35
17	Revenue from sale of power to other States	150.00	98.49	98.49
18	Revenue from sale of power to Traders		434.87	434.87
19	Add shortfall in revenue due to 20 ps rebate			122.33
20	Less incentives retained			(50.00)
21	Revenue from non-tariff income	290.51	406.46	406.46
22	Total (16+17+18+19+20+21)	3,865.06	4,416.17	4,488.50
23	Revenue Surplus/(gap) (22-14)	184.63	(142.23)	1,035.85

80. From the above, the Commission notes that the disallowances are under power purchase cost (Rs.32.76), Interest & financing charges (Rs.10.20 Crore), Depreciation (Rs.175.31 Crore), A&G expenses (Rs.85.61 Crore), other expenses (Rs.634.15 Crore), Statutory Return (Rs.167.42). Of this disallowance only Rs.32.76 Crore affects the cash out flow and the balance are non-cash items. But the Commission has allowed Rs.50 Crore as cash incentive, which will off set the disallowances. Hence, there will not be any substantial impact on the cash flow of the Board, thus the Commission has endeavored to balance the interest of the consumers and the licensee in this Order.

81. It is seen that the Board has collected Rs.208.45 crore during the year from the consumers towards electricity duty and state levies which is an amount to be passed on to the Government. But it is seen retained as is the case with subsequent periods. This is a breach of trust with the consumers. The Board has no right to keep and use the amount unless it is provided by the Government as a part of the adjustment of dues or claims from the Government or as a grant or subsidy consistent with the provisions of the Act. No orders are seen passed for this purpose. Substantial amount of electricity dues are pending from Government agencies. The Government if deem fit may adjust the duty collected against the dues. Till then this amount will be provisionally added to the surplus of Rs.1035.85 crore making the surplus Rs.1244.30 crore and will be reversed if the duty amount is paid to Government or formally allowed to retain as a part of adjustment of the claims of the Board or allowed as a subsidy under the provisions of the Act.

82. Before concluding, the Commission takes serious note of the audit remarks pointed out by the C&AG in the accounts of the Board for 2006-07. The Commission hereby directs that proper systems have to be strengthened or created to rectify the remarks made.

Order of the Commission

83. The Commission after considering in detail, the petition filed by the Board, the objections from stakeholders and other materials placed before it hereby arrives at a **revenue surplus of Rs.1035.85 Crore (excluding the Electricity duty retained by the Board provisionally) as against a revenue gap of Rs.142.23 Crore** presented by the Board based on the audited accounts. The revenue surplus so arrived would be adjusted against accounts of subsequent years..

Sd/-
M.P.Aiyappan
Member

Sd/-
C. Abdulla,
Member

Sd/-
K.J. Mathew
Chairman

Approved for issue

Secretary in Charge

ANNEXURE

List of persons attended the Public hearing held on 11-3-2010

1. Shri. George Thomas, President, Kerala State HT & EHT Industrial Consumers Association
2. Shri. A.A.M.Nawas, M/s Binani Zinc Limited
3. Shri. A R Satheesh, Carborandum Universal Limited
4. Shri. Ajith. R, CE(LT), TCC Limited
5. Shri. P.S.Premachandran DA, TRAC, KSEB
6. Shri. Dinesh D, Dy. CE, TRAC KSEB
7. Shri. Arunagireeswara Iyer, FA, KSEB
8. Shri.Ramesh Babu V, DCE, KSEB
9. Shri. PV Sivaprasad, EE, KSEB