

**CENTRAL ELECTRICITY REGULATORY COMMISSION
NEW DELHI**

Coram:

- 1. Shri Ashok Basu, Chairperson**
- 2. Shri K.N. Sinha, Member**
- 3. Shri Bhanu Bhushan, Member**
- 4. Shri A.H. Jung, Member**

Petition No. 25/2005

In the matter of

Reimbursement of the cost of hedging as pass through on account of currency and/or interest rate swap in the changed scenario on account of FERV on the foreign loans as per revised AS-11.

And in the matter of

Power Grid Corporation of India Ltd., Gurgaon Petitioner

Vs

1. Bihar State Electricity Board, Patna
2. West Bengal State Electricity Board, Kolkata
3. Grid Corporation of Orissa Ltd., Bhubaneswar
4. Damodar Valley Corporation, Kolkata
5. Department of Power, Govt. of Sikkim, Gangtok
6. Jharkhand State Electricity Board, Ranchi
7. Assam State Electricity Board, Guwahati
8. Meghalaya State Electricity Board, Shillong
9. Govt. of Arunachal Pradesh, Itanagar
10. Power & Electricity Deptt., Govt. of Mizoram, Aizwal
11. Electricity Deptt., Govt. of Manipur, Imphal
12. Department of Power, Govt. of Nagaland, Kohima
13. Department of Power, Govt. of Tripura, Agartala
14. Ajmer Vidyut Vitran Nigam Ltd. Ajmer,
15. Jaipur Vidyut Vitran Nigam Ltd, Jaipur
16. Jodhpur Vidyut Vitran Nigam Ltd, Jodhpur
17. Himachal Pradesh State Electricity Board, Shimla
18. Punjab State Electricity Board, Patiala
19. Haryana Vidyut Prasaran Nigam Ltd., Panchkula
20. Power Development Department, Govt. of J&K, Jammu
21. Uttar Pradesh Power Corporation Ltd., Lucknow
22. Delhi Transco Ltd., Delhi
23. Chandigarh Administration, Chandigarh
24. Uttaranchal Power Corporation Ltd., Dehradun
25. Karnataka Power Transmission Corporation Ltd., Bangalore
26. Transmission Corporation of Andhra Pradesh Ltd., Hyderabad
27. Kerala State Electricity Board, Thiruvananthapuram
28. Tamil Nadu Electricity Board, Chennai
29. Electricity Department, Pondicherry,

30. Electricity Department, Govt. of Goa, Panaji, Goa
31. Madhya Pradesh Electricity Board, Jabalpur
32. Maharashtra State Electricity Board, Mumbai
33. Gujarat Electricity Board, Vadodara
34. Electricity Department, Admn of Daman & Diu, Daman
35. Electricity Department, Admn. of Dadra Nagar Haveli, Silvassa
36. Chhattisgarh State Electricity Board, Raipur ... **Respondents**

The following were present.

1. Shri R.T. Agarwal, PGCIL
2. Shri M.M. Mondal, PGCIL
3. Shri P.C. Pankaj, PGCIL
4. Shri U.K. Tyagi, PGCIL
5. Shri C. Kannan, PGCIL
6. Shri S.K. Niranjana. Manager, PGCIL
7. Shri Prashant Sharma, PGCIL
8. Shri T.C. Nigaliga, XEN, AVVNL
9. Shri S.N. Joshi, RPPC/JUVNL
10. Shri S.N. Joshi, XEN, JUVNL
11. Shri S.P. Srivastava, EE, UPPCL
12. Shri T.P.S. Bawa, OSD (C), PSEB
13. Shri D. Khandelwal, ACE, MPSEB
14. Shri Deepak Shrivastava, EE, MPSEB
15. Shri Chetan Kumar Jaiswal, MPSEB
16. Ms. Aditi Raja, KPTCL

ORDER

(DATE OF HEARING: 23.3.2006)

The petitioner, Power Grid Corporation of India Ltd., seeks permission for management of foreign exchange rate variations on foreign currency borrowings through hedging and reimbursement of the cost of hedging as “pass through” wherever hedging option is exercised by the petitioner, keeping in view the benefits accruing to the respondents and overall sectoral development.

2. The petitioner is engaged in the business of inter-State transmission of electricity and has been notified as the Central Transmission Utility by the Central Government. The petitioner has submitted that there would be a need for investment of Rs.71,000 crore in the central transmission sector by 2012

for evacuation of additional power generation planned by the Central Government, out of which the petitioners' share of investment is likely to be about Rs.50000 crore and the balance investment is expected to come through IPTC and JV routes. Based on the existing debt-equity norm of 70:30, the petitioner is likely to deploy equity of Rs.15000 crore. The remaining investment of Rs.35000 crore by the petitioner is proposed to be through domestic and foreign currency loans, since in the estimation of the petitioner, because of various constraints the domestic market is not likely to be able to meet the huge requirements of funds.

3. The petitioner has submitted that under the Accounting Standard 11 (AS-11) as applicable from 1.4.2004, FERV on the loan outstanding at the end of the year, that is, on 31st March of each year is required to be charged to Profit & Loss Account, considering the applicable exchange rate. However, it is submitted, in accordance with the norms notified by the Commission, reimbursement of FERV by the respondents is against payment of interest and repayment of foreign currency loan in the year. The petitioner has submitted that the disparity between AS 11 and the Commission's norms regarding treatment of FERV as also the fluctuations in foreign exchange rates will impact its profits, resulting in fluctuation in its profitability, credit rating and finally its capacity to borrow money at competitive interest rates.

4. The petitioner, under these circumstances, feels the need for management of foreign currency exchange risks arising out of fluctuations in foreign exchange rates. The petitioner has submitted to overcome the uncertainties on account of fluctuations in foreign currency exchange rates, popularly called Foreign Exchange Rate Variations or FERV, by entering into

hedging contracts. The petitioner has classified hedging contracts into three categories, namely, (i) Principal only swap (ii) Interest rate only swap and (iii) Both Principal and Interest rate swap. The petitioner proposes to recover the costs of hedging from the respondent beneficiaries. The petitioner is of the opinion that hedging will cause reduction in borrowing costs and resultantly the capital cost and in this manner, benefits of hedging accruing to the respondent beneficiaries will outweigh the costs involved and has sought the costs to be recovered from them. The petitioner, in the petition has referred to some of the hedging products offered by State Bank of India.

5. The petitioner has filed the present petition to seek permission for resorting to hedging and recovery of costs thereof from the respondents, with principal prayer noted in opening part of this order.

6. The petition was initially heard on 19.5.2005, when it was noticed that only three respondents, namely Tamilnadu Electricity Board, Kerala State Electricity Board and Gujarat Urja Vikas Nigam Ltd had filed replies. The Commission noted that poor response could be for the reason that advantages of the proposal made in the petition were not adequately explained to the respondent beneficiaries. Therefore, the petitioner, by order dated 30.5.2005 was directed to place on record detailed analysis of merits and demerits of the proposal. The petitioner was further given option to convene a meeting with the respondents and explain to them the proposal.

7. The petitioner filed its affidavit dated 24.6.2005 to place on record an analysis of the hedging proposal. The petitioner sought to explain the proposal through two sets of calculations, one with Euro currency loan and

other with USD loan. The petitioner brought out that in both these cases, hedging would be beneficial to the respondents since savings on FERV would outweigh the costs involved. The petitioner submitted a further affidavit dated 6.10.2005 to report the outcome of the meetings held with the respondents in pursuance of the option given by the Commission. It was submitted that the representatives of State Bank of India and ICICI Bank explained to the respondents the concept of hedging and the benefits thereof. The petitioner, in the affidavit, referred to various apprehensions raised on behalf of the respondents and the clarifications furnished. The petitioner stated that the response of the respondents was favourable to the proposal. It appears that in the course of these meetings some of the respondents suggested that instead of exercising the hedging option, the petitioner might explore the possibility of showing annual fluctuations in foreign exchange rates in Profit & Loss Account/Balance Sheet through notional accounting entries, as sum recoverable/payable from/to the beneficiaries. The petitioner, therefore, suggested the following two options for consideration of the Commission.

Option I or First Option

1. To permit hedging under Principal and Interest rate swap and allow recovery of interest on loan from the beneficiaries in accordance with loan and hedging agreements, and
2. Permission to avail option of conversion of floating rate of interest (Interest rate only swap) if the terms and conditions of the foreign currency loan so provide and allow recovery of interest on loan based on swapped interest rates.

Option II or Second Option

1. To permit billing of FERV (loss or gain) on accrual basis, as per AS 11 though payments be regulated on actual basis and the difference between the amount billed on account of accrual basis and recovered on actual basis, to be carried forward recoverable/payable in the Balance Sheet as separate item, adjustable on year to year basis over the tenure of the foreign currency loan.
 2. The petitioner requested the Commission to seek clarification from the Institute of Chartered Accountants of India on the admissibility of the course of action proposed.
8. The second option insulated the petitioner against fluctuations in profit on account of Foreign Exchange Rate Variations, without involving any extra cost to the respondent beneficiaries.
9. Subsequently, responses were filed by some other respondents, namely Karnataka Power Transmission Ltd, Assam State Electricity Board, Gird Corporation of Orissa Ltd, West Bengal State Electricity Board, Bihar State Electricity Board, Haryana Power Generation Corporation Ltd., Ajmer Vidyut Vitran Nigam Ltd., Jaipur Vidyut Vitran Nigam Ltd., Jodhpur Vidyut Vitran Nigam Ltd., and Punjab State Electricity Bard. These respondents generally opposed “pass through” of the cost of hedging, though they were not opposed to the concept of hedging as such.
10. The petition was again heard on 23.2.2006. After the hearing the Commission made the following order of that date:

“5. At the hearing, the representatives of the petitioner ruled out the first option and hedging of foreign exchange loan. The representatives of the petitioner pressed for acceptance of the second option. The representatives of the respondent beneficiaries submitted that pros and cons of the second option were not clear to them. In response the representatives of the petitioner agreed to hold a fresh meeting with the respondent beneficiaries to explain to them the concept contained in the second option during the first week of March 2006. We allow time to the petitioner to hold a fresh meeting as stated.”

11. During the pendency of the present petition, tariff policy was formulated by the Central Government in exercise of its powers under Section 3 of the Electricity Act, 2003 (hereinafter referred to as “the Act”), and notified on 6.1.2006. The tariff policy, inter alia, states that

“Foreign exchange rate variation risk shall not be a pass through. Appropriate costs of hedging and swapping to take care of foreign exchange variations should be allowed for debt obtained in foreign currencies. This provision would be relevant only for the projects where tariff has not been determined on the basis of competitive bids”.

12. The petitioner, on 20.3.2006, made an interlocutory application (No.14/2006) to seek review of order dated 23.2.2006, and for permission to the petitioner to exercise the first option, that is, management of foreign exchange risk in line with the tariff policy and rule out the second option since it is not in accord with the tariff policy, the relevant part of which has been extracted above. With reference to order dated 23.2.2006, it has been stated that since the respondents were not in favour of hedging under the first option, the representatives of the petitioner sought to put forth their views on the second option, without ruling out the first option. It has been emphasized that the petitioner, as a company owned by the Central Government cannot overlook the provisions of tariff policy on the question of management of foreign exchange risk. In other words, the petitioner has sought to withdraw the second option and sticks to the first option which is in terms of the prayer

made in the main petition. The interlocutory application was heard on 23.3.2006, along with main petition.

13. In terms of section 61 of the Act, the Commission is to specify through the regulations the terms and conditions for determination of tariff. In exercise of these powers, the Commission has notified the Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations, 2004. Regulation 9 of these regulations provides for recovery on account of Foreign Exchange Rate Variations. It lays down that extra rupee liability towards interest payment and loan repayment corresponding to normative loan or actual foreign loan, as the case may be, arising out of Foreign Exchange Rate Variation is permissible and is recoverable on year to year basis. These regulations are valid for the period 1.4.2004 to 31.3.2009. Tariff for transmission assets owned by the petitioner has already been determined based on these regulations, in many cases even prior to notification of the tariff policy. Acceptance of the prayer made by the petitioner will need amendment of Regulation 9 *ibid* and consequently re-determination of tariff already fixed. It will involve enormous amount of effort and exercise. The petitioner has not yet resorted to hedging of foreign currency loans. It may do so in future. Major part of the current tariff period which is up to 31.3.2009, may be over. Accordingly, we do not favour any modification of the existing regulations on terms and conditions of tariff at this stage to meet the prayer made by the petitioner.

14. The petitioner has emphasised that by virtue of sub-section (4) of Section 79 of the Act, the Commission, in discharge of its functions, is guided, among others, by the tariff policy, and the tariff policy lays down that the

appropriate costs of hedging and swapping are to be allowed in tariff and the tariff policy provides that Foreign Exchange Rate Variations shall not be pass through in tariff. We are conscious of the statutory provisions emphasized by the petitioner. The provisions of the tariff policy on the management of foreign exchange risks in their present form cannot be transplanted in the terms and conditions for determination of tariff and a further detailed study is needed before incorporating these in the tariff regulations. For example, the tariff policy provides for recovery of “appropriate costs” of hedging and swapping. It is, therefore, necessary to specify the criteria for ascertaining the “appropriate costs” of hedging and swapping. It is a long-drawn exercise. It is not appropriate or desirable to change or modify the terms and conditions for determination of tariff mid-stream, without adequate mechanism for ascertaining the “appropriate costs” of hedging and swapping of foreign currency loan. The guidelines laid down in the tariff policy will be taken note of and considered by the Commission while specifying the terms and conditions for determination of tariff for the period beyond 31.3.2009.

15. A prayer similar to that made in the present petition, was made by National Thermal Power Corporation Ltd in Petition No.18/2001. The Commission by its order dated 14.2.2002, had observed that NTPC could resort to hedging at its own risks and costs. The Commission noted that gains or losses accruing as a result thereof would be of NTPC alone and the State Utilities would neither be liable for any losses nor entitled to gains in case NTPC resorted to hedging. The petitioner is aware of this decision of the Commission, but has urged that the decision need not be followed as a binding precedent since it was rendered before revision of AS 11 with effect from 1.4.2004. In our opinion, the revision of the procedure prescribed in AS

11 for dealing with accounting of Foreign Exchange Rate Variations does not upset the earlier decision, rendered after careful consideration of the matter. In fact, NTPC had recently made a fresh petition (No.17/2005) wherein it again prayed for permission for hedging of foreign currency loans and recovery of costs of hedging from the beneficiaries. While disposing of the petition, by order dated 28.6.2005, the Commission reiterated the earlier decision in petition No.18/2001. We are not inclined to re-open the matters already settled.

16. In view of the settled position, we dispose of the present petition with the observation that petitioner may for the purpose of avoiding fluctuations in its annual profits and stabilizing financial results employ hedging of foreign currency loans, whether the Principal only swap or Interest rate only swap or both Principal and Interest rate swap, at its own risk and costs. The respondents shall neither bear the costs of such hedging nor shall they be entitled to any gains or liable for any losses as a result of hedging. With this decision, the present petition and IA No.14/2006 stand disposed of.

Sd/-
(A.H. JUNG)
MEMBER

Sd/-
(BHANU BHUSHAN)
MEMBER

Sd/-
(K.N. SINHA)
MEMBER

Sd/-
(ASHOK BASU)
CHAIRPERSON

New Delhi dated the 9th May 2006