

**CENTRAL ELECTRICITY REGULATORY COMMISSION  
NEW DELHI**

**Coram**

1. Shri D.P. Sinha, Member
2. Shri G.S. Rajamani, Member
3. Shri K.N.Sinha, Member

**Petition No. 18/2001**

In the matter of

Approval of Management of Foreign Exchange Rates through hedging

And in the matter of

National Thermal Power Corporation Ltd.                      ..... **Petitioner**

Vs

1. Transmission Corporation of Andhra Pradesh Ltd.
2. Grid Corporation of Orissa
3. Damodar Valley Corporation
4. Bihar State Electricity Board
5. West Bengal State Electricity Board
6. Rajasthan State Electricity Board
7. Delhi Vidyut Board
8. Uttar Pradesh Power Corporation Ltd.
9. Punjab State Electricity Board
10. Madhya Pradesh Electricity Board
11. Haryana Vidyut Prasaran Nigam Ltd.
12. Maharashtra State Electricity Board
13. Kamataka Power Transmission Corporation Ltd.
14. Tamil Nadu Electricity Board
15. Assam State Electricity Board
16. Gujarat State Electricity Board
17. Himachal Pradesh State Electricity Board
18. Power Development Department, J&K
19. The C.E.-Secretary, Engg. Deptt., Chandigarh Admn.
20. Kerala State Electricity Board
21. Government of Pondicherry
22. Government of Sikkim
23. Government of Goa
24. Administration of Daman & Diu
25. Administration of Dadar Nagar Haveli
26. Powergrid Corporation of India Limited

27. National Hydroelectric Power Corporation Ltd.
28. Neyveli Lignite Power Corporation Ltd.
29. Union of India through Ministry of Power

..... Respondents

The following were present:

1. Shri P. Narasmiharamulu, Dir (Fin), NTPC
2. Shri B.K. Mandal, Addl. GM (Fin), NTPC
3. Shri M.R.K. Rao, Sr. Mgr., NTPC
4. Smt. Sangeeta Bhatia, Sr. Mgr. NTPC
5. Shri R.K. Gupta, Mgr. (IF), NTPC
6. Shri S. Sowmyanarayanan, TNEB
7. Shri S. Jayaraman, Director (Fin.), NLC
8. Shri R. Suresh, Chief Engineer, NLC
9. Shri A. Ganesan, NLC
10. Shri S.P. Degwekar, Comm.Officer, MPSEB
11. Shri D.K. Shrivastava, EE, MPSEB
12. Shri Prashant Kaul, SM (Comm), NHPC
13. Shri D.S. Ahluwalia, SM (F), NHPC
14. Shri V.K. Gupta, SE (ISP), RRVPNL
15. Shri J.S. Bhargava, A.EM (ISP), RRVPNL
16. Shri R.K. Arora, XEN, HVPNL
17. Shri M.H. Parviz, KPTCL
18. Shri Milind Kumar, PDD, J&K

**ORDER (Date of Hearing :  
29.10.2001)**

### **PETITION**

In this petition, the petitioner, National Thermal Power Corporation Limited (NTPC) has prayed as under:

"(a) The calculation of liability of the SEBs on foreign exchange loans shall be determined based on the rates contracted in the hedging agreements. The impact of these adjustments on depreciation, interest and return will be paid to/by the respondents by/to the NTPC on annual basis, calculated based on the rates of forex contracted in the hedging agreements based on accrual concept.

- (b) Other hedging costs, if any, will be passed through based on accrual concept.
- (c) Pass any other order as the Hon'ble Commission may find appropriate in the circumstances pleaded above."

2. The petition was admitted on 6.7.2001, with state utilities buying power from the petitioner as the respondents. In view of the importance of the issues raised in the petition, we had directed the petitioner to implead PGCIL, NHPC and NLC as respondents in addition to Union of India through Ministry of Power. This direction has been complied with by the petitioner, who has since filed the amended cause title of the petition.

#### BACKGROUND

3. In January 1998, the Central Government constituted a committee under the Chairmanship of Dr. Y.V. Reddy, Deputy Governor, Reserve Bank of India, with experts from Ministry of Finance, State Bank of India, Public Sector Enterprises, All India Financial Institutions, as members, hereinafter referred to as the Reddy Committee, to formulate necessary guidelines on management of exchange and interest rate risks for adoption by Public Sector Enterprises (for short, the PSEs) as, according to the petitioner, many of the PSEs had not evolved well-defined policy on these matters.

4. The Reddy Committee submitted its report in August, 1998 and recommended that the PSEs having foreign currency exposure should adopt a comprehensive policy on risk management and procedure depending upon their exposure to foreign exchange risks. In the context of the petitioner, the Reddy Committee specifically recommended since SEBs( the state utilities purchasing power from the petitioner)," are yet not in a position to hedge their exchange rate risk, it would be appropriate for NTPC (the petitioner) to disregard the pass through factor and appropriately balance their risks and costs". The Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 framed under the Foreign Exchange Management Act, 1999, allow any person who is a resident in India to enter into a foreign exchange derivative contract to hedge an exposure to exchange risk in respect of transactions permissible

5. In keeping with the recommendations of the Reddy Committee, the petitioner has formulated the Exchange Risk Management Policy, hereinafter referred to as the Policy. Under the Policy, the petitioner seeks to reduce the risks arising out of the current and offshore interest rate movements by using (a) Forward Rate Contract (b) Currency Swaps and (c) Interest Rate Swaps, by entering into hedging contracts. According to the petitioner, through this process the liability of the state utilities purchasing power from the petitioner on account of foreign exchange element would be fixed and ascertainable in advance in accordance with the hedging contracts. The petitioner prays that it be allowed to

recover the hedging costs from the state utilities impleaded as respondents 1 to 25 in the petition. The prayers made by the petitioner and reproduced above, need to be viewed in this background.

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6. The replies to the petition have been filed by West Bengal State Electricity Board (WBSEB) (respondent No.5), Rajasthan Rajya Vidyut Prasaran Nigam Ltd. (RRVPL) (the successor entity of respondent No.6) and Uttar Pradesh Power Corporation Ltd. (UPPCL) (respondent No.8), so far as the state utilities are concerned. A reply has also been filed on behalf of Neyveli Lignite Corporation (NLC) (respondent No.28), a central sector generating company under the administrative control of Ministry of Coal, which is supplying power to state utilities in the Southern Region. The other respondents have not filed any response. We had expected some assistance from Union of India and accordingly Union of India was directed to be impleaded as a party-respondent. However, no assistance became available to us.

7. The state utilities, who have filed their responses are generally opposed to the proposal of making the hedging costs as pass through, made by the petitioner. On the contrary, NLC (respondent No.28), which is similarly placed as the petitioner, has supported the petitioner's case.

8. The state utilities have objected to the proposal on the ground that the report of the of the Reddy Committee was not accepted by the Central Government and, therefore, it cannot validly form the basis for the proposal. It is further stated that the proposal needed to be considered by the Commission as part of the terms and conditions of tariff and not in isolation. RRVPNL has raised a fundamental question of jurisdiction of the Commission to decide on the issue raised in the petition since, according to this respondent, it is a matter of policy which is within the exclusive competence of the Central Government. WBSEB has submitted that acceptance of the proposal would create an extra liability and may have an adverse impact on the rate of purchase of power, which may prove to be against the interests of the consumers in the State. It has expressed an apprehension that WBSEB may not be compensated by the State Regulatory Commission.

### **EXISTING FRAMEWORK**

9. In exercise of its powers under Section 43 A(2) of the Electricity (Supply) Act, 1948, as it then existed, the Central Government in Ministry of Power had on 30.3.1992, notified the factors for determination of tariff for sale of electricity from the generating stations. In the said notification the interest of the generators was protected by making a provision as under:

" Extra rupee liability towards interest payment and loan repayment actually incurred in the relevant year shall be admissible provided it directly arises out of foreign exchange rate variation and is not attributable to Generating Company or their suppliers or contractors."

10. The Central Government had also been notifying the tariff and the terms and conditions of tariff in respect of the generating stations owned by the petitioner by virtue of the powers vested under proviso to Section 43 A(2) of the Electricity (Supply) Act, 1948. In these notifications also, it was provided that the effect of foreign exchange rate variation to be paid to/by the petitioner by/to the beneficiaries (the state utilities) would be determined by the Central Government at the end of each financial year.

11. In accordance with the provisions of the notification issued by the Central Government, at the end of a financial year the petitioner used to seek approval of that Government to the extra rupee liability to the state utilities on account of foreign exchange rate variation. It was added to the capital cost of the generating station, which was recovered from the state utilities by revision of fixed charges. In other words, the extra liability arising out of foreign exchange rate variation was capitalised and made a "pass through" in the tariff and the liability was borne by the state utilities.

12. Section 43 A(2) of the Electricity (Supply) Act, 1948 was omitted from the statute book w.e.f. 15.5.1999, when power to determine terms and conditions of tariff came to be vested in the Commission. The Commission in its order dated 21.12.2000 in Petition No.4/2000 and other related petitions, dealing with terms and conditions of tariff, on the question of foreign exchange rate variation, noted that:

"This system of passing on the risk, however, has been accepted over the years and there has not been any resistance from the beneficiaries. In fact, there has been a general consensus before us that this risk should be protected and built into the tariff."

The Commission further noted that:

"Keeping the best practice in mind, we consider that foreign exchange risk need protection. This is agreeable in principle to the beneficiaries also. The protection as far as debt is concerned, has to be allowed both on account of principal repayment and interest to the extent not already included in the tariff which is decided up front."

In its order dated 21.12.2000, the Commission prescribed a methodology for recovery in order to smoothen the shocks arising out of the foreign exchange rate variation and bring about uniformity in its treatment across utilities.

13. The Commission's order dated 21.12.2000 in Petition No.4/2000 and the related petitions has been translated into a notification issued on 26.3.2001 and this notification, on the question of liability of the state utilities arising out of foreign exchange rate variation provides as under: "1.13 **Extra Rupee Liability**

- (a) Extra rupee liability towards interest payment and loan repayment actually incurred, in the relevant year shall be admissible; provided it directly arises out of foreign exchange rate variation and is not attributable to Utility or its suppliers or contractors. Every utility shall follow the method as per the Accounting Standard-11 (Eleven) as issued by the Institute of Chartered Accountants of India to calculate the impact of exchange rate variation on loan repayment.
- (b) Any foreign exchange rate variation to the extent of the dividend paid out on the permissible equity contributed in foreign current, subject to the ceiling of permissible return shall be admissible. This as and when paid, may be spread over the twelve-month period in arrears.



The terms and conditions of tariff contained in the notification dated 26.3.2001 are applicable from 1.4.2001 to 31.3.2004.

14. Thus, under the existing framework, the extra liability arising out of foreign exchange rate variation, whether on account of repayment of principal amount or on account of interest, is borne by the state utilities and the central generating companies are completely insulated from the risks.

15. We heard Shri P. Narasimhamulu, Director (Finance), along with Shri B.K. Mandal and Smt. Sangeeta Bhatia for the petitioner in support of the proposal. The representatives of the respondent state utilities present at the hearing were opposed to the petitioner's proposal. Shri S. Jayaraman, Director (Finance), NLC, assisted by Shri R. Suresh, Chief Engineer, argued in its favour.

### **ANALYSIS OF PRELIMINARY ISSUES OF STATE UTILITIES**

16. In the first instance, we propose to deal with the objection raised on behalf of RRVPNL regarding jurisdiction of the Commission to approve the proposal made by the petitioner. We are of the opinion that the issue raised merits a summary rejection. In our view, the treatment of risks arising out of foreign exchange exposure forms part of the terms and conditions of tariff which are within the exclusive domain of the Commission under Section 28 of the Electricity Regulatory Commissions Act, 1998. In fact, as has been noticed above, the Commission in its order dated 21.12.2000 in petition No.4/2000 and the related

petitions, has considered this issue. The notification on terms and conditions of tariff issued by the Commission on 26.3.2001 already makes provisions for meeting of liability arising out of foreign exchange rate variation by the state utilities. Merely because a different methodology has been proposed by the petitioner to meet the risks, it does not take the matter out of the jurisdiction of the Commission. For these reasons, we do not find any merit in the objection raised by RRVPNL

17. Similarly, we do not find any justification for the apprehensions raised on behalf of WBSEB. The proposal, when accepted by the Commission, would relieve it of its liability to meet the extra rupee liability arising out of foreign exchange rate variation under the existing framework and the beneficiaries would be liable to make payments in accordance with the decision of the Commission. On the question of non-acceptance of liability by the State Regulatory Commission, suffice it to say that discharge of functions by the State Regulatory Commissions is subject to the functions performed by this Commission. Therefore, ordinarily the question of decline by the State Regulatory Commission of the liability on account of terms and conditions of tariff determined by this Commission should not arise.

### **ANALYSIS OF THE PROPOSAL**

18. The foreign exchange risk arises out of fluctuations in foreign exchange rates, which may have adverse impact on the utility having foreign exchange

exposure. In this context, hedging refers to the use of financial arrangement with a view to protecting against adverse changes in exchange rates and interest rates on loans with foreign exchange exposure.

19. The petitioner has proposed to hedge a part of its foreign exchange exposure on loans, and seeks to recover the costs from the state utilities by making these costs " pass through" in tariff. In other words, the costs of undertaking of hedging activity and consequences flowing therefrom are to be borne by the state utilities and the petitioner would be totally immune to them. The arrangement proposed by the petitioner has made the state utilities wary of the proposal, since activity is to be undertaken by one person but the consequences would be borne by a different person. This has made the proposal unworthy of acceptance. At one stage, we gave our thought to giving appropriate direction for sharing of risks, gains and losses arising out of hedging activity by the petitioner and the state utilities. However, we had to abandon that thought because we could not evolve a satisfactory formula for sharing of costs, gains and losses.

20. We have earlier concluded that the proposal, made by the petitioner falls within the statutory function of the Commission of determination of terms and conditions of tariff. The Commission has already notified on 26.3.2001 the terms and conditions of tariff applicable from 1.4.2001 to 31.3.2004. At this stage, we do not favour any mid-term major modifications to the terms and conditions

already notified because of our anxiety to guard the utilities against regulatory uncertainties. For this reason also, we are reluctant to uphold the proposal made by the petitioner. We had directed the petitioner to ascertain whether any other regulatory authority had allowed hedging or "pass through" of the hedging costs. The petitioner, however, could not furnish any details in this regard. This has also dissuaded us to accept the proposal.

21. In the light of the above discussion, we feel that balance of advantage lies in continuing to follow the existing framework on the question raised in the present petition. This should , however, not be construed to preclude the petitioner from following the Policy formulated by it at its own risks and costs. The gains or losses accruing as a result of following the Policy shall be of the petitioner alone. We make it clear that the state utilities shall neither be liable for any losses nor entitled to gains, in case the petitioner pursues the Policy.

22. With the above, the petition stands disposed of

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**(K.NTSinha)  
Member**

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**(G.S. Rajamani)  
Member**

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Member**

New Delhi dated: j) -.February, 2002.