# Comments on Draft CERC ( Terms and Conditions of Tariff ), Regulations, 2014

On behalf of
UPPCL,
UPCL and
Madhu Gupta & Co.

# Thank You

**We thank Hon’ble Commission for accepting our request that only actual tax paid should be recovered .This would provide substantial relief to cash starved discoms .We anticipate that it would stop over recovery of cost of Rs.1000/- crores p.a. ( Rs.5000/- crores for 5 year period ) on this account from NTPC alone. If we add PGCIL,NHPC , etc this amount would become all the more substantial.**

**Detailed computation of NTPC is furnished below.**

# Tax on Return on Equity ( Reg.25)

| | 2009-10 | 2010-11 | 2011-12 |
|---|---|---|---|
| | | | |
| Grossed ROE | 4977.84 | 5550.41 | 6037.15 |
| Base ROE | 3285.87 | 3706.57 | 4078.09 |
| Income tax Recovered | 1691.97 | 1843.85 | 1959.06 |
| Income tax on ROE ( as per 2014-19 Draft Regulations ) | 773.72 | 849.33 | 959.51 |
| Excess Recovery on account of Income Tax ( Rs. Crores ) | 918.24 | 994.52 | 999.54 |

# Regulatory Treatment of Tax on ROE

| | |
|---|---|
| 2004-9 | Actual Tax Paid including Tax on ROE,UI, Incentive and Efficiency Gains |
| 2009-14 | Grossing Tax on ROE ,Allowing Retention of benefit of Tax Holiday by Generator/Transmission Licensee |
| 2014-19 | Recovery of Tax on ROE only on actual basis |

# Reconciliation of Book Profit and Regulatory Profit

- Central Commission has on many occasions directed utility to prepare and submit this reconciliation .However utility has not prepared this reconciliation till date. An attempt has been made by us based on the information available in public domain. We are submitting the reconciliation along with the process and key findings to the Central Commission so that public interest is safeguarded.

- ***Difference between Book Profits and Regulatory Profits (excluding efficiency gains ) is Rs.3970.71 crores for 2009-10, Rs.4515 crores for 2010-11 and Rs. 5223.75 crores for 2011-12.***

## Reconciliation of Regulatory Profits and Book Profits (NTPC Ltd.)

| | | | | | |
|---|---|---|---|---|---|
| A | Book Profit | | 2009-10 | 2010-11 | 2011-12 |
| | Profit Before Tax | Rs Crores | 10885.46 | 12049.60 | 12326.16 |
| B | Regulatory Profits | | | | |
| | Return on Equity | Rs Crores | 4977.84 | 5550.41 | 6037.15 |
| | UI Income | Rs Crores | 834.15 | 858.87 | 554.00 |
| | Incentive | Rs Crores | 1102.76 | 1124.65 | 511.26 |
| | Efficiency Gains | | | | |
| | Total | | 6914.75 | 7533.93 | 7102.41 |
| C | Variance | | 3970.71 | 4515.67 | 5223.75 |
| D | Interest /Dividend and other non-operative income | | 2856.19 | 2344.65 | 2778.42 |
| E | Unexplained Variance( Efficiency Gains(?)) | | 1114.52 | 2171.02 | 2445.33 |
| E. 1 | Over Recovery Coal Stock- IWC | | 500 | 520 | 560 |
| E. 2 | Residual Unexplained Variance (Efficiency Gains(?)) | | 614.52 | 1651.02 | 1885.33 |

# Non Tariff Income

| | | | | |
|---|---|---|---|---|
| | 2009-10 | 2010-11 | 2011-12 | 2012-13 |
| Other income ( Rs. Crores ) | 2856.19 | 2460.81 | 2789.65 | 3101.58 |
| | | | | |
| Interest Income from Bank ( Rs Crores ) | 1342.92 | 1195 | 1608.52 | 1839.30 |
| | | | | |

# Key Issues-1

**Is the utility justified in not giving credit to discoms in respect of interest income forming substantial part of non-tariff income?**

**Before answering the question it is important to assess how the investable surplus is generated. Clue to this query can be found in the concept paper issued by CERC itself. Clause3.4.1 of concept paper is reproduced below :**

Quote

"3.4.1 The existing approach of Gross Fixed Assets creates internal resources for capacity replacement/addition through return on equity base of 30% (normative equity) even though the assets are written off up to 10% (salvage value)."

Unquote

- The clause means that depreciation funds recovered from beneficiaries over and above loan repayment amount is being used by the utility to create internal resource. This surplus so invested earns interest for the utility. 2009 Regulations and Draft Regulations,2014-19 provide for a way for use of such depreciation funds.

# Four Fold benefit to Generating Companies/Transmission Licensees

I. **Return on Equity on Equity Capital even when plant is fully depreciated ( upto 90%).**

II. **Interest on normative loan amount.**

III. **Interest on depreciations funds retained over and above amount used for repayment of loan.**

IV. **Special Allowance**

We have quantified the position in respect of Singrauli STPS which is placed below.

| | | | | | | Rs Crores |
|---|---|---|---|---|---|---|
| Singrauli | | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 |
| Capital Cost ( Closing ) | | 1294.87 | 1295.92 | 1301.41 | 1305.51 | 1393.43 |
| Depreciation including AAD recovered ( closing ) used for repayment of Loan | | 1137.65 | 1152.40 | 1156.75 | 1157.34 | 1160.14 |
| Residual Capital Cost | | 157.22 | 143.52 | 144.66 | 148.17 | 233.29 |
| | | | | | | |
| Equity Capital ( Closing ) on which ROE Is being paid | | 616.36 | 616.67 | 618.32 | 619.55 | 645.93 |
| Normative Loan Amount Closing | | 111.21 | 97.47 | 97.46 | 99.74 | 158.48 |
| Loan and Equity being serviced | | 727.57 | 714.14 | 715.78 | 719.29 | 804.41 |
| | | | | | | |
| Excess Equity Capital ( Closing ) on which ROE Is being paid | | 570.35 | 570.62 | 571.12 | 571.12 | 571.12 |
| | | | | | | |
| Earnings of Generator | | | | | | |
| ROE | | 144.01 | 143.09 | 141.65 | 141.98 | 145.15 |
| Interest on Loan | | 5.08 | 3.82 | 3.38 | 3.32 | 4.10 |
| Special allowance Recovered | | 40.00 | 52.86 | 55.88 | 59.08 | 93.69 |
| Interest on Investment @ 8.5% tax free | | 48.48 | 48.50 | 48.55 | 48.55 | 48.55 |
| Total | | 237.57 | 248.28 | 249.46 | 252.93 | 291.49 |

- It shows that in 2009 -10 against total capital cost of Rs.1294.87 crores , an amount of Rs.1137.65 crores has been recovered by way of depreciation. Thus only Rs.157.22 crores of the utility are invested in the station. However equity of Rs. 616.36 crores is being serviced and loan of Rs. 111.21 crores is being serviced. Thus an amount of Rs.727.57 crores is being serviced on an investment of Rs.157.22 cores.

- The total earnings of the utility in 2009 -10 is Rs.237.57 crores on an investment of Rs.157.22 crores. **For 2009-14 period earnings /recovery of fixed charges is Rs.1279.72 crores which is equivalent to total capital cost of the plant.**

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| Grand Total ( 7 stations) | | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 |
|---|---|---|---|---|---|---|
| Residual Capital Cost | Rs. Crs | 2349.75 | 2275.70 | 2124.38 | 1992.02 | 1990.97 |
| Loan and Equity being serviced | Rs. Crs | 5422.01 | 5406.70 | 5384.42 | 5376.17 | 5468.86 |
| Excess Equity Capital ( Closing ) on which ROE Is being paid | Rs. Crs | 3072.25 | 3131.00 | 3260.04 | 3384.15 | 3477.88 |
| Earnings of Generator | Rs. Crs | 1482.75 | 1492.39 | 1496.76 | 1524.37 | 1588.87 |
| Cumulative Earnings | Rs. Crs | 1482.75 | 2975.13 | 4471.89 | 5996.27 | 7585.13 |

# 6.5 Commission's Proposal

- Taking into cognizance of the views and suggestions of various stakeholders and also taking into consideration the market conditions, the Commission proposes that existing GFA approach for providing the returns on investments may be continued as the sector is fraught with various challenges such as fuel availability, availability of land and water, etc, and change in approach at this stage may have detrimental effect on the investments in the sector.

# Electricity Act,2003( Preamble)

- An Act to consolidate the laws relating to generation, transmission, distribution, trading and use of electricity and generally for taking measures conducive to development of electricity industry, promoting competition therein, **protecting interest of consumers** and supply of electricity to all areas, rationalization of electricity tariff, **ensuring transparent policies regarding subsidies**, promotion of efficient and environmentally benign policies, constitution of Central Electricity Authority, Regulatory Commissions and establishment of Appellate Tribunal and for matters connected therewith or incidental thereto.

**We request Hon’ble Commission that at least from 2014-19 period :**

- ✓ **Depreciation funds recovered in excess of loan amount should be deducted from Equity Capital**

- ✓ **Benefit of Non-tariff income should be passed to Beneficiaries.**

## Key Issue II: Whether there is a need for Truing up of expenditure and sharing of efficiency gains?

- Both the need for truing up and sharing of efficiency gains are well established. Draft Regulations provide for truing up (for certain components only) and sharing of efficiency gains. For 2011-12 efficiency gains are Rs.2445.33 crores (including prior period income ). It is important that till the utility is able to explain and quantify source of such gain, benefit of such gain should be passed to beneficiaries either in totality or largely (75%) as the gains are accruing on account of relaxed normative norms. For instance working capital norms have been allowing for 45/60 coal stock when actual 5 year average for Singrauli is 10.98 days and for Rihand it is 12.40 days

# Actual Average Fuel Stock and Maximum Fuel Storage Capacity

| S.No. | Station | 5 year Average ( Days ) |
|---|---|---|
| 1 | Singrauli Super Thermal Power Station | 10.98 |
| 2 | Rihand Super Thermal Power Station | 12.40 |
| 3 | Tanda Thermal Power Station | 26.75 |
| 4 | Unchahar FGUTPP | 10.62 |
| 5 | Korba Super Thermal Power Station | 11.32 |
| 6 | Vindhyachal Super Thermal Power Station | 7.77 |
| 7 | Sipat Super Thermal Power Station | 12.25 |

| S.No. | Station | 5 year Average |
|---|---|---|
| 8 | Ramgundam Super Thermal Power Station | 8.94 |
| 9 | Simhadri Super Thermal Power Station | 7.70 |
| 10 | Farakka Super Thermal Power Station | 4.35 |
| 11 | Kahalgaon Super Thermal Power Station | 2.11 |
| 12 | TTPS Thermal Power Station | 18.48 |
| 13 | Tal kaniha Super Thermal Power Station | 2.97 |
| 14 | Badarpur Thermal Power Station | 14.12 |
| 15 | Dadri Thermal Power Station | 9.69 |

**We request Hon'ble Commission that at least from 2014-19 period :**

- **Truing up should be done in totality for all components of capacity charges and for variable charges.**
- **Till the norms are aligned with actuals ,at least 75% of the efficiency gains should be passed to beneficiaries.**
- **Concept of mid-term truing should be made mandatory and not at the discretion of generator/transmission licensee.**

# Reg. 8(3) Sharing of Gains of Truing Up

(3) The financial gains by a generating company on account of controllable parameters shall be shared between generating company and the beneficiaries on monthly basis, in the ratio of 3:1 as per the following formulae:

(4) The financial gains and losses by a generating company or the transmission licensee, as the case may be, on account of uncontrollable parameters shall be passed on to beneficiaries of the generating company or long term transmission customer/DICs of transmission system, as the case may be.

# Observations

A. The Regulations do not provide for treatment of loss on account of controllable factors by generating company.

B. The Sharing Ratio of 3:1 is skewed in favour of Generator with no corresponding risk.

C. The Sharing ratio should be 1:3 as the norms are relaxed limiting norms and not stringent base norms .

D. Term ‘Force Majeure’ has not been defined.

E. Would inability to obtain coal linkage or delay in operationalization of mine qualify for force majeure event or infrastructure bottlenecks like ports/railways etc. constitute force majeure event.

# Reg.3(4) Definition of 'Auditor'

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| **Draft Regulation** | **'auditor' means an auditor appointed by a generating company or a transmission licensee, as the case may be, in accordance with the provisions of sections 224, 233B and 619 of the Companies Act, 1956(1 of 1956)], as amended from time to time or any other law for the time being in force;** |
| Observation | Section 233 B provides for appointment of Cost Auditor. However the Commission has not asked for nor have the Generating Companies/Transmission Licensees furnished Cost Audit Report. We request that furnishing of cost audit report at the time of filing of true up petition may be made mandatory. |

# Reg.9(2)(a):Capital Cost

- The Capital Cost of new project shall include the following :

a) The expenditure incurred ~~or projected to be incurred~~ to the date of Commercial operating of the Project.

# Reg.10 **Prudence Check of Capital Expenditure**

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| **Draft Regulation** | **In case of the thermal generating station and the transmission system, prudence check of capital cost may be carried out taking into consideration the benchmark norms specified/to be specified by the Commission from time to time:** |
| Observation | It is suggested that the capital cost of thermal stations should be vetted, just like hydro stations. Benchmarking norm by their very nature have a comfort element built into it. |

# Reg.11(A) **Interest during construction (IDC)**

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| **Draft Regulation** | **Provided that if the delay is not attributable to the generating company or the transmission licensee as the case may be, and is due to uncontrollable factors as specified in Regulation 12 of these regulations, IDC may be allowed after due prudence check:** |
| Observation | The cost of delay cannot be passed to consumers. It has to borne by generating company/transmission licensee. The project execution risk is inherent part of business and consumers cannot be asked to bear it. |

# Reg.11(A) **Incidental Expenditure during Construction (IEDC)**

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|---|---|
| **Draft Regulation** | **Provided that if the delay is not attributable to the generating company or the transmission licensee, as the case may be, and is due to uncontrollable factors as specified in Regulation 12, IEDC may be allowed after due prudence check.** |
| Observation | The cost of delay cannot be passed to consumers. It has to borne by generating company/transmission licensee. The project execution risk is inherent part of business and consumers cannot be asked to bear it. |

# Reg.12(1) **Controllable factors**

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| **Draft Regulation** | **The "controllable factors" shall include but shall not be limited to the following:**<br><br>**i. Variations in capital expenditure on account of time and/or cost overruns on account of land acquisition issues;**<br>**ii. Efficiency in the implementation of the project not involving approved change in scope of such project, change in statutory levies or force majeure events; and**<br>**iii. Delay in execution of the project on account of contractor, supplier or agency of the generating company or transmission licensee.** |
| Observation | |

**Factors like operation and maintenance expenses have not been considered. There is a need for harmonization of regulations of generation, transmission and distribution utilities. State ERC cannot follow different set of principles for different utilities in the same state.**

**In a state ERC shall undertake truing up of all components of distribution licensee. Whereas for transmission and generation utilities truing up of capital cost and select O&M items shall be done. This discrepancy would result in a legally unacceptable position for State ERCs.**

# Reg.14(1):**Additional Capitalisation**

(1) The capital expenditure in respect of the new project or an existing project incurred or projected to be incurred, on the following counts within the original scope of work, after the date of commercial operation and up to the cut-off date may be admitted by the Commission, subject to prudence check:

(i) Undischarged Liabilities recognized to be payable at a future date;

(ii) Works deferred for execution;

(iii) Procurement of initial capital spares within the original scope of work, in accordance with the provisions of regulation 13;

(iv) Liabilities to meet award of arbitration or for compliance of the order or decree of a court of law; and

(v) **Change in law or compliance of any existing law**:

- Reg.14(1)(v) has incorporated the words ‘or compliance of any existing law’. This is departure from current practice where only ‘change in law’ was allowed. Incorporation of these words would expand the scope of additional capitalization very significantly. The project when envisaged shall include compliance of all current laws. Only any change needs to be incorporated. The words ‘or compliance of any existing law’’ should be deleted.

# Treatment of capital expenditure during terminal years has not been referred to it.

| Draft Regulation | None |
|---|---|
| Observation: Concept Paper | 3.1.2.(vi) The treatment of additions at the fag end of project life and after allowing compensatory allowance has consequential impact on tariff as entire depreciation would have to be charged within balance useful life. The additional capital expenditure during fag end would be justified when project is expected to provide its intended service for reasonable period. This position calls for requirement of re-assessment of useful life so that investment during fag end of life could be justified. |

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| **Commissions Response : Explanatory Memorandum** | 5.5.4 :For the assets that get added during the fag end of the life of the project, i.e., after 20 years of operation for thermal power stations and 30 years of operation for hydro generating stations and transmission projects, the Commission proposes that the generating company or transmission licensee, as the case may be, shall submit the details of proposed capital expenditure during the fag end of the project. The Commission based on prudence check of such submissions shall approve the depreciation on capital expenditure during the fag end of the project. |

# Reg.15:**Renovation and Modernization & Reg.16:Special Allowance for Coal-based/Lignite fired Thermal Generating station**

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|---|---|
| **Draft Regulation** | **15(4) Any expenditure incurred or projected to be incurred and admitted by the Commission after prudence check based on the estimates of renovation and modernization expenditure and life extension, and after deducting the accumulated depreciation already recovered from the original project cost, shall form the basis for determination of tariff.** |
| Observation | **The Regulations provide for utilization of accumulated depreciation for purpose of R&M expenditure. However in event generator does not opt for R&M and claims special allowance how accumulated depreciation shall be utilized has not been stated. Consequently generator is enjoying four fold benefit :**<br><br>✓ **Return on Equity on Equity Capital even when plant is fully depreciated ( upto 90%).**<br>✓ **Interest on normative loan amount.**<br>✓ **Interest on depreciations funds retained over and above amount used for repayment of loan.**<br>✓ **Special Allowance** |

# Reg.24:**Return on Equity**

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|---|---|
| **Draft Regulation** | **Provided that in case of projects commissioned on or after 1st April, 2014, an additional return of 0.50 % shall be allowed if such projects are completed within the timeline specified in Appendix-I:** |
| Observation | **The draft Regulations provide for an incentive for doing the job. Similarly disincentive should be built into the Regulations.**<br><br>Provided further that in case of projects commissioned on or after 1st April, 2014, an deduction **0.50 %** shall be allowed if such projects are not completed within the timeline specified in **Appendix-I**: |

# Reg.26:**Interest on loan capital**

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|---|---|
| **Draft Regulation** | **(7) The generating company or the transmission licensee, as the case may be, shall make every effort to re-finance the loan as long as it results in net savings on interest and in that event the costs associated with such re-financing shall be borne by the beneficiaries and the net savings shall be shared between the beneficiaries and the generating company or the transmission licensee, as the case may be, in the ratio of 2:1.** |
| Observation | The cost of refinancing shall be borne by beneficiaries (100%) while benefit shall be shared in the ratio of 2:1 in favour of generating companies/transmission licensees. This is violative of risk reward mechanism. |

# Reg.28(1)(a):**Interest on Working Capital**

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| **Draft Regulation** | **(1) The working capital shall cover:**<br>**(a) Coal-based/lignite-fired thermal generating stations**<br>**(i) Cost of coal or lignite and limestone towards stock, if applicable, for 15 days for pit-head generating stations and 30 days for non-pit-head generating stations for generation corresponding to the normative annual plant availability factor or the maximum coal/lignite stock storage capacity whichever is lower;**<br>**(ii) Cost of coal or lignite and limestone for 30 days for generation corresponding to the normative annual plant availability factor** |
| Explanatory Memorandum | 11.5.3 The Commission therefore proposes that the cost of fuel towards fuel stock shall be considered as 15 days for pits head stations and 30 days for non pit-head stations subject to maximum storage capacity. |

| | |
|---|---|
| Observations | Draft Regulations have split Reg.18(1)(a)(i) of 2009 Regulations in two parts where coal stock for 30 days is maintained for stock ( for non-pit head generating stations ) and coal for 30 days is maintained for generation. In totality coal stock of 60 days is being permitted.<br><br>Similarly for non-pit head stations stock of 15 days plus 30 days is being permitted. In totality coal stock of 45 days is being permitted.<br><br>This is reinstating the position of 2009 Regulations<br><br>However this is contradictory to findings of the Commission itself which form part of Explanatory Memorandum. |
| | The Commission is requested that creditors for goods and services should be reduced to determine working capital. This is in line with established accounting and banking principles. |