Before the
MAHARASHTRA ELECTRICITY REGULATORY COMMISSION
World Trade Centre, Centre No.1, 13th Floor, Cuffe Parade, Mumbai 400 005
Tel. No. 022 22163964/65/69 – Fax 022 22163976
E-mail mercindia@mercindia.com
Website: www.mercindia.com

Case No. 45 of 2011

In the matter of

RInfra's Petition for deferment of the implementation of the MERC (Multi Year Tariff) Regulations, 2011

Shri V.P. Raja, Chairman
Shri Vijay L. Sonavane, Member

ORDER

Dated: September 2, 2011

Reliance Infrastructure Limited (hereinafter referred as "RInfra"), a Generating Company, Transmission Licensee, as well as Distribution Licensee, submitted a Petition under affidavit before the Commission on March 25, 2011, under Section 94 (2) of the Electricity Act, 2003 (EA 2003), Regulation 85 (a) of the MERC (Conduct of Business) Regulations, 2004, and Regulations 4.1, 99 and 100 of the MERC (Multi Year Tariff) Regulations, 2011 (hereinafter referred as MYT Regulations, 2011), seeking deferment of the implementation of MYT Regulations, 2011, with the following prayers:

"

(a) that this Hon'ble Commission may be pleased to defer the implementation of MYT framework for one year as the issues pertaining to RInfra-D's licence, new licensees, if any, approval of PPAs, rules for operation of parallel licensees, cross-subsidy and regulatory recovery, etc. are pending consideration of this Hon'ble Commission;

(b) that this Hon'ble Commission may be pleased to re-initiate consultative process on some of the provisions of MYT Regulations as brought out in this petition;

(c) that this Hon'ble Commission may grant liberty to the petitioner to carry out alterations, additions, modifications or deletions to the petition at a future date

(d) For such and further and other reliefs as the Hon'ble Commission may deem appropriate in the facts and circumstances of the case."

2. RInfra submitted in its Petition that Regulation 7 of the MYT Regulations, 2011, notified on February 4, 2011 for determination of tariff in all cases covered under the Regulations from April 1, 2011 to March 31, 2016, requires the Generating Company, Transmission Licensee and Distribution Licensee to file a five-year Business Plan from April 1, 2011 to March 31, 2016. The Business Plan is expected to contain detailed category-wise sales and demand projections, power procurement plan, capital investment plan, financing plan and physical targets, which have to be approved by the Commission. RInfra, i.e., as a Generating Company and Licensee, is required to then file MYT Petition for determination of ARR and tariff for each year of MYT Control Period based on the approved Business Plan. However, the Commission has suo-motu issued an Order dated February 23, 2011 for Removal of Difficulty, dispensing the requirement of a separate Order/approval of Business Plan trajectories. The applicants are still required to file MYT Business Plan and ARR and Tariff petitions for FY 2011-12 to FY 2015-16, containing detailed forecasts of all business variables for each financial year.

3. RInfra added that Part B (General Principles) of MYT Regulations, 2011 states that the Commission shall issue MYT Order on the basis of Multi-Year forecasts made by the Applicants and the Order will contain approved ARR for each year of the Control Period, along-with retail tariffs for each consumer category. The MYT Regulations, 2011 further provide that once the Order is issued, the Applicants can only seek a limited half-yearly review of certain uncontrollable expenses such as fuel escalation costs and certain other uncontrollable costs. Regulation 12.1 of the MYT Regulations specifies the items, other than fuel escalation, that could be considered as uncontrollable, viz., force majeure events such as acts of war, fire, natural calamities, etc., change in law, changes in taxes and duties and changes in freight rates. Other than half yearly review and pass through of additional expenses due to uncontrollable events, a mid-term review at the end of two and half years is also envisaged, where trajectories and targets for rest of the Control Period could potentially be reset based on past performance.

4. RInfra submitted that the MYT Regulations, 2011 are inflexible with respect to allowing variations in forecast, and variations are allowed only on account of some very limited events causing changes to costs or performance targets, which will be permitted to be passed through in tariffs. While these provisions help to bring regulatory certainty in the process, the sectoral changes and events presently occurring particularly in the area of supply of RInfra-D, relating to licence, power purchase agreement approvals and retail competition, cause a large degree of business uncertainty. The possibility of building forecasts in the background of these uncertainties and consequent contingencies in the forecasts seems

impossible, given that little is known about the likely impact of impending changes at this juncture. RInfra further submitted that events having a potential to fundamentally alter the business scenario are presently looming in RInfra-D's area of supply and therefore, the time is not ripe to bring about a new tariff regime such as the MYT Regulations, 2011. One of the mainstays of the MYT Regulations, 2011 is to limit changes in tariff, once announced, for a period of five years. This would be possible only where businesses are reasonably stable, where the future can be forecast with a sufficiently high degree of accuracy and not in a situation like the one prevailing in RInfra-D's area of supply.

5. RInfra further submitted that the Commission has initiated a process of inviting Companies having experience in electricity distribution to undertake distribution in the area of supply of RInfra-D. This is because the Specific Conditions of License applicable to RInfra-D specify a terminal date of licence as August 15, 2011. An Expression of Interest was issued by the Commission to initiate the process, in response to which five Companies have finally been asked to submit their Licence Application. One of the Applicant Companies, out of the five, has applied for a licence in only two of the five distribution zones of RInfra-D area, while the others have applied for the entire area. It is also understood from a presentation made before the Commission by its Consultants on the subject of distribution licence, that the Commission is exploring geographical division of RInfra-D's area of supply as one of the options for awarding distribution licence and bringing in more players in the area. Some of the other options being discussed are division of RInfra-D's licence into wires licence and retail supply licensee. Clearly, there are a lot of uncertainties surrounding the continuance of status quo ante of RInfra-D's licence beyond August 15, 2011 and the form and specifics of market structure for electricity distribution in RInfra-D's area of supply will be known clearly only when the present activities culminate into final shape. In this scenario, RInfra-D can prepare a five-year plan only by assuming status quo as far as distribution market structure in its area of supply is concerned. While such an assumption is possible theoretically; in practice, the decisions of the Commission on the presently on-going considerations relating to licence would have profound implications on such five-year plan, to the extent of making the plan invalid.

6. RInfra submitted that RInfra-D's area of supply already has TPC-D as a distribution licensee. The Commission, vide its Order dated October 15, 2009 in Case No. 50 of 2009, approved an interim scheme of customer change-over from one licensee to another. Pursuant to the said Order about 1,11,000 customers of RInfra-D have already changed-over to TPC-D for supply of electricity and the process is continuing at the rate of about 4500 customers per week at present. RInfra submitted that the final Order or Regulations on Parallel Licensee

framework in Case No. 50 of 2009 is pending and it is understood that TPC-D has also started expanding its distribution network in RInfra-D's area of supply in order to supply power to RInfra-D's existing customers and new applicants. In such circumstances, if more entities are awarded distribution licence in RInfra-D's area, a greater number of options would be created for customers and change-over process could accelerate rapidly. This also has the potential of rendering the distribution assets of RInfra-D redundant, as more parallel wires are drawn up to reach customers.

7. RInfra added that it understands that the Commission is seized of the situation and has initiated the process of developing a framework for operation of more than one distribution licensees in a given area of supply. A draft of the impending framework circulated and discussed in State Advisory Committee meetings shows that the Commission may be contemplating to levy a surcharge on the customers choosing to change-over to other licensee for recovery of regulatory assets. In the impending framework, rules for capital expenditure and extension of network by parallel licensees are also proposed to be incorporated. Rules relating to capital expenditure incurrence to develop network have a potential impact on capital expenditure plans in MYT framework.

8. RInfra further submitted that it has informed the Commission about the large quantum of cross-subsidy lost due to migration of high end subsidizing consumers of RInfra-D to TPC-D. RInfra-D has also apprised the Commission of the problem of non-recovery of regulatory assets, if large numbers of customers choose to migrate to TPC-D. RInfra-D had also filed a Petition before the Commission bearing Case No.7 of 2010 for specifying an appropriate mechanism for recovery of regulatory assets and cross-subsidy, which matter ultimately reached the Hon'ble Appellate Tribunal for Electricity (ATE). The Hon'ble ATE had vide its Judgment dated March 1, 2011 in Appeal No. 200 of 2010 directed the Commission to decide on the issues of recovery of regulatory assets and cross-subsidy surcharge within a period of 120 days and the said issues are now pending before the Commission. A decision on the said issues, being a part of revenue recovery and estimated revenue gap, is integral to MYT forecasts and retail tariffs to be proposed by RInfra-D considering the forecast revenue gap. Further, the existence or otherwise of Cross-subsidy Surcharge and charge, if any, for recovery of regulatory assets from migrating consumers is a major determinant of whether and how much customer change-over will occur during the MYT Control Period. This, in turn, is a determinant of load forecast and energy sales and its consequential impact in terms of power purchase requirements. A certainty on these issues is therefore, essential to make a reasonably correct demand forecast for each year of the Control Period.

9. RInfra submitted that it has completed its process of procurement of power for the medium-term and long-term and has submitted the Power Purchase Agreements (PPAs) to the Commission for approval, which are pending before the Commission. RInfra submitted that power purchase forecasts form 80% of costs in the Business Plan and ARR Petitions and in the absence of any approval or otherwise from the Commission for the PPAs submitted by RInfra-D, it will not be possible for RInfra-D to correctly forecast power purchase cost in its MYT Petition, making the whole Petition meaningless.

10. RInfra summarized that the following uncertainties prevail in RInfra-D's area of supply, which would materially affect its forecasts of revenues and expenses for the MYT Control Period:

(i) Possibility of many distribution licensees in RInfra-D's area of supply in the near future, causing all business forecasts and plans to necessarily factor in the effects of competition and strategies to counter the same;

(ii) Possibility of licence area boundaries of RInfra-D getting re-defined post August 15, 2011, making the MYT Petition submitted before the date, invalid.

(iii) Uncertainty over the extent of recovery of the lost cross-subsidy from the change-over customers, i.e., the magnitude of Cross-Subsidy Surcharge and its influence on extent of customer change-over in future.

(iv) Uncertainty over recovery of regulatory assets and past revenue gaps due to shrinking customer base.

(v) Possibility of an impending new framework of operation of parallel licensees inter alia having significant potential impact on planning and execution of capital expenditure and the final determination of issues raised by the Petitioners in Case No. 50 of 2009.

(vi) Non-approval of PPAs executed by RInfra-D for the medium-term and long-term till date, without which power purchase forecast cannot be prepared and the MYT Petition will remain incomplete. Also, if the PPAs are rejected by the Commission or if any changes are sought, the effect of the same and/or alternative arrangements will need to be built in the forecasts.

Operational difficulties due to provisions in MYT Regulations, 2011

A. Operations and Maintenance (O&M) expenses for Distribution

11. RInfra submitted that the Commission had issued the draft MYT Regulations for public consultation on August 30, 2010. In Clause 73.3 and Clause 87.6 of the draft MYT Regulations, the norms were specified for determination and allowance of O&M Expenses for Distribution Wires Business and Distribution Retail Supply Business, respectively, of a

distribution licensee in the State of Maharashtra. RInfra submitted that on perusal of the draft MYT Regulations and final MYT Regulations, 2011, it is observed that there is a significant difference between the norms specified in the Draft MYT Regulations, on which consultation was held with the Utilities and members of public, and those specified in the final MYT Regulations, 2011. The alteration in the norms has been made without offering any opportunity to RInfra-D (and other stakeholders) to provide their comments on the same.

12. RInfra further submitted that the change in O&M norms between the draft MYT Regulations and final MYT Regulations, 2011, significantly reduces the total allowable O&M expenses to RInfra-D to levels much lower than its actually incurred expenses. RInfra contended that being a distribution licensee, it is entitled to pass through of all expenses reasonably and justifiably incurred for the purpose of maintaining quality and reliability of supply and meeting Universal Service Obligation.

13. RInfra added that the logic behind setting these norms is faulty, which is evident from the fact that the weightages of different drivers of expenses, viz., energy, customers and GFA have undergone drastic revision between the draft MYT Regulations and final MYT Regulations, 2011. RInfra-D submitted that before linking the O&M norms of a Utility business to output parameters such as energy, customers, assets, etc., the existing level of expenses and how the same are allocated to the different drivers must first be ascertained with sufficient degree of confidence. RInfra-D submitted that the Utility is in the best position to identify how its various costs for operations and maintenance are linked to various business drivers and consequently it is only prudent for the Commission to carry out consultations with the Utility to determine these proportions. Alternatively, a statistical analysis over the past several years' data is carried out to regress the expenses with the value of drivers, to arrive at statistically significant regression factors. These regression factors can then be employed to allocate the total expenses over the drivers. However, the very fact that the weightage of expenses has undergone such a drastic revision between the draft MYT Regulations and final MYT Regulations, 2011 makes it evident that it is arbitrary and no such analysis has been carried out by the Commission.

B. Norms for Station Heat Rate for RInfra Generation – Dahanu TPS

14. RInfra submitted that Regulation 44.2 of the MYT Regulations, 2011 specifies different norms for Station Heat Rate for different thermal generating stations in Maharashtra. However, in the previous MYT Control Period, the normative Station Heat Rate (SHR) for all thermal generating stations was specified as 2500 kcal/kWh, same as that specified by the CERC.

15. RInfra submitted that in practice, however, over the previous MYT Control Period, only RInfra's Dahanu Thermal Power Station (DTPS) was consistently able to meet and over achieve vis-a-vis the normative SHR, while the Stations/Units of MSPGCL and TPC generation were actually far from the normative value. The Commission deviated from its Regulations and allowed MSPGCL and TPC generation higher than normative SHR under the previous MYT Control Period. The Commission also attempted to revise downward the SHR of DTPS in its Tariff Order in Case Nos. 25 and 53 of 2005 as DTPS was consistently over-performing, but RInfra challenged the same before the Hon'ble ATE. The ATE, in its Judgment (Appeal No. 251 of 2006) decided the issue in favour of RInfra and held as under:

> *" 55. Norms for operation for power stations are determined for the industry based on the technology, industry performance and in order to ensure optimum utilization of machines with efficient and economic operation. Black's Law Dictionary defines norms as: "An actual or set standard determined by the typical or most frequent behaviour of a group". We are quite intrigued: once the Commission has specified "norms" how the same can be changed for a particular generator merely because it has consistently performed better. One can understand if the entire industry performs at better operational levels, then observing the consistent industry average improve, norms for all can be upgraded. It is against natural justice that an individual station, instead of being rewarded for better performance, is made to meet higher targets of performance and exposed to the risk of not achieving it. Achieving exceptionally high levels of efficiencies requires great deal of effort and expertise and must be incentivised. If Commission wishes to revise norms upward, it may also do so but such a revision has to be applied to all players after watching the industry performance over a period of time.*
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> *56. The Proviso to Regulation 26.2 of MERC does provide leeway to MERC to deviate from the norms where it so deems appropriate having regard to the circumstances of the case. It can be understood if it makes a departure from the norm if a station has met an accident or has inherent deficiencies in design or workmanship and unless the norms are so moderated generator will have no incentive to generate and may have to wind up if the station continually operates at below norms. We are not convinced that MERC can upgrade norms for individual generator even if it performed better year after year. If the entire industry operates at better operating parameters for sufficient number of years, then MERC may consider to revise the norms for all."*

16. RInfra submitted that notwithstanding the Judgment of the Hon'ble ATE as referred above, the Commission has in the present MYT Regulations, 2011 reduced the normative SHR value for DTPS from the earlier norm of 2500 kcal/kWh, while it has allowed much higher SHR targets for MSPGCL and TPC generation. The CERC has also revised the normative SHR for 210/250 MW thermal generating Units from the earlier 2500 kcal/kWh to 2450 kcal/kWh. However, the norms set by the Commission are different for different generating Units across Maharashtra and are seemingly based on the actual performance of these generating Units in the previous MYT Control Period. It is quite evident that while DTPS has consistently over-performed against its SHR norm in the past, all other generating Units of other generating companies have failed to meet their targets and have actually significantly under performed. Naturally, under the provisions of previous Tariff Regulations, DTPS, as a consequence of its better performance, has earned efficiency gains for its achievement. Apparently, the Commission by tightening the normative level for DTPS alone has sought to take away those efficiency gains from DTPS, while providing leeway to poorly performing generating Units/Stations.

17. RInfra submitted that the MYT Regulations, 2011 result in giving a go-by to the ratio of the aforesaid Judgment of the ATE, which, in RInfra's submission, is a settled law. RInfra added that the issue decided upon in the above quoted ATE Judgment is one of principle and is not dependent on the facts of any particular circumstance. Consequently, the Judgment should act as a guiding principle for all SERCs while they go about forming their respective Regulations on the subject. Instead, the Commission has disregarded the principle so established by the ATE and has framed its Regulations in complete contravention to that principle.

18. RInfra submitted that the SHR, as with other parameters of a generating Unit, is a parameter for which an ideal normative value is determined based on industry performance and taking into account the specifications of manufacturer, the deterioration over time due to vintage and ambient conditions. The manufacturer does not specify different SHR values for different generating sets so long as those sets are of same technology and capacity (in MW) and use the same fuel type/grade. However, in practice, due to efficient maintenance efforts of Utility personnel, such different sets, which start out at the same manufacturer specified normative SHR value, yield varying level of SHRs in use. Ceteris Paribus, the deviation between actual SHR yields and the manufacturer specified SHR of two such generating Units is only a reflection of varying level of efficiency employed to run those Units. The differences are only a result of varying level of efforts put in by the Utilities in beating the ideal, technical limit. RInfra submitted that in whichever way the MYT dispensation is

designed, the aspect that it should reward the Utility for its efficiency in operations should be retained and efforts should be made so that the regulatory regime does not take away such incentive from the Utility.

19. Based on the above, RInfra submitted that the Commission has violated the basic tenet of setting a norm, by resetting and tightening the SHR norm for RInfra, simply because it has consistently performed better in the past. Further, by setting the norm close to its actual better performance, the Commission has left no scope for efficiency gains and the whole purpose of setting the norms is lost. This aspect has been specifically and principally settled by ATE in its Judgment in Appeal No. 251 of 2006 quoted earlier.

20. RInfra submitted that Clause 5.3 (f) of the Tariff Policy stipulates as under regarding the operating norms and how they should be set in MYT regime:

> *"f) Operating Norms*
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> *Suitable performance norms of operations together with incentives and dis -incentives would need to be evolved along with appropriate arrangement for sharing the gains of efficient operations with the consumers. Except for the cases referred to in para 5.3 (h)(2), the operating parameters in tariffs should be at "normative levels" only and not at "lower of normative and actuals". This is essential to encourage better operating performance. The norms should be efficient, relatable to past performance, capable of achievement and progressively reflecting increased efficiencies and may also take into consideration the latest technological advancements, fuel, vintage equipments, nature of operations, level of service to be provided to consumers etc. Continued and proven inefficiency must be controlled and penalized.*
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> *The Central Commission would, in consultation with the Central Electricity Authority, notify operating norms from time to time for generation and transmission. The SERC would adopt these norms. In cases where operations have been much below the norms for many previous years, the SERCs may fix relaxed norms suitably and draw a transition path over the time for achieving the norms notified by the Central Commission. Operating norms for distribution networks would be notified by the concerned SERCs. For uniformity of approach in determining such norms for distribution, the Forum of Regulators should evolve the approach including the guidelines for treatment of state specific distinctive features." (Emphasis supplied)*

21. RInfra submitted that, thus, it is mandated by the Tariff Policy that norms specified by CERC would be adopted by SERC and SERCs may deviate from such norms and fix relaxed norms with a transition path over time (trajectory) in case the operations are below (meaning

not meeting) the norms. However, at the end of the trajectory specified by SERC, it should meet the norms specified by CERC. It may be noted that application of relaxed norms shall be specified only in cases of operations being "below" (not meeting) the norms and deviation from norms is not permissible in cases where operations are better than the norms.

22. RInfra submitted that the Commission had published the draft MYT Regulations on August 30, 2010 for public consultation. The draft Regulations were backed up with an Approach Paper, which explained the Commission's reasoning and logic behind the provisions proposed in the Regulations. The Approach Paper, which has been published in accordance with Section 181(3) of the Act, itself indicated that despite having similar technology, fuel, size and vintage, not all power plants operate efficiently. The better efficiencies of such plants are primarily on account of better upkeep of the equipment and systems through better O&M practices and skilled manpower. Such practices have helped these better performing plants to overcome the normal deterioration in performance on account of wear and tear and technological obsolescence. Older the plant, it is more difficult to sustain the efficiency and performance. DTPS has sustained its efficiency in the face of advancing age, simply because of practices, systems and commitment of its manpower. One of the key reasons for DTPS to motivate itself and sustain its efficiency is the opportunity to earn financial incentives provided under the previous MYT Regulations. Financial incentives are the main ingredient of Performance Based Regulation (PBR) and it is the lure of financial incentives and the deterrence of penalties that nudge Firms to improve their performance. Firms also pass on part of these gains to their employees in order to keep them motivated and make it possible to achieve such performance in the first place. DTPS has built incentive schemes for its employees indexed to SHR performance and the efficiency and skill of DTPS's human resource has been a key contributor to its performance. In no international jurisdiction or even domestic regulatory jurisdictions have PBRs ever been designed without the possibility of earning incentives. As pointed out earlier, the incentive to firms directly translates into benefits for its consumers in the form of reduced power purchase cost and tariffs. It is therefore a win-win situation both for the firm, its employees and its consumers. This balance should not be disturbed. Hence, in the circumstances it is necessary that the Commission ought to adopt the CERC norms for Station Heat Rate, except in case of particularly poorly performing stations, where waivers could be granted.

C. Tax on Income

23. RInfra submitted that Regulation 34.1 of the MYT Regulations, 2011 states the following:

"The Commission, in its MYT Order, shall provisionally approve Income Tax payable for each year of the Control Period, if any, based on the actual income tax paid on permissible return as allowed by the Commission relating to the electricity business regulated by the Commission, as per the latest Audited Accounts available for the applicant, subject to prudence check:

Provided that no Income Tax shall be considered on the amount of efficiency gains and incentive earned by the Generating Companies, Transmission Licensees and Distribution Licensees...."

24. RInfra submitted that at the time of determination of ARR and tariffs, the Income Tax payable should be estimated on Regulated Return on Equity only as that is what is projected to be the profit to the licensee. ARR determination is based on projected performance and therefore, at the time of ARR determination, it is assumed that the licensee shall maintain all parameters of expenses and revenues as projected, consequently, the net profit at the end of the year shall be equal to his regulated return only. Or, in other words, the regulated Profit Before Tax (PBT) at the end of the year shall be such that after paying the Income Tax, the Profit After Tax is equal to the Regulated Return on Equity. This can only be achieved if the Income Tax, at the time of determination of ARR is determined by grossing up of Regulated Return on Equity by the tax percentage.

25. RInfra submitted that Regulation 34.1 of the MYT Regulations, 2011 provides that provisional approval of Income Tax at the start of MYT will be done based on actual income tax paid on permissible return as allowed by the Commission relating to the electricity business regulated by the Commission, as per latest Audited Accounts of the Applicant. In this regard, it was further submitted that Income Tax is paid by a Company based on its book profits, which is determined based on the prescribed rules of accounting as per the Companies Act, 1956 and the Income Tax Act, 1961. The book profits are a consequence of costs and revenues of the Company and are not dependent merely on Regulated Return.

26. RInfra submitted that Companies, which are vertically integrated or have businesses in sectors other than regulated electricity business maintain their accounts for the Company as a whole, as required by the Companies Act. For such companies (RInfra being such a Company), Income Tax is paid on the net profits or loss of the Group put together, and hence, it is not possible to determine how much Income Tax is actually paid on Regulated Return of regulated business(es).

27. RInfra further submitted that each regulated activity should be treated in a separate compartment in order to determine allowable Income Tax, both at the commencement and end of financial year, such that License business's Income Tax liability is determined independently and it should neither subsidize nor get subsidized by Income Tax gains or losses from other businesses of the Licensee, if any. This issue has been principally settled by the Hon'ble ATE in its Judgment in Appeal No. 90 of 2007, which states as under:

> *"49. The Commission, in line with this Tribunal order dated April 04, 2007, has ruled that the actual income tax payable by the licensee for the distribution business considered on a standalone basis will be allowed. The Commission has also ruled that the income tax will be trued up once the actual audited tax figures are furnished. We hold the view that the Commission has to ensure that the consumers in the licensee's area are always protected from the burden of the income tax on account of other businesses of the licensee. It may happen, during any year, that the distribution company entails losses whereas there are enormous profits for other businesses of the REL. If the Commission was to apply the criteria of actual tax paid even the consumers of the distribution licensee will have to bear the brunt of income tax whereas they would not have to pay any tax as the licensee's distribution business has suffered losses. On the other hand it may happen that the distribution business of the licensee has earned profits but other businesses suffer losses. In this case the overall income tax payable by the umbrella company may be Nil due to the losses of other business. It has to be borne in mind that as per the Income Tax Act the losses occurred during a year can be set off against the profits during the following years. In this context the relevant section 72 of the Income Tax Act is extracted below:*
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> ...
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> *50. The criteria is that in spite of the enabling provision of the Income Tax Act the liability of the income tax out of other businesses cannot be allowed to be passed on to the consumers of the distribution licensee. It is equally just, fair and equitable that the reverse also does not happen i.e. the liability of income tax pertaining to the distribution business is not passed on to the other businesses.*
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> *51. In view of the foregoing discussions we decide that the income tax to be allowed must be worked out on the basis of the income tax payable solely on account of the distribution business of the licensee."*

28. RInfra submitted that the first proviso to Regulation 34.1 of the MYT Regulations, 2011 states that no Income Tax shall be considered on the amount of efficiency gains and incentive earned by the generating companies, transmission licensees and distribution

licensees. RInfra submitted that Income Tax is actually paid by a Company on its profits before tax as per its Annual Accounts. The PBT of a company is derived from the actual revenues and actual costs (including depreciation) of the Company during the course of the financial year. The revenues include revenues on account of all incentives, while the efficiency gains are reflected in the cost reduction/higher revenue, as achieved by the Company, as against allowed costs/revenues. Thus, these elements on which the proviso does not permit tax reimbursement are subsumed within the costs and revenues as actually achieved by the Company and reflected in its profits/losses as per its annual accounts.

29. RInfra submitted that the Regulation 34.2 specifies that the variation between Income Tax actually paid and that approved shall be reimbursed to/recovered from the Company or Licensee, as the case may be. In this regard, RInfra submitted that if actual Income Tax paid by the Company is being ascertained at the end of the year, the same would necessarily be the amount paid by the Company or Licensee on the profits as realized, which profits are worked out using all actual revenues and costs. However, it is the reasonable apprehension of RInfra that such actual income tax shall be determined by the Commission from RInfra's Audited Accounts (Regulation 34.2 mentions that the actual Income Tax paid shall be based on documentary evidence). It is humbly submitted that RInfra, being a Company having many unlicensed and unregulated and non-power activities pays its Income Tax for RInfra as a Company as a whole. Therefore, the figure of Income Tax contained in the Audited Accounts of the Company is meaningless and using that would be in contravention to the Judgment of the Hon'ble ATE referred above. Further, as that figure will not be based solely on the costs and revenues of regulated business, using that would amount to mean that other businesses' liabilities or gains are passed on the Regulated business, which is certainly not permitted. RInfra submitted that in such circumstances, the Commission may be pleased to clearly specify the way in which actual Income Tax paid will be determined at the time of mid-term performance review, taking into account the Judgments of the Hon'ble ATE.

30. RInfra submitted that the Commission may redraft the provisions of Income Tax allowance to make it abundantly clear as to how Income Tax would be allowed at the commencement of the financial year and further at the time of truing-up, when actual revenues and expenses are available. The Commission may also treat each activity – generation, transmission, distribution in a separate compartment for the purpose of determining Income Tax liability, based on their individual Return on Equity at the start of the year and on the Regulatory Profit Before Tax determined by the Commission at the end of the year for each such activity in isolation with the rest of the activities/Companies that the

licensee may be having. It is necessary to elucidate these principles clearly in the MYT Regulations, 2011.

31. In view of the above, RInfra requested the Commission to amend the MYT Regulations, 2011 as regards Income Tax, to include a proviso that for Companies, which have other non-regulated businesses in addition to regulated electricity business, the actual Income Tax notionally payable shall be worked out by using regulatory allowed costs and revenues and determining profit/loss thereon having no regard to other businesses.

32. Considering the various pending issues related to RInfra, such as RInfra-D's licence, new licensees, if any, approval of PPAs, rules for operation of parallel licensees, cross-subsidy surcharge, and regulatory asset recovery, etc. RInfra submitted that until the pending issues are resolved, financial implications of these issues will adversely affect RInfra and MYT will not get implemented in the true sense and will make the operations of RInfra totally unviable.

33. Considering the above factors and in the larger consumer interest, RInfra submitted that it is just and necessary to defer the implementation of MYT Regulations, 2011 for RInfra till all issues are sorted out.

34. The Commission, vide its Notice dated April 01, 2011, scheduled a hearing in the matter on May 04, 2011, and directed RInfra to serve a copy of its Petition to the authorized consumer representatives.

35. At the hearing held in the matter on May 04, 2011, Shri. Kapil Sharma, Head Regulatory, and Shri. Bhatt, Sr. Advocate appeared on behalf of RInfra.

36. RInfra submitted that the under the proviso to Regulation 4.1 of MYT Regulations, 2011, the Commission may exempt the determination of tariff under the MYT framework for a Generation Company, Transmission Licensee, and/or Distribution Licensee for a specified period, either suo-motu or on application made by the applicant, however, RInfra was seeking exemption for only one year.

37. Shri. Kapil Sharma, representing RInfra, explained the difficulties in complying with the MYT Regulations, 2011, as under:

a) As regards Parallel Licensing Regulations, after the Interim Order dated October 15, 2009 in Case No. 50 of 2009, the final Order and final Regulations are sill awaited.
b) The issue of recovery of cross subsidy and regulatory assets from change-over consumers also arises from the Order dated October 15, 2009, on account of migration of consumers to TPC-D, which needs to be addressed.
c) The Commission has issued Expression of Interest on October 6, 2010 for inviting applications from interested Parties for obtaining distribution licence in the area of supply of RInfra-D, and this matter is also pending before the Commission.
d) RInfra's Petitions in the matter of approval of PPAs and adoption of tariffs for Wardha Power and Abhijeet Power are also pending.
e) In the light of the pending issues, RInfra submitted that the MYT filing may be deferred for one year.
f) The Approach Paper was published along with the draft MYT Regulations, and the MYT Regulations, 2011 were notified in February 2011. In the Approach Paper, the objectives of the MYT are mentioned as to provide regulatory certainty to the Utilities, investors and consumers; to address the risk sharing mechanism between the Utility and consumers; to ensure financial viability of the sector to attract investment and ensure/safeguard interest of the consumers.
g) The norms considered in the MYT Regulations, 2011 are substantially lower than that proposed in the draft MYT Regulations that were published for comments and suggestions from stakeholders. Further, the norms considered in the final Regulations are lower than the actual expenses even after adjusting the expenses towards the normal entries, hence, the viability of the sector will not be protected.
h) The norms for Generation Business in the MYT Regulations, 2011 are not consistent with the CERC norms and industry standard, which are followed and also recommended by APTEL.
i) Reduction in tariff in the long term by way of operational efficiency - Tariff is nothing but a derivative of ARR and all cost elements of ARR. There is little scope for improvement. If there is any scope, RInfra will address the issue while submitting the ARR Petition.

38. Having heard RInfra and after considering the material placed on record, the Commission is of the view that the issues raised by RInfra in this Petition could be categorised under two heads, as under:

a. Reasons for seeking deferred implementation of the MYT Regulations, 2011, as summarised in paragraph 10 of this Order.
b. Operational difficulties due to certain provisions in the MYT Regulations, 2011.

The Commission has given its views and ruling on each of the issues raised by RInfra under these two heads, in the following paragraphs.

Deferred Implementation of MYT Regulations, 2011

39. As regards the need to factor in the effects of competition in view of the possibility of many distribution licensees being present in RInfra's area of supply, the Commission is of the view that this issue was raised by RInfra in the context of the Licence Applications made by four other Parties in addition to RInfra, and the possibility of distribution licence being given to all these Parties in the area of supply of RInfra. However, the Commission has rejected the Licence Applications made by the other four Parties vide the following Orders:

a. Order dated August 11, 2011 in Case No. 8 of 2011, on the Application submitted by Lanco Infratech Limited for grant of Distribution Licence in the area of supply of RInfra-D.
b. Order dated August 11, 2011 in Case No. 7 of 2011, on the Application submitted by Torrent Power Limited for grant of Distribution Licence in the South Zone of RInfra-D area of supply.
c. Order dated August 11, 2011 in Case No. 6 of 2011, on the Application submitted by Maharashtra State Electricity Distribution Company Limited (MSEDCL) for grant of Distribution Licence in the area of supply of RInfra-D.
d. Order dated August 11, 2011 in Case No. 5 of 2011, on the Application submitted by Indiabulls Power Limited for grant of Distribution Licence in the area of supply served by RInfra-D in the suburbs of Mumbai.

Hence, RInfra's apprehension as regards the four other applications for grant of distribution licence is no longer relevant. However, there always exists a possibility that another Company or the same Companies may apply again for issue of parallel Distribution Licence in RInfra's area of supply, since there is no bar on the same. This is true for any distribution licence area in the country, and this cannot be a valid ground for seeking deferment of the MYT Regulations, 2011.

40. As regards the possibility that the licence area boundaries of RInfra may get re-defined post August 15, 2011, the Commission is of the view that this issue is no longer relevant, since the Commission has issued its Order dated August 11, 2011 in Case No. 65 of

2011, granting the Distribution Licence to RInfra in and around suburbs of Mumbai inclusive of area covered under Chene and Varsova which are contiguous with RInfra's existing area of supply, for a period of 25 years from August 16, 2011. Hence, this cannot be a valid ground for seeking deferment of the MYT Regulations, 2011.

41. As regards the uncertainty over the extent of recovery of the lost cross-subsidy and regulatory assets and past revenue gaps from the change-over consumers, the Commission has already clarified regarding the same in its Order dated July 29, 2011 in Case No. 72 of 2010, wherein the Commission has approved the regulatory assets upto FY 2010-11 and approved the applicability of charges for recovery of regulatory assets and the cross-subsidy surcharge as per the following matrix:

Sl.	Particulars	Applicability of Charges to		
		Group I	Group II	Group III
1	Charges for recovery of Regulatory Assets	Yes	Yes	No
2	Cross-subsidy Surcharge	No	Yes	No

Note:
Group I: Consumers who are receiving supply from RInfra-D through RInfra-D's wires
Group II: Consumers who are receiving supply from TPC-D through RInfra-D's wires
Group III: Consumers who are receiving supply from TPC-D through TPC-D's wires

Further, in the above-said Order, the Commission has stated that the method of computation of cross-subsidy surcharge as applicable would be finalised under the Open Access Regulations, and the actual cross-subsidy surcharge to be levied can be determined only after RInfra-D proposes the same, based on the appropriate formula to be determined.

Hence, this cannot be a valid ground for seeking deferment of the MYT Regulations, 2011.

42. As regards the possibility of a new framework of operation of parallel licensees having significant impact on planning and execution of capital expenditure, the Commission is in the process of formulating the final dispensation in this regard. However, the Commission has already clarified regarding the issue of capital expenditure to be undertaken by the parallel distribution licensee, in its Order dated July 29, 2011 in Case No. 72 of 2010, as reproduced below:

"2.25 CAPITAL EXPENDITURE FOR CHANGE-OVER CONSUMERS

...

Commission's Ruling

"Section 2(17) of the EA 2003 defines a "distribution licensee" as a licensee authorised to operate and maintain a distribution system for supplying electricity to the consumers in his area of supply, while the sixth proviso to Section 14 of the EA 2003 states that "...the Appropriate Commission may grant a license to two or more persons for distribution of electricity through their own distribution system within the same area...". Hence, each licensee has to have its own distribution system for supplying electricity to consumers in its area of supply. As a consequence, TPC-D also will have to set up its own distribution network in its area of supply, and the utilisation of the existing distribution network of RInfra-D for supplying to change-over consumers is only an interim solution, till such time TPC-D sets up its own network."

Since, the Commission has already clarified regarding this aspect, which is in accordance with the EA 2003, RInfra has to plan its capital expenditure accordingly, and hence, this cannot be a valid ground for seeking deferment of the MYT Regulations, 2011.

43. As regards the issue of non-approval of PPAs for the medium-term and long-term, the Commission has already approved the PPAs vide its following Orders:

a. Order dated July 1, 2011 in Case No. 84 of 2011 for procuring 55 MW from Abhijeet MADC Nagpur Energy Pvt. Ltd.
b. Order dated July 1, 2011 in Case No. 85 of 2011 for procuring 260 MW from Wardha Power Company Ltd.

Hence, this cannot be a valid ground for seeking deferment of the MYT Regulations, 2011.

44. However, the Commission is of the view that RInfra must file its application under Section 64 of the EA 2003 seeking approval for its aggregate revenue requirement and determination of tariffs for FY 2011-12, which may not be possible under the MYT Regulations, 2011 in view of the fact that by the time RInfra files its Business Plan under the MYT Regulations, 2011; an Order is passed thereon; and by the time RInfra files its MYT Petition under the MYT Regulations, 2011 based on the forecasts and trajectories approved in the Order approving the Business Plan, in all probability the entire FY 2011-12 would get over. There is no other choice but to enable RInfra to file its ARR and Tariff Petition under

the "Maharashtra Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations, 2005". However, the said 2005 Regulations stood repealed in terms of Regulation 101.1 of the MYT Regulations. Therefore, the said 2005 Regulations will need to be revived atleast for the period for which RInfra would file its ARR and Tariff Petition.

45. The Commission has therefore published draft of amendments to the MYT Regulations viz., Maharashtra Electricity Regulatory Commission (Multi Year Tariff) (First Amendment) Regulations, 2011, on August 13, 2011. This is to enable the continuance of ARR and Tariff filings under the 2005 Regulations. Currently, the amendments are undergoing previous publication.

46. The Commission is empowered under the proviso to Regulation 4.1 of the MYT Regulations, 2011 to exempt the determination of tariff of a Generating Company or Transmission Licensee or Distribution Licensee or category of Transmission Licensee or Distribution Licensee under the Multi-Year Tariff framework, as reproduced below:

> ***"4 Multi-Year Tariff Framework***
> *4.1 The Commission shall determine the tariff for matters covered under clauses (i), (ii), (iii), (iv) and (v) of Regulation 3.1 above under a Multi-Year Tariff framework with effect from April 1, 2011:*
> *Provided that the Commission may, either on suo-motu basis or upon application made to it by the applicant, exempt the determination of tariff of a Generating Company or Transmission Licensee or Distribution Licensee or category of Transmission Licensee or Distribution Licensee under the Multi-Year Tariff framework for such period as may be contained in the Order granting such an exemption."*

47. In light of the above, the Commission is of the view that it has become necessary to invoke the proviso to Regulation 4.1 of MYT Regulations, 2011 in order to exempt the determination of tariff of RInfra under the Multi-Year Tariff framework till March 31, 2012 (i.e., for a period of 1 year). The said exemption is hereby granted. The Commission is also empowered under Regulation 100 of the MYT Regulations, 2011 to remove any difficulty arising in giving effect to the provisions of MYT Regulations 2011. Accordingly, the Commission hereby directs RInfra to file the Petition for determination of tariff for FY 2011-12 within 2 months time, i.e., on or before October 31, 2011.

48. Further, the Commission has already separately directed RInfra to submit the Truing Up Petition for FY 2009-10 and APR Petition for FY 2010-11, vide its letter ref: MERC/Tariff/0946 dated July 7, 2011 The Commission has also directed RInfra to submit the Business Plan for the MYT Control Period from FY 2011-12 to FY 2015-16 vide its letter ref: MERC/MYT 2nd Control Period/1105dated July 27, 2011. RInfra needs to comply with these directives.

Operational Difficulties due to provisions of MYT Regulations, 2011

49. As regards the issues related to operational difficulties due to the provisions of the MYT Regulations, 2011, the Commission is of the view that the MYT Regulations, 2011 provide that the Commission shall be guided by the terms and conditions contained in the Regulations, provided that the Commission may deviate from the norms or specify alternative norms for particular cases, where it so deems appropriate, having regard to the circumstances of the case. Further, in the Approach Paper published along with the draft MYT Regulations, the Commission has clearly enunciated its rationale for specifying certain norms as well as the formulation for income tax. Based on the comments received on the draft MYT Regulations and the Commission's best judgement, the Commission revised the norms and clauses in the final MYT Regulations, 2011. Therefore, regarding RInfra's request for revising the norms for Station Heat Rate and O&M, the Commission may invoke the above powers, if required.

With the above ruling and directions, the Petition filed by RInfra in Case No. 45 of 2011 stands disposed of.

Sd/-	Sd/-
(Vijay L. Sonavane)	(V.P. Raja)
Member	Chairman