

Before the
MAHARASHTRA ELECTRICITY REGULATORY COMMISSION
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Case No. 18 of 2005

In the matter of
Review of directions on Fuel Adjustment Cost (FAC) Charges dated 19th January, 2005 in
respect of Reliance Energy Ltd.

Dr Pramod Deo, Chairman,
Shri A. Velayutham, Member

ORDER

Dated: 3rd August, 2005.

In the Commission's Tariff Order dated 1st July, 2005 on the ARR and Tariff Petition filed by Reliance Energy Limited (REL) (formerly BSES Ltd.), the Commission had stipulated the basis and formula for recovery of Fuel Adjustment Cost (FAC) through FAC Charges, as follows:

“While estimating the ARR of BSES for FY 2004-05, the Commission has projected the fuel and power purchase expenses, as detailed in an earlier Section... As discussed earlier, the Commission has merged the existing FAC charge with the basic energy charge approved by the Commission and thus, the FAC is zero, as on date. The Commission has also modified the methodology to be applied for charging the FAC, in line with the overall approach used for determining the FAC Formula for MSEB and TPC... The variation in the fuel cost of own generation and of power purchase vis-à-vis the fuel prices considered by the Commission in this Order, subject to operational norms and generation and power purchase mix, will be allowed to be recovered through the FAC mechanism.

The Commission clarifies that the FAC charge is levied to recover/refund the variation in the fuel cost of own generation and of power purchase being incurred by the Licensee for supplying power to various consumers... The FAC should be computed and charged on the basis of actual variation in fuel costs and power purchase including the FAC charged by TPC during the month, once the costs are incurred and not on the estimated costs for the future period.

Approval of FAC charge

BSES will be required to obtain post facto approval of the Commission on a quarterly basis for the FAC charged. For this purpose, BSES should submit the details of FAC incurred and FAC chargeable from all consumers for each month in that quarter, alongwith the detailed computations and the supporting documents for verification by the Commission, and will be displayed prominently at the cash collection centres and on BSES' website.

However, after the issuance of this Order, whenever the FAC charge is being levied by BSES for the first time on the basis of the formula and principles approved in this Order, the BSES would obtain the prior approval of the Commission before levying FAC charge.



Approved FAC Formula

The FAC formula approved by the Commission for levying FAC charges for any variation in fuel and variable cost of power purchase including FAC charged by TPC vis-à-vis the fuel and power purchase costs approved by the Commission in this Order is as follows:

FAC	=	C + I + B where,
FAC	=	<i>Total Fuel Cost Adjustment</i>
C	=	<i>Change in cost of own generation and power purchase due to variation in the fuel cost</i>
I	=	<i>Interest on Working Capital</i>
B	=	<i>Adjustment Factor for over-recovery/under-recovery</i>
...		

The Adjustment for over-recovery/under-recovery 'B', should be calculated as:

B_{j-2}	=	$[(A_{j-4} - R_{j-2})]$, where
A_{j-4}	=	<i>Incremental cost in month j-4</i>
R_{j-2}	=	<i>Incremental cost in month j-4 actually recovered in month j-2</i>

2. Accordingly, REL sought approval for adjustment of the FAC amount of Rs. 0.91 crore pertaining to the month of July 2004 against accumulated over recovery (Rs 38.70 crore as on 31st March, 2004) towards FAC through its Application dated 29th September, 2004. The Commission issued its directions on REL's Application after vetting vide letter dated 19th January, 2005. The Commission inter alia, directed REL as follows:

"While processing the Application for approval of FAC Charge for July 2004, the Commission has assessed the FAC Charge for July 2004 only, and has not considered any adjustment towards under recovery for the period from April to June 2004. The Commission directs REL to adopt the methodology described herein for determining the amount of FAC chargeable for April, May and June 2004 and then determine the adjustment for Over-Recovery/Under Recovery pertaining to those months.

The Commission directs REL to determine Total Fuel Cost and Power Purchase Cost Adjustment for the month of April to June 2004 and August to October 2004 by applying the methodology detailed herein for July 2004. Such Total Fuel Cost and Power Purchase Cost Adjustment for the period from April 2004 to October 2004 should be adjusted against the amount of Rs. 38.70 Crore over recovered towards FAC at the beginning of FY2004-05 and FAC recovered for the period from April 2004 to June 2004 (prior to the Tariff Order) to arrive at the requirement of Net Total Fuel Cost and Power Purchase Cost Adjustment for the period from April 2004 to October 2004. In case such Net Total Fuel Cost and Power Purchase Cost Adjustment is positive (over recovery towards FAC), then the same shall have to be adjusted against the recoverable FAC for future periods after accounting for any disallowance towards excess T&D Loss before charging the recoverable FAC Charge to the consumers."

3. Subsequently, REL sought clarifications and modifications in the Commission's directives, specifically with regard to the determination and application of FAC charges for the months of April to June, 2004 (i.e. the period of FY 2004-05 prior to the Tariff Order) by applying the methodology approved by the Commission for July, 2004, vide letter dated 15th February 15, 2005. This letter, inter alia states that *"The total amount of FCA chargeable for the period April to June 2004 was determined at Rs 111.77 crores accordingly and accounted as revenue for that quarter for the purpose of declaring the results."* Meanwhile an application for post facto approval of FCA for the period (a) August 2004 to September 2004 and (b) October to December 2004 was submitted under letter dated 28th February, 2005 under the Tariff Order. While the Commission was deliberating on REL's letter



referred to above, REL filed a formal Petition on March 11, 2005 seeking review of the Commission's directions dated 19th January, 2005.

4. In its Review Petition, REL raised the following issues (which are essentially the same as those raised in its earlier letter dated 15th February, 2005):

- (a) The Commission revised the retail tariff for REL consumers with effect from 1st July, 2004, vide its Tariff Order dated 1st July, 2004. In the Tariff Order, the base cost of fuel has been revised from Rs. 325/Mkcal to Rs. 434/Mkcal, and the FAC has been equated to zero by merging FAC with the energy charges.
- (b) On account of FAC, REL has recovered an amount of Rs 111.77 crore from consumers during the period from April to June 2004 as per the earlier mechanism of FAC recovery, which was based on the then existing tariff structure and the excess of fuel cost over the base fuel cost of Rs. 325/Mkcal. The FAC amount so recovered has been accounted as revenue for the first quarter of FY 2004-05 for the purpose of declaring the financial results.
- (c) With the Commission's direction for application of the revised FAC Charge mechanism retrospectively from 1st April, 2004, the FAC actually chargeable from consumers for that period works out to be negligible, since the base fuel cost has been revised upwards.
- (d) The Commission has revised the Energy Charges upwards from 1st July, 2004 by merging FAC into these charges. If adjustment on account of FAC is done in isolation without considering recovery through Energy Charges, then it would lead to under-recovery on account of Energy Charges for the period from April to June, 2004. This would, in effect, be tantamount to only a notional benefit of higher base tariff for the same period as actual realisation would take place unless and until a truing up exercise carried out at the year end. Retrospective application of the revised base fuel cost only for FAC calculations and Charges and not for Energy Charges will result in an anomaly and call for avoidable truing up for loss or under recovery of Energy Charges for those months.
- (e) Such retrospective adjustment, by way of adjustment for refund in the last quarter on account of FAC would have a significant impact on the financial results of REL for the last quarter ending on 31st March, 2005 as well as its cash flows.
- (f) Refund of FAC Charges for the period from April to June, 2004 to all consumers is not appropriate since earlier the consumption upto 100 units per month of residential consumers was exempted from FAC under the old tariff structure.

5. REL has submitted that its Review Petition is maintainable under Regulation 85(a) of the MERC (Conduct of Business) Regulations, as REL had no opportunity to make a submission with respect to the recovery of FAC for the period April to June, 2004 and because of the anomalies and other reasons mentioned above. Accordingly, REL has sought modification in the Commission's directions, and urged that the Commission to:

- (a) Apply the revised methodology for computation of FAC from 1st July, 2004 instead of retrospectively from 1st April, 2004, or
- (b) Allow REL to adjust the shortfall in Energy Charges for the period from April to June, 2004 against the FAC for the period from April to June, 2004.

6. The Commission held a hearing on 21st April, 2005. Meanwhile, the Commission also received from REL its proposal for post facto approval of FAC pertaining to the last quarter of FY 05. At the hearing, REL was asked to furnish written submissions on (a) elaborating further the grounds and admissibility of review of the Commission's directions, and (b) regarding the negative impact of the Commission's directions on the Annual Revenue Requirement in FY 2004-05, as contended by REL, to enable the Commission to decide on the admissibility and/or merits of REL's Review Petition.



7. REL submitted the grounds on which review was being sought and claimed as maintainable, as well as the overall impact of the Commission's directions on the financial position of REL, vide its submission dated 24th May, 2005. REL has stated that,

- (a) The Review Petition has been filed under the provisions of Regulation 85(a) of the MERC (Conduct of Business) Regulations, inter alia, as there is "some mistake or error, apparent from the face of the record" and for reasons of discovery of important matters and evidence which after exercise of due diligence was not within the knowledge of REL, and for the other sufficient reasons as set out in the Petition.
- (b) All costs should be considered for the relevant period only and not retrospectively as is sought to be done by the Commission's directions. Applying FAC retrospectively is, inter alia, without any basis.
- (c) The FAC account had a credit balance of Rs. 38.70 crore, on the basis of provisional billing in the month of March, 2004 of Rs. 26.63 crore. However, the actual figure as computed for March, 2004 was Rs. 25.06 crore, leading to an adjustment of Rs. 1.57 crore (credit balance).
- (d) Comparison of actual billing in April to June, 2004 and the billing based on the Tariff Order shows that there is a shortfall of Rs. 28.25 crore in recoveries from the basic account (energy charges plus fixed charges).
- (e) Amount of FAC incurred from April to June, 2004 by REL for own generation and for power purchased from Tata Power Company (TPC) was Rs. 111.77 crore, whereas the amount actually recovered was Rs. 109.79 crore.
- (f) REL has paid an amount of Rs. 53.87 crore to TPC towards FAC for the billing months of April and May, 2004. However, since TPC's tariff, though actually applied from June 2004, has also been computed with effect from April 2004, it is expected that TPC would make a refund to REL if it had not incurred any FAC on the basis of the revised tariff rates.
- (g) It would be very unfair to REL if it is required to refund the notional surplus of FAC amount held by it as on 30th June, 2004 to the consumers,
 - i. Without receiving any refund on account of FAC from TPC
 - ii. Without being compensated for higher basic tariff charges paid to TPC for June, 2004 while REL's tariff revision was made applicable from July, 2004
 - iii. Without any compensation for the shortfall in basic tariff account of Rs. 28.25 crore.

8. The Commission notes that:

- (a) In the Tariff Order for FY 2004-05, the base fuel cost has been considered at the weighted average base fuel cost of Rs.434/Mkcal (instead of the earlier prevalent base cost of Rs.325/Mkcal) for the entire FY 2004-05 for the purpose of determining the Annual Revenue Requirement.
- (b) In the earlier FAC mechanism, REL was billing FAC based on its advance projection of fuel cost for the remaining part of the year, and not on the actual fuel costs incurred. The revised FAC Charge mechanism is structured to allow REL to adjust the differences between actually incurred fuel costs and the base fuel costs considered in the Tariff Order.
- (c) Since the base fuel cost has been considered at Rs.434/Mkcal for the entire FY 2004-05 while determining the ARR, if the FAC is recoverable over month-to-month basis, re-computation needs to be done starting from April 2004. Any recovery of FAC considering the lower base fuel cost of Rs.325/Mkcal for April to June, 2004 would amount to over-recovery, to be refunded to the concerned consumers.
- (d) REL would be entitled to refund from TPC for the FAC paid in the months of April and May 2004, as TPC's costs and revenues have also been projected in a similar manner. Admittedly, FAC was recovered during June 2004 through TPC's tariff, being effective from 1st June, 2004 with FAC merged into energy charges, but TPC did not levy FAC to REL.
- (e) Energy Charges for the period from April to June, 2004 were recovered by REL based on the then prevalent tariff structure. Subsequently, the Commission effected the revised basic



tariff structure from 1st July, 2004 through its Tariff Order. For the purpose of matching estimated revenue recovery with the ARR, the revenue for the entire FY 2004-05 (including the period from April to June, 2004) was considered based on the revised tariff structure, including Energy Charges (exclusive of FAC charges) and Demand Charges, and projected sales.

- (f) As a result, REL may face an under-recovery on the base revenue, excluding FAC Charge, for the period from April to June, 2004. However, the actual application of the revised basic tariff structure only from the date of the Tariff Order, i.e. 1st July, 2004, was the consequence of delay in the entire tariff process. The Commission has noted in the Tariff Order that *"the delay has been on account of delay in submission of the Tariff Petition and the requisite data for FY 2003-04 and FY 2004-05 by BSES, despite several directives given by the Commission."*
- (g) The FAC formula is structured to allow REL to adjust only the differences (whether positive or negative) between actual fuel costs and the base fuel costs considered in the Tariff Order on a monthly basis, and is distinct from the matter of under/over recovery of any of the other tariff components, including Energy Charges.
- (h) REL's submission dated 24th May, 2005 does not show the impact on its annual revenue (refer Annexure 1) by carrying out the required FAC computation for the first quarter based on the revised heat value considered in the Tariff Order.

9. The Commission also notes that its vetting of proposed FAC Charges for July, 2004 was intended to ensure that the proper methodology was being followed considering the FAC formula in the Tariff Order, and to set a template for future implementation. Clearly, therefore, such vetting cannot be inconsistent or substantively go beyond the Tariff Order from which it flows. Upon careful reconsideration, the Commission recognizes that the Tariff Order does not explicitly stipulate that the FAC should be applied and implemented with respect to the base fuel costs considered in the Tariff Order, with effect from 1st April, 2004. It can be argued that this underlying principle is implicit in references to the base fuel cost considered while determining the ARR for FY 2004-05, and the stipulation that the FAC should be computed on the basis of the difference in the fuel costs vis-à-vis the fuel costs considered in the Tariff Order, and the Commission's decision of 19th January, 2005 has also relied on it. The Commission had adopted a similar approach in the case of the erstwhile Maharashtra State Electricity Board (MSEB) also, the difference being that this position and its implications were explicitly brought out in the Tariff Orders for MSEB. On the other hand, it can also be argued, with reference to various other statements, that the REL Tariff Order implies that all components of tariff, including FAC charges, are to be actually applied from 1st July, 2004.

10. Considering the ambiguity on this important point and the genuine scope for differing interpretations, and the fact that FAC vetting has to flow from the Tariff Order, the Commission finds that the essential ingredients for review of the decision dated 19th January, 2005 in this regard are met. The Commission also recognizes the fact that if the entire amount of over-recovery on the FAC account is to be refunded to consumers in one go now, it would have an adverse impact on the financials of the Licensee. Moreover, it appears that REL has under-recovered revenue through energy charges during the same period. Hence, it would be appropriate to take a holistic view of the matter, rather than limit the consideration to the over-recovery on account of FAC for the months of April to June, 2004. Besides, REL has already filed its ARR and tariff Petition.

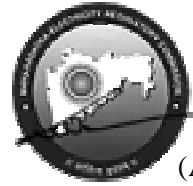
11. In view of the foregoing, and in modification of this aspect of its decision while vetting the computation of REL's FAC Charges for July, 2004, under these circumstances the Commission clarifies that the over-recovery on account of FAC for the period April to June, 2004, along with interest for the period for which it is due for refund to consumers, may be adjusted at the time of 'truing up' for FY 2004-05 along with other expenses and revenue heads. Subject to the dispensation clarified in this Order, FAC is otherwise to be computed as per the Commission's letter dated 19th January, 2005.



12. While TPC has not filed a formal Petition seeking review of the FAC vetting decision in its case, which was similar to that taken for REL (except that TPC's revised base tariff was effective from 1st June, 2004, and the issue with regard to actual application of FAC Charges as per the TPC Tariff Order computations is in respect of April and May, 2004), a representation dated 1st March, 2005 was submitted to the Commission by TPC. Hence, TPC was also invited and participated at the hearing held on 21st April, 2005. The position being the same as in the case of REL, the dispensation at para 11 above is being applied through this Order to TPC also for the period April to May, 2004.

Sd/-
(A. Velayutham)
Member

Sd/-
(Dr Pramod Deo)
Chairman, MERC



(A.M. Khan)
Secretary, MERC